

Crowe Horwath LLP
Independent Member Crowe Horwath International

May 31, 2013

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

Via email to director@fasb.org

RE: File Reference No. 2012-260, Proposed Accounting Standards Update, "Financial Instruments—Credit Losses (Subtopic 825-15)"

Dear Ms. Cosper:

We are pleased to comment on the FASB's Proposed Accounting Standards Update, "Financial Instruments—Credit Losses (Subtopic 825-15)" (Proposal). While we support the Board's objective to provide financial statement users with more decision-useful information about expected credit losses, we do not support issuance of the Proposal due to certain of its underlying concepts. Our main concerns with the Proposal are the departure from the incurred loss model, that is, an event driven framework, as well as the complexity and subjectivity that the expected credit loss model introduces. As addressed further in our responses, we have particular concerns regarding the use of projected cash flows as a basis for recording expected credit losses on broad categories of assets

The incurred loss model is a conceptually sound approach to measuring credit impairment and we continue to believe that the act of lending money is not, in and of itself, a credit loss event. We do not share the Board's observation that entities felt constrained from recording losses leading up to the recent credit crisis. During that time, the magnitude and duration of negative economic events were not predicted as a matter of consensus.

We do not believe there is sufficient basis for having two different recognition contingency models – one for financial assets which uses an expected loss model and one for certain types of contingencies, such as lawsuits, which retains the incurred loss model. Also, there is a distinction between forward-looking information used in a specific measurement attribute for an asset and forward-looking information applied broadly to many financial assets. While this Proposal does use a specific measurement attribute, the difference is the broad nature to which it is applied.

Furthermore, we envision challenges for preparers to accumulate the necessary data. In our experience in working with community financial institutions, very few maintain static pool data as described in one of the illustrative examples. As such, it could be labor intensive to develop that information for the proposed use for many institutions. The examples also mention probability of default and loss-given default statistics which are not widely used by community financial institutions.

We also believe there are other more practical solutions to consider. Rather than using reasonable and supportable forecasts, we recommend the Board instead retain the incurred loss model but lower the threshold from probable to "reasonably possible" or "more likely than not" and explore use of the loss

emergence period. Both of these changes would, in theory, permit earlier recognition of losses, which is one of the Board's objectives. Secondly, clarifying in U.S. GAAP the importance of current trends and their impact on repayment of the assets at the reporting date would be a meaningful change. Including such guidance would be consistent with a market participant view of expected cash flows but would not require forecasting economic cycles.

Also, we observe in the recognition and measurement Proposal, the Board encouraged constituents to consider both Proposals in tandem. To alleviate any confusion, we recommend the Board issue either one standard to cover recognition and measurement as well as credit impairment, or issue the two standards concurrently. In addition, we noted that the FASB FAQ, "Proposed Accounting Standards Update, Financial Instruments—Credit Losses (Subtopic 825-15)," contains concepts and basis for conclusions which are absent from the Board's Proposal. We recommend the information from the FAQ, to the extent possible, be included in any final standard.

Lastly, we commend the Board for its commitment to both international convergence and meeting the needs of U.S. stakeholders. In this regard, we appreciate the Board's willingness to explore an alternative to the IASB's Proposal, which received many concerns from U.S. stakeholders during the joint deliberations of its development. Our understanding is the Board is committed to still exploring a convergence solution with the IASB and we support that objective. However, we do not support such a solution if it is to the determent of the needs of U.S. stakeholders.

Our responses to the Proposal's questions are included in the attachment.

Please contact Sydney K. Garmong or Scott G. Lehman should you have any questions.

Cordially,

Crowe Horwath LLP

Crowe Horwath LLP

Responses to the Proposal's Questions

Scope

Question for All Respondents

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?

No. We recommend the scope should be consistent with the Board's proposal on recognition and measurement. Consistent with our comments on the Board's recognition and measurement proposal for financial instruments, we agree with the scope exceptions for employer's or plan's obligations, not-for-profit's contribution receivables, loans to participants in employee benefit plans and life insurance assets.

Also, we observed in the recognition and measurement proposal, the Board encouraged constituents to consider both proposals in tandem. To alleviate any confusion, we recommend the Board issue either one standard to cover recognition and measurement as well as credit impairment, or issue the two standards concurrently.

While the Proposal applies broadly to financial assets (e.g., debt securities, trade receivables), it is crafted almost extensively as a loan loss model discussion. Most of the terminology is traditional lending terms such as "borrower" and "underwriting" which are not commonly used terms for other financial assets, particularly for debt securities. We recommend the terminology be broader than traditional lending.

Recognition and Measurement

Questions for Preparers and Auditors

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?

We noted that the FASB FAQ, "Proposed Accounting Standards Update, Financial Instruments—Credit Losses (Subtopic 825-15)," contains concepts and basis for conclusions which are absent from the Board's Proposal. In particular, we note four areas of the FAQ which provide additional clarification to the Proposal. Upon initial evaluation of the Proposal, our understanding was that an economic forecast, albeit reasonable and supportable, would be required. However, the FASB FAQ states that the "life-of-loan estimate will largely be informed by historical lifetime loss experience for similar assets," which suggests that expected credit losses would be primarily derived from historical experience rather than an economic forecast over the life of the asset. Secondly, the FAQ clarifies in Question 7 that the credit losses represent a "life of the loan" estimate rather than "lifetime losses," given that some stakeholders view the term "lifetime losses" to suggest that projections over the entire lifetime are required. Thirdly, the FAQ, in Questions 10 and 13, describes several different approaches for adjusting historical loss experience for current conditions and reasonable and supportable forecasts about the future. Lastly, the two methods presented in Question 13 of the FAQ clarify that the Board does not envision a true forecast of expected credit losses. At a minimum, the guidance from the FAQ, for these four areas, should be included in the final standard.

We recognize that forward-looking information is used to evaluate some amounts recorded on the balance sheet (for example, expected cash flows, salvage values and estimate lives for evaluating asset impairment). The Board also appropriately acknowledged, in Statement of Financial Accounting Concepts No. 8, "Conceptual Framework for Financial Reporting," (CON 8) that excluding such information about those estimates would make the financial reports much less useful. The Board went on to acknowledge, in par. QC28, that "filt may not be possible to verify some explanations and forward-looking financial information until a future period, if at all. To help users decide whether they want to use that information, it normally would be necessary to disclose the underlying assumptions, the methods of compiling the information, and other factors and circumstances that support the information," This suggests a distinction between forward-looking information used in a specific measurement attribute for an asset and forwardlooking information applied broadly to many financial assets. Currently, expected cash flows are used throughout the financial statements but their use is confined to evaluating specific assets rather than broad categories of assets. While the Proposal does use a specific measurement attribute, the difference is the broad nature to which it's applied – essentially all financial assets. Specifically, we envision difficulty in calculating the expected cash flows on smaller credits because extensive segmentation would be needed to assemble truly homogeneous pools. We also note that there are unique characteristics between loans and debt securities, particularly in the resolution of the asset upon impairment. For loans, typically the resolution is addressed over a short time horizon, through the disposition of the underlying collateral, so there are not long periods of cash flow estimation as is the case for debt securities.

The Board acknowledged in the FAQ the difficulty of trying to define a time frame that would cover reasonable and supportable forecasts. Rather than using a forecast, we recommend lowering the trigger for recognition from "probable" to "reasonably possible" or "more likely than not" which would, in theory, permit earlier recognition of losses which is one of the Board's objectives.

We understand one of the reasons, as noted in Question 12 of the FAQ, for the Board's reluctance to shorten the time horizon is the need to define what "near term" means, of which we agree. We suggest an alternative would be the loss emergence period, based on the following reasoning.

Historical loss rates are typically determined using several periods of loss history but are then reduced to a one year time horizon by calculating an annualized loss rate. From there, an additional multiplier may or may not be used, depending on whether the entity believes the loss coverage should be more or less than one year. As such, pools do not have life of the loan allowances but rather a much shorter time horizon.

One of the most challenging and controversial points in current practice is determining how much "coverage" should be provided for pools, after determining the annualized loss rate. In other words, at issue is the amount by which the annualized loss rate should be multiplied, or for short term loans, divided. These techniques are attempts to identify losses which have been incurred, but have not yet surfaced for more precise measurement, similar to the measurement of incurred but not reported losses in the insurance industry. In the absence of addressing this issue, the default, if using an annualized loss rate, results in one year of coverage. As such, we recommend the Board address this issue and consider introducing a loss emergence period.

The loss emergence period, also referred to as a loss confirmation period, would represent the time horizon from incurrence of a credit loss (i.e., deterioration in the borrower's financial condition) to the confirmation of that loss (i.e., identification of the individual loan as impaired). Addressing this component of the methodology would be helpful in practice as the question of coverage is simply not addressed. Without providing additional guidance in this area and using an annualized loss rate, the default period is one year.

We believe that considering the current trends is meaningful and that including such guidance would be consistent with a market participant view of expected cash flows without forecasting economic cycles. As

such, we recommend including the guidance from the December 13, 2006, Interagency Policy Statement on the Allowance for Loan and Lease Losses, which states (underlining added):

"When estimating credit losses on each group of loans with similar risk characteristics, an institution should consider its historical loss experience on the group, <u>adjusted for changes in trends</u>, <u>conditions</u>, and other relevant factors that affect repayment of the loans as of the evaluation date."

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?

Access to historical information is generally obtainable, although to be meaningful, it would need to be based on historical static pool data. Other than consumer lending, such data is typically not readily available for community financial institutions. In our experience, loss data is accumulated by general ledger line. For example, loss data would be available for 1-4 family mortgage loans in total. For other consumer loans, the data is typically more granular. To achieve a reasonable level of precision would take effort and require tools which are not currently employed by most community financial institutions.

There are instances where an entity may not have any experience of their own, either because the entity is new or because the entity has entered a new product line. The FAQ states that "...the Board expects that an entity's estimate of expected credit losses largely will be informed by historical loss information for financial assets of a similar type and credit risk." Given the focus on use of historical loss information as the starting point, we recommend guidance be provided to address the situation where an entity does not have experience of its own. Although, the Proposal, nor the FAQ, address this fact pattern, it seems logical that an entity would look to peer data in those situations. As such, it would be beneficial for the Board to provide guidance on the appropriate use of peer group data.

While access to historical information might be obtainable, we do not believe an economic forecast could practically be made with any level of sufficient reliability and consistency among entities. Particularly with community financial institutions, there is not necessarily a consistent, reliable source of economic data available for many non-metro areas. Rather than using reasonable and supportable forecasts, we recommend the Board instead retain the incurred loss model but lower the threshold from probable to reasonably possible or more likely than not and explore use of the loss emergence period as further described in our response to Question 9.

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?

We believe the requirement in 825-15-25-5 is unclear and it is uncertain how the requirement would be met. We considered whether the Board was trying to ensure that use of historical data is unbiased, including both winners and losers in the data, which we understand. As the Board notes in 825-15-55-6, the requirement to consider both a loss and no loss possibilities for pools using historical data can be met if the data is complete. However, it is not clear on how to apply the multiple loss possibilities requirement to an individual financial asset. It seems if one is evaluating the expected credit losses, the amount should result in the most likely outcome.

We are also concerned about the practical application of prohibiting the "most likely outcome." Consider the following fact pattern: Borrower pays off a significant loan in full satisfaction, two days after the close of a period. For purposes of this example, we assume the payoff represents a confirmation of conditions existing at the balance sheet date. In this scenario, one has unequivocal information to evaluate the expected credit losses (zero) at the balance sheet date. However, as written, that would be prohibited even though the most likely outcome is confirmed. In another example, consider a U.S. Treasury debt security. To our knowledge, no holder of a U.S. Treasury has ever experienced a credit loss on that instrument.

In addition, it is not clear how an entity would comply with the requirement to consider both the possibility that a credit loss will result and the possibility that no credit loss will result without using probability weighting, which is not required in the Proposal. If there is no quantitative requirement, we recommend the Board specify what criteria should be used to determine whether the requirement has been met.

It is not clear why in paragraph 825-15-55-6, the use of the fair value of collateral in estimating credit losses for collateral dependent loans implicitly satisfies the loss possibilities requirement. While we agree the fair value of collateral reflects several potential outcomes, it would seem unusual that those inputs would definitively consider the required two possibilities: a loss occurs and a loss does not. Further, the appraised value will be a most likely outcome which, as we understand, is prohibited.

Again, we believe the Board's basis for this position was clarified in the FAQ in Question 11 which states: "That is, even when the most likely outcome (which is a common way to determine estimated cash flows) is zero credit loss, an entity would be required to establish an allowance for expected credit losses based on the risk of credit loss for similar assets with a similar credit rating." Based on our understanding, this is attempting to require that every asset within scope must have an allowance, albeit perhaps small. We disagree with this conclusion for three reasons. First, the operational challenges would be untenable. Currently, most entities run one model and it is the "most likely" scenario. Secondly, it is unclear how a preparer should comply with this requirement when a probability assessment is not required. From an audit perspective, we envision an outcome with very wide ranges. It would be difficult to support, without probability factors, the recorded allowance within those wide ranges. Lastly, sometimes the answer really is zero, as noted in our examples above. In fact, there are many debt instruments that never suffer a credit loss by the holder. If the Board's intention is to prohibit an answer of zero, which we do not agree with for reasons previously stated, that guidance should be specifically included rather than obfuscate the Board's intent with the proposed requirement 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.

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?

We agree with the concept of discounting in an expected loss model; although as previously noted, we do not agree to its use without an incurred loss trigger. That aside, it is not clear how some of the methods mentioned by the Board implicitly include the time value of money. With that assertion, our concern is that auditors and regulators will feel compelled to obtain evidence to corroborate that certain methods implicitly include the time value of money. Rather than suggest those methods implicitly include the time value of money, we recommend the Board simply provide those examples as practical expedients.

The Board has afforded much latitude by citing various methods which may be used. With such a wide range of methods available, we question the comparability among entities. At a minimum, we suggest the Board include some guidance on consistent application of the method chosen.

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?

We do support the Board's efforts to reduce the complexity for purchased credit impaired (PCI) assets. While we are generally supportive of the proposed changes, additional clarification is needed in several areas. Below we have provided our comments related to PCI asset accounting.

Conceptual distinction between PCI and non-PCI assets

Based on our understanding of the Proposal, the only distinction between PCI and non-PCI assets is the establishment (or carryover) of a separate valuation allowance at acquisition, as described in the proposed amendments to 805-20-30-4. Conceptually, it is not clear why the need for the distinction, particularly given the dollar amount of the credit component for non-PCI assets might be larger than for PCI assets. If the end objective is true simplification, then it seems this distinction should be eliminated as well. Furthermore, we envision the end result would not be meaningful to users.

In our experience, in "open" deals (i.e., acquisitions of a non-troubled entity), a vast majority of the portfolio will be considered non-PCI assets. While the amount of expected credit loss per non-PCI asset is not significant, the sheer size of the portfolio might result in a significant amount of expected credit losses. For example, consider a transaction in which a \$1 billion loan portfolio is acquired. Out of that portfolio, \$30 million are considered PCI loans, based on 2% of non-performing loans and an additional 1% of substandard commercial loans. The allowance is determined to be \$7.5 million or 25% of par.

The remaining portfolio represents non-PCI loans amounting to \$970 million. Using a simple assumption of 1% cumulative loss rate on the remaining portfolio, an allowance of \$9.7 million would be required. Under the Proposal, the \$9.7 million of allowance would not be presented on the balance sheet. We

envision that users will want to understand the "allowance coverage" on the \$970 million of the \$1 billion portfolio.

As such, we recommend the distinction between PCI and non-PCI assets be eliminated and the proposed amendments to 805-20-30-4 be applicable to all acquired assets. In other words, carrying over the allowance should apply to all acquired assets.

Definition of Purchased Credit Impaired Financial Assets (Glossary)

If the Board chooses to retain the distinction between PCI and non-PCI assets, we recommend the definition of PCI financial assets be changed. The proposed definition differs from the current definition in U.S. GAAP in two regards. First, the criterion that the investor has an expectation that not all contractual cash flows will be collected has been removed. Because the Board is proposing to establish an allowance that represents that very assertion, it seems that criterion should be part of the definition.

Secondly, and more importantly, the proposed changes to raise the threshold from "evidence of deterioration of credit quality since origination" to "significant deterioration of credit quality since origination." When the original guidance was issued, the Board's basis for inserting that criterion was to avoid gamesmanship by acquiring unseasoned paper from a third party. By having a third party originator, an entity could use the PCI model without regard to the fact that the paper is unseasoned. The end result, without the criterion, would be disparity for originated asset accounting as some (who acquired unseasoned paper from third parties) would be using the PCI model while others would be using originated asset accounting. Given the genesis for the criterion, we see no reason to raise the threshold. In addition, we envision practice issues arising in making the determination on what is significant. For these reasons, we recommend the existing definition of PCI assets be retained.

The possible aggregation criteria are numerous but the guidance does not seem to require use of any particular aggregation criteria or criterion. Given the wide band-width of available criteria, it seems that pools could be created that would include a wide range of disparate assets. Given the purpose of the aggregation to assemble like assets, we recommend more structure be required to create pools. We recommend the Board consider using the existing aggregation requirements for PCI assets in ASC 310-30, "Loans and Debt Securities Acquired with Deteriorated Credit Quality." This guidance permits aggregation for "loans acquired in the same fiscal quarter that have common risk characteristics," which requires aggregation be based on similar credit risk or risk ratings, and one or more predominant risk characteristics.

Also without one of the criterion being assets acquired in the given time period, the implication is that pools do not need to be closed pools. It would be helpful for the Board to clarify whether or not the pools would be closed or open. Lastly, we note that current U.S. GAAP contains a definition of "common risk characteristics." Rather than create a new term, "shared risk characteristics," we suggest the Board use the existing definition of common risk characteristics, defined as:

"Loans with similar credit risk (for example, evidenced by similar Fair Isaac Company [FICO] scores, an automated rating process for credit reports) or risk ratings, and one or more predominant risk characteristics, such as financial asset type, collateral type, size, interest rate, date of origination, term, and geographic location."

Improvements in Expected Cash Flows

We agree with the Proposal that increases in expected cash flows should be recognized immediately as a change to bad debt expense rather than yield. From a user's perspective, this change and the proposed presentation as bad debt expense, should provide transparency about changes in credit quality of the entity's portfolio.

Nonaccrual Guidance

As we mention in our response to Question 15, the proposed nonaccrual guidance in 825-15-25-10 uses a trigger point for nonaccrual based on "substantially all of the principal or substantially all of the interest." This would result in many PCI assets to be placed on nonaccrual. Given that PCI assets are acquired, albeit at a discount, with the expectation that not all contractual amounts will be collected but rather with an expectation that the initial investments, plus a suitable return, will be achieved, it seems punitive to require the nonaccrual determination be based on contractual cash flows. We recommend the nonaccrual guidance be modified to accommodate these assets and the test for accrual should be based on the remaining investment, including accretion, rather than the principal. We note that the federal financial institution regulators have such nonaccrual guidance for PCI assets in their call reporting instructions.

Measurement for non-PCI assets

Under current U.S. GAAP, the measurement basis for impairment is clear for impaired loans, stating in 310-10-35-24, that:

"If the present value of expected future cash flows (or, alternatively, the observable market price of the loan or the fair value of the collateral) is less than the recorded investment in the loan (including accrued interest, net deferred loan fees or costs, and unamortized premium or discount), a creditor shall recognize an impairment by creating a valuation allowance with a corresponding charge to bad-debt expense or by adjusting an existing valuation allowance for the impaired loan with a corresponding charge or credit to bad-debt expense."

In the Proposal, the measurement seems to be solely based on contractual cash flows not expected to be collected, without regard to the recorded investment of the asset being measured. We recommend that some basis of the asset be provided for which to measure credit losses. With the distinction being drawn between PCI and non-PCI assets, having such a basis is important. During the most recent credit cycle, most non-PCI assets were acquired at a discount, albeit less than PCI assets. Within that acquired discount are expectations of credit losses, although under the Proposal they are not separately presented as such. When making a determination of the amount needed to reflect credit losses, it seems the asset's existing basis should be taken into account rather than measuring the total expected cash flows which will not be collected. We acknowledge that under non-PCI asset accounting, the credit losses in the discount will be accreted into income which means that at some point, credit losses will have to be recognized once the point is reached where the discount has decreased to the point that asset's basis exceeds the par less expected credit losses.

Absent such a change, essentially losses will be double-counted – once in the asset's recorded investment and again in the valuation allowance. As illustrated in the following example for an acquired non-PCI asset, expected credit losses of \$30 would be recorded on day one as a valuation allowance. However, the \$30 of expected credit losses is already included in the \$40 initial discount. As proposed, the carrying amount of the asset (that is, the recorded investment less the valuation allowance) would be understated at \$930, which would not represent the present value of expected cash flows of \$960. If the Board retains the separate models for PCI and non-PCI assets, we recommend that a measurement basis for the asset be provided to which credit losses would be measured. In other words, we recommend that any premium or discount on the asset be factored in when determining the amount of valuation allowance.

Present value of contractual cash flows Discount Recorded investment	<u>Day One</u>	Period Two	Period Three	Period Four
	\$1,000	\$950	\$900	\$850
	(\$40)	(\$35)	(\$30)	(\$25)
	\$960	\$915	\$870	\$825
Present value of contractual cash flows 3% loss rate Expected credit losses (rounded)	\$1,000	\$950	\$900	\$850
	<u>.03</u>	<u>.03</u>	<u>.03</u>	<u>.03</u>
	\$30	\$29	\$28	\$26
Present value of contractual cash flows Expected credit losses Expected cash flows	\$1,000	\$950	\$900	\$850
	(\$30)	(<u>\$29)</u>	(<u>\$27)</u>	(<u>\$26)</u>
	\$970	\$921	\$873	\$824
According to the Proposal: Present value of contractual cash flows Discount Recorded investment Valuation allowance Carrying amount	\$1,000	\$950	\$900	\$850
	(<u>\$40)</u>	(<u>\$35)</u>	(\$30)	(\$25)
	\$960	\$915	\$870	\$825
	(<u>\$30)</u>	(<u>\$29)</u>	(\$27)	(\$26)
	\$930	\$886	\$843	\$799
Our recommendation: Present value of contractual cash flows Discount Recorded investment Valuation allowance Carrying amount	\$1,000	\$950	\$900	\$850
	(<u>\$40)</u>	(<u>\$35)</u>	(\$30)	(<u>\$25)</u>
	\$960	\$915	\$870	\$825
	(<u>\$0)</u>	(<u>\$0)</u>	(\$0)	(<u>\$1)</u>
	\$960	\$915	\$870	\$824

Terminology: Use of the Term "Purchase Price"

The marked changes to 805-20-30-24 refer to the "purchase price" for the PCI financial assets. There are instances where the assets are not purchased or bought but rather acquired. As such, we suggest using the term "fair value at acquisition" to clarify this point.

Other

We have included our comments on the PCI example, which is Example 6, in our response to Question 19.

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?

We support having a practical expedient available for financial assets measured at fair value with changes in other comprehensive income. However, we recommend the only criterion should be the fair value of the asset is greater than the amortized cost, which is criterion (a). First, a practical expedient should afford ease and requiring an evaluation of whether the credit losses expected to be insignificant inhibits that ease. Therefore, limiting the criterion solely to (a) would provide such an accommodation.

Secondly, if the fair value is above amortized cost, it seems that losses would inherently be minimal. Lastly, we envision disparity in determining whether expected credit losses are in fact insignificant. For these reasons, we recommend the practical expedient be provided when the fair value exceeds the amortized cost.

We also note that this practical expedient would not be in compliance with the requirement in 825-15-25-5 to consider the both a loss and no loss possibilities and the suggestion in the FAQ that the amount of credit loss cannot be zero. We support retaining this practical expedient but recommend the Board specifically provide an exception to that requirement when the practical expedient is used.

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?

We agree with the Board's decision to provide guidance for nonaccrual assets to promote consistency and comparability between regulated and non-regulated entities. For financial institutions, this guidance is not inconsistent with existing regulatory guidance for loans; however, regulatory guidance does not use the term "probable" whereas the Proposal does include such a threshold.

We envision the nonaccrual guidance will represent a change in practice for debt securities because under current U.S. GAAP, the accrual guidance is largely predicated on having some expectation about cash flows rather than whether the principal and interest is recoverable. However, in the interest of consistency, we support broad application of the proposed nonaccrual guidance to all assets within the scope. We do not envision significant operational or audit issues to be encountered.

However, we are concerned with the application of the proposed guidance to PCI assets. In the regulatory guidance for financial institutions, an exception is provided for PCI assets which are recognizing income based on expected cash flows. Between the proposed nonaccrual guidance and the proposed PCI guidance, we expect that many PCI assets would be placed on nonaccrual, which seems inappropriate, since such assets are acquired, albeit at a discount, with the expectation that not all contractual amounts will be collected, but rather with an expectation that the initial investment, plus a suitable return, will be achieved. If an asset is acquired with the explicit expectation that the investment will be recovered, it does not seem appropriate that the test for nonaccrual should be based on the contractual amount. As such, we recommend that for PCI assets, the test for accrual should be based on the remaining investment, including accretion, rather than the principal.

Because the cash basis and cost recovery methods are in existing U.S. GAAP, we do not envision any operational or audit issues with the guidance.

For the restoration to accrual status provided in the Proposal at 825-15-25-11, we recommend the Board clarify how to account for those assets that were on nonaccrual using the cost recovery method as described in 825-15-25-11a. It is not clear whether or not the basis reduction can be restored. We note that the federal financial institution regulators provide such guidance, in the FFIEC "Instructions for Preparation of Consolidated Reports of Condition and Income," stating that:

"If any interest payments received while the asset was in nonaccrual status were applied to reduce the recorded investment in the asset, as discussed in the preceding section of this entry, the application of these payments to the asset's recorded investment should not be reversed (and interest income should not be credited) when the asset is returned to accrual status."

Questions for All Respondents

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?

We understand the Board's basis to continue the guidance for troubled debt restructurings, as discussed in BC45-47, however, we disagree with the proposed change to record the adjustment as a basis adjustment rather than through the valuation allowance. We believe that recording this as a basis adjustment would create comparability issues that are unnecessary. Many troubled debt restructurings are executed to extend loans, reduce payments or both to allow the borrower a better opportunity to make the newly agreed upon payments. At the onset, the creditor is usually hopeful that the cash payments under the new terms will be received. However, there is some uncertainty given the borrower is experiencing financial difficulty. As such, the lender might have expectations of a lesser amount than the revised contractual terms which might result in an increased valuation allowance for that uncertainty. Over time, as the revised contractual payments are received, there is less uncertainty about the borrower's ability to make such payments and the lender might revise its expectation to receive all the contractual payments, under the revised contract. If there is a valuation adjustment for a troubled debt restructuring, this situation is no different than other impaired loans - the valuation allowance would be adjusted given the changes in expected cash flow stream. If there is a basis adjustment for the troubled debt restructuring, there is no ability to recapture improvements in expected cash flows until the very end of the loan when the last payments are received. While the loan may have improved much earlier, the improvement in expected cash flows would not be recorded until the last payments are received.

Requiring troubled debt restructurings initial adjustment as a basis adjustment would also create a separate presentation for a subset of impaired loans that simply is not necessary and would impair comparability. Continuing the use of a valuation allowance provides comparability and ability to more easily adjust for changes in the cash flow stream.

If the Board does retain the distinction for troubled debt restructurings, we recommend the Board provide guidance on when an asset no longer meets the definition of a troubled debt restructuring. Based on a literal read of existing U.S. GAAP, there is no de-recognition criteria available and therefore no clear option exists for moving the asset out of the troubled debt restructuring guidance other than to sell the asset or if the asset pays off in full. From a practical standpoint, there are modifications occurring of troubled debt restructurings where the borrower has recovered from its financial difficulty and the lender wishes to retain the loan and the relationship. It seems punitive to require the modification to be accounted for as a troubled debt restructuring in situations where the debtor is no longer experiencing financial difficulty and can fully support future cash flow requirements. We note current practice is mixed some of the alternatives used to determine whether a restructuring of a troubled debt restructuring continues to be a troubled debt restructuring include various permutations of evaluating whether the borrower is still experiencing financial difficulty and whether the loan is underwritten according to the lender's standard underwriting criteria, and analogizing to other guidance contained in the ASC such as the debt extinguishment guidance and accounting for nonrefundable fees and other costs. As such, we recommend the Board provide guidance on if and when a modification of troubled debt restructuring can receive fresh-start accounting and no longer be accounted for as a troubled debt restructuring.

Disclosures

Questions for Preparers and Auditors

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

Yes, we envision operational and auditing challenges with several of the proposed disclosures. We also recommend clarifications for some of the disclosures. Our concerns are discussed below.

Allowance for Expected Credit Losses

For the activity in the valuation allowance, as required by 825-15-50-10, we suggest the Board clarify whether these disclosures should also be presented by instrument type, for example, trade receivables, debt securities and loans.

In 825-15-50-11, the amortized cost balance for PCI assets is defined as the sum of the asset's purchase price and the expected credit losses on the asset at the time acquisition. Because this disclosure is required at each reporting date and the balance will change over time, we question whether disclosing those amounts at the time of acquisition is meaningful. Instead, it seems to be more meaningful to disclose the amortized cost, which based on the definition in the Proposal's glossary of amortized cost, would be the remaining par amount less the noncredit discount.

Roll-forward of Certain Debt Instruments

For the roll-forward requirements in 825-15-50-12 to 13, we disagree with the Proposal for two reasons. First, we question the usefulness of the information to users, particularly since the disclosures are largely balance sheet (point in time) driven. Disclosure of activity within each portfolio segment is not as meaningful to the reader as merely comparing the changes in composition from one period-end to another. We believe it is far more meaningful to provide a roll-forward of the allowance, as is current U.S. GAAP, which provides information about the changes in credit quality. Secondly, we envision operational issues with this requirement. We acknowledge this proposed requirement is consistent with certain of the preliminary conclusions drawn by the Board in the Financial Statement Presentation project and believe these same operational challenges are applicable to that project as well.

Practices among entities vary as to how they accumulate and post daily activity. For example, one entity may post loan renewals to its general ledger as a payoff of the existing loan and funding a new loan, even though no cash inflows or outflows took place. Another entity may not record renewals on the general ledger, but rather track them with its loan accounting system. Other examples where operations differ among entities include how draws and pay-downs on open-ended lines of credit are recorded, how renewals when extending new funds are recorded, and how mispostings and corrections are accumulated.

To accumulate the roll-forward information called for by the Proposal would likely require many entities to assemble information manually in the short term, with varying degrees of reliability, and require systems changes in the long term.

Some of these operational challenges were addressed in the basis for conclusions in FASB Statement No. 104, "Statement of Cash Flows-Net Reporting of Certain Cash Receipts and Cash Payments and Classification of Cash Flows from Hedging Transactions—an amendment of FASB Statement 95." In particular, we note paragraph 14 which states:

"The Exposure Draft proposed to amend Statement 95 to permit banks, savings institutions, and credit unions to report net cash flows for certain deposit and lending activities. Most respondents agreed with that proposal and contended that the requirements of Statement 95 for reporting cash flows for deposit and lending activities are costly for those enterprises to apply and that information about the gross cash flows for those activities is not useful. Representatives of the banking industry asserted that banks have had to spend an inappropriate amount of time and money to comply with the requirements for reporting cash flow information and that the additional costs include not only start-up costs or costs of modifying systems to adopt the standard but also ongoing costs of periodic reporting."

Collateralized Financial Assets

825-15-50-19 and 20 require disclosure about the quality of the collateral securing the financial assets. However, it is unclear to which assets this disclosure is intended to apply: (1) to all financial assets that are secured by collateral, which would include most loans, or (2) to collateralized pools of financial assets, such as collateralized debt obligations. In 825-15-50-1, the term "collateralized financial asset," in item h, is in bold, which suggests it is a term defined in the glossary. However, the term does not appear in the glossary in the Proposal nor in the master glossary in the Codification.

We recommend the Board clarify the scope for purposes of the disclosures in 825-15-50-19 and 20 and strongly suggest the definition be based on collateralized pools of financial assets, such as collateralized debt obligations. We believe providing information to users about the performance of the assets underlying a collateralized pool would be useful and that information is generally readily available from trustee reports.

Our suggestion to limit this disclosure to collateralized pools of financial assets is based on several concerns. As proposed, the information is too subjective and varies widely between entities. Based on our experience, and as described below, the information is not readily available.

If the Board intends for this disclosure to apply to all financial assets secured by collateral, more guidance should be provided. While one could accomplish this objective with one asset, we believe it would be difficult to do so on a portfolio level. For example, for a class of loans that is secured by automobiles, we can envision challenges because typically, the lender will not have any idea of the quality of the those assets until the loan experiences performance issues – and even then, the lender probably does not know the true quality of the collateral. For many loans, the quality of the collateral will not be known until a performance issue emerges, at the earliest, and when the collateral is taken over, at the latest. At the latest point, the asset is typically no longer a financial asset.

We also envision that there will be varying degrees of quality within a class, which would inherently complicate the disclosure. The disclosure could be rendered meaningless with the wide ranges of collateral securing a particular class. It would be helpful to provide additional guidance for this proposed disclosure. One consideration would be to include guidance on what qualitative factors should be considered when assembling this disclosure.

Nonaccrual Status

Item d of 825-15-50-17 proposes to require disclosure of the amortized cost of debt instruments on nonaccrual status for which there are no related expected credit losses because the debt instrument is a fully collateralized collateral-dependent financial asset. However, we cannot envision that such a scenario, an asset on nonaccrual with no loss, would exist for the following reasons.

First, the Board's proposed definitions of nonaccrual is "when it is not probable that the entity will receive substantially all of the principal or substantially all of the interest" and the definition of expected credit loss

as "an estimate of all contractual cash flows not expected." If there is no loss because the entity does expect to receive all contractual cash flows, albeit by underlying collateral, then it does not seem the asset should be placed on nonaccrual based on the proposed definition of nonaccrual.

Secondly, 825-15-25-5 requires use of multiple outcomes and consideration of both a loss and no loss possibilities, and as suggested in the FAQ Question 11, every asset in the scope must have an allowance, albeit small. As such, it is not clear how this scenario could exist for an asset on nonaccrual with no expected credit loss, given these requirements.

Implementation Guidance and Illustrations

Questions for All Respondents

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?

No, we do not believe the guidance and examples, which are almost exclusively focused on loans, are sufficient. There are no illustrative examples in implementation guidance for debt securities. Also missing are how to account for a beneficial interest in a securitization trust and how to account for variable rate instruments.

In addition, it is unclear how debt securities, in particular a beneficial interest in a securitization trust, might comply with the collateral dependent definition as that would be a measurement method available to debt securities. It would be helpful for the Board to add guidance to address these matters.

Implementation Guidance

- 825-15-55-2 For the judgments to be considered, item d states: "The method of adjusting loss statistics for recoveries." Common practice for financial institutions is to calculate historical loss rates net of recoveries to arrive at net charge-offs. Item d suggests that practice would continue, however, it would be helpful for the Board to provide guidance whether to the inclusion of recoveries.
- 825-15-55-2 From an audit perspective, we are concerned with the last sentence in this
 paragraph which states: "Similarly, an entity is not required to reconcile the estimation technique
 it uses with a probability-weighted discounted cash flow model." Consistent with our response to
 Question 11, we do not believe it is possible to comply with, or how auditors are to audit, the
 requirements to consider multiple outcomes without performing a probability weighted test.
- 825-15-55-3 Consistent with our response to Question 12, we recommend the Board recast the
 description of implicit inclusion of the time value of money. Alternatively, we recommend the
 Board include a numerical example to illustrate the numerical consideration of the time value of
 money.

Illustrative Examples

Examples 1, 2 and 3: Loss-Rate Approach, Base Component and Credit Risk Adjustment and By-Vintage

Example 1 uses static pools. In our experience in working with community financial institutions, very few maintain static pool data, other than for PCI loan pools. As such, we believe it would be labor intensive to develop that information. This example also mentions probability of default and loss-given default statistics which are also not typically used by or available to community financial institutions. Given the large number of institutions that are under \$1 billion in assets, many of these institutions do not have the resources to develop such modeling tools. In addition, the past historical data needed to develop this

information is likely limited in the number of years available for most entities. There are similar challenges with the base component and credit risk adjustment (example 2) or vintage basis (example 3). All of these methods are data intensive and data sensitive that would require significant effort for preparers to calculate and maintain as well as significant efforts for auditors to audit. As such, the risk of material misstatement due to formula errors or data manipulation would be exacerbated. In general, we recommend that a cost-effective workable solution be developed for the majority of entities, which for financial institutions are primarily those with less than \$1 billion in assets.

Example 1: Loss-Rate Approach

825-15-55-24 states that: "It typically would be inappropriate to estimate the expected credit losses for a long-term asset by multiplying an annual loss rate (that is, the net amount written off in a 12-month period divided by the average amortized cost) by the remaining years of the asset's contractual term because loss experience is often not linear." However, it seems that if one could demonstrate the average life in the portfolio is unchanged, it would represent a reasonable approach. As such, we recommend the Board re-consider its assertion that multiplying an annual loss rate by the remaining term is inappropriate.

Example 6: Purchased Credit Impaired Assets

- 825-15-55-42 The \$75,000 amount of non-credit discount in this example works well for a loan currently in default as the discount accretion would occur immediately. However, in the case of a currently performing credit with an expectation of loss at some point in the future, for example a balloon maturity, there could initially be amortization, rather than accretion, if the income recognition is based on a constant yield on the initial investment of \$750,000, as is required under ASC 310-20-35-18. If this is what the Board envisioned, the language may need to be modified in this paragraph to refer to either accretion or amortization. We can provide a numerical example if requested by the Board.
- 825-15-55-42 It would be helpful to clarify the "life of the debt instrument." If an entity holds a 10 year amortizing note, but expects default in 2 years, it is unclear whether the accretion occurs over 10 years or over the expected cash flow period of 2 years.

Examples 7-8: Illustrative Disclosures

- The illustrative disclosure examples only cover some of the required disclosures the credit
 quality information and the past due status. It would be helpful if the Board provided illustrative
 disclosures for all the required disclosures.
- Also, the disclosure examples are seemingly exclusively for loans. It would be helpful provide illustrative disclosures for all types of assets within the scope as well. As drafted, the disclosures are helpful for lenders, that is, primarily financial institutions. However, given the broad scope of the proposal, many entities other than financial institutions will be impacted. As such, we recommend the illustrative examples be expanded to include other entities besides lenders.

Transition and Effective Date

Questions for All Respondents

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

Yes, we agree transition should occur by means of a cumulative-effect adjustment to the statement of financial position as of the beginning of the first reporting period in which the final standard is effective.

However, clarification is needed for transition issues related to assets currently accounted for under ASC 310-30 and assets with an other than temporary impairment charge recorded. As drafted, it is unclear whether those two categories of assets would be subject to the transition. For assets that have an other than temporary impairment charge record, it is unclear whether the basis would be restored and a valuation allowance established or whether the basis would remain the same and a valuation allowance established only for the additional credit loss. We recommend the Board provide clarification. For assets accounted for under ASC 310-30 at transition, it is unclear whether that accounting, including assets currently accounted for as a pool, should be "unwound" and accounted for using the revised guidance or whether those assets would remain in that accounting, with credit losses adjusted in accordance with the revised guidance.

We recommend that for both categories, the transition be applied fully. So, for assets with an other than temporary impairment charge, the basis be re-established with a corresponding valuation allowance, in accordance with the revised guidance, be established, and for assets accounting for under ASC 310-30, the current accounting be unwound and accounted for using the revised guidance.

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

We have concerns with comparability if early adoption were to be permitted; therefore, we concur with the Board that 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?

No, we propose separate effective dates for public and nonpublic entities. Although we acknowledge some concern with comparability, the benefit of affording additional time to nonpublic entities outweighs that concern. Nonpublic entities typically have fewer resources for implementation of accounting standards. A delayed effective date, of at least one year, would permit nonpublic entities to benefit from the implementation by public entities.

In addition, we recommend the effective date of a final standard on credit losses be aligned with the effective date of a final standard on recognition and measurement.

Questions for Preparers and Auditors

Question 23: Do you believe that the transition provision in this proposed Update is operable? If not, why?

Yes, the transition provisions are operable and other transition provisions are not necessary. However, as noted in our response to Question 20, clarification is needed for transition for assets currently accounted for under ASC 310-30 and assets with an other than temporary impairment charge recorded.

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?

As currently drafted, we envision a significant amount of time will be needed in order for auditors, as well as preparers, to be appropriately prepared. Based on our experience as auditors, while historical loss information is largely available for trade receivables and loans, we envision challenges in obtaining similar information for debt securities. Processes would have to be put in place to comply with the requirements

to evaluate collectibility based on reasonable and supportable forecasts which includes an evaluation of the forecasted direction of the economic cycle. Furthermore, we envision challenges with complying with the use of multiple outcomes. Like the requirement to forecast, processes would have to be put in place by preparers. Auditors would have to put in place audit procedures and perform requisite training.

For some of the proposed disclosures, we envision challenges to accumulate the required information which also adds to the time needed to implement.

Sufficient time will be needed to vet methods available to comply, identify and adapt for reporting systems modifications. It also depends on when a final standard is available for preparers and auditors to understand the requirements. If a final standard is issued in late 2013, we recommend an effective date of no sooner than Jan. 1, 2015 for public companies and Jan. 1, 2016 for nonpublic entities. If the Board retains the expected loss model and the use of reasonable and supportable forecasts, more time may likely be required.

Other Comments on the Proposal

The following are additional comments on the Proposal.

Peer Group Information

One fundamental question is whether peer group information can be used. Under current U.S. GAAP for loans (310-10-35-10) and regulatory guidance, peer group information may only be used when the entity has no loss experience of their own. If the Board has views on whether or not use of peer group data is appropriate, it would be helpful to explicitly include guidance in the final standard. As the Proposal is written, it does not appear that use of peer group data would be prohibited.

Definition of Collateral Dependent

We support the Board's proposed changes to the definition of collateral dependent; specifically on widening the application by replacing the term "solely" with "primarily or substantially," as well as clarifying that the operation of the collateral is by the use of the lender rather than the borrower.

Aggregation

The Proposal appears to permit the use of pools for measuring credit losses; however, there is no guidance provided on how to establish such pools and whether the pools would be open or closed. If the Board has views on aggregation, we recommend those be included.