

September 1, 2010

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

**File Reference No: 1810-100**

Dear Mr. Golden:

Deloitte & Touche LLP is pleased to comment on the FASB's proposed Accounting Standards Update *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities* (the "proposed ASU").

We welcome the Board's effort to improve accounting for financial instruments. We support the Board's objective of providing financial statement users with more timely and representative information about an entity's involvement with financial instruments, and we share the Board's desire to reduce excessive complexity in the accounting for financial instruments. In addition, we support the Board's steps toward achieving the goal of a single set of high-quality global accounting standards in this important area. In our view, however, the proposed ASU falls short of accomplishing these objectives, and accordingly we do not support the issuance of the proposed ASU as a final standard.

To support well-functioning global capital markets, a single converged financial reporting model for financial instruments for the benefit of financial statements users should be a top priority. We are concerned, therefore, that the FASB and IASB are developing divergent models for how to account for financial instruments. The model in the proposed ASU is significantly different from the classification and measurement model for financial assets in IFRS 9<sup>1</sup> and from the proposed model for financial liabilities in the IASB's exposure draft ED/2010/4.<sup>2</sup> In addition, the credit impairment models being proposed by the two boards differ in important respects. Further, the IASB is currently deliberating an approach to hedge accounting that is different from that in the proposed ASU. If the development of a common set of high-quality global accounting standards is to be achieved, the accounting for financial instruments must be a key area of focus. Accordingly, we strongly encourage the two boards to work collaboratively with a common goal of achieving convergence in this important area by agreeing to a single converged high-quality accounting standard for financial instruments.

The remainder of this letter addresses (1) classification and measurement, (2) credit impairment, (3) hedge accounting, and (4) other issues. The appendixes contain our responses to questions identified in the proposed ASU and other comments.

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<sup>1</sup> IFRS 9, *Financial Instruments*.

<sup>2</sup> IASB Exposure Draft ED/2010/4, *Fair Value Option for Financial Liabilities*.

## **Classification and Measurement**

We do not support the proposed classification and measurement approach in the proposed ASU. We do not believe the proposed approach achieves the Board's objectives of improving the accounting for financial instruments and reducing complexity in the accounting for those instruments. In our view, the proposed ASU in certain circumstances inappropriately extends fair value accounting to certain financial instruments for which amortized cost is a meaningful measurement attribute when it is accompanied by fair value disclosures in the notes to the financial statements. Moreover, we are concerned about an increase in the extent to which own credit risk will be recognized in comprehensive income and in equity through increased use of fair value for nonderivative financial liabilities that are not managed on a fair value basis, including the counterintuitive result that an entity would recognize a gain in net income when it experiences deteriorating credit quality on liabilities that it cannot or will not settle at fair value. Further, in some areas the proposed ASU replaces existing complexity with new complexity. For example, the proposed approach effectively replaces the existing classification categories for financial liabilities (e.g., amortized cost and fair value with changes in fair value recognized in net income) with more new classification categories (fair value through net income, fair value through other comprehensive income (OCI), amortized cost, remeasurement attribute through net income, and remeasurement attribute through OCI). In addition, the proposed ASU adds complexity by introducing a new remeasurement approach to core deposit liabilities. In addition, because it is neither fair value nor amortized cost, it is unclear what that new measurement attribute purports to represent.

We therefore recommend that the Board reduce the number of measurement attributes to two (amortized cost and fair value with changes in fair value recognized in net income) and clearly delineate when financial instruments should be measured at either fair value or amortized cost on the face of the financial statements. In addition, we recommend that the Board consider enhancing existing disclosure requirements about the fair values of financial instruments to include information not only about the fair values as of the reporting date (by class of financial instrument) but also changes in fair values during the period for each class. Such disclosures would permit users who have expressed a desire for information about fair value information, in addition to amortized cost, to understand how the financial statements would have looked had all financial instruments been accounted for at fair value with changes in fair value recognized in net income. We believe that our proposed approach, described in more detail below, better meets the key objectives of this project, that is, to improve the accounting for financial instruments for the benefit of financial statement users and reduce complexity in the accounting for those instruments. At the same time, we believe our proposed approach is a more suitable foundation on which to base international convergence toward a common set of high-quality global accounting standards.

Our proposed approach to classification and measurement of financial instruments is similar in some respects to the approach in IFRS 9 for financial assets and to the proposed guidance in IASB ED/2010/4 for financial liabilities. To illustrate our proposed model, we differentiate between derivative financial instruments, nonderivative financial assets, and nonderivative financial liabilities, as discussed below.

### *Derivative Financial Instruments*

Under our proposed approach, all derivative financial instruments would be initially and subsequently measured at fair value. For nonhedging derivative financial instruments, changes in fair value would be recorded in net income. Derivative financial instruments that are designated in a qualifying hedging relationship would be accounted for in a manner consistent with the hedge accounting model.

### *Nonderivative Financial Assets*

Under our proposed approach, which is somewhat similar to that in IFRS 9, a financial asset would be measured at amortized cost if **both** of the following criteria are met:

1. *Cash flow characteristics* — The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.
2. *Business model* — The asset is not held within a business model whose objective is to manage financial assets on a fair value basis<sup>3</sup> or evaluate their performance primarily on a fair value basis.

If the financial asset meets both of the conditions above, it would be measured at amortized cost. If it does not meet both conditions, the financial asset would be measured initially and subsequently at fair value with changes in fair value recognized in net income (“FV-NI”). For example, equity investments<sup>4</sup> (except those accounted for under the equity method of accounting), freestanding derivative financial assets, and certain structured debt instruments would be measured at FV-NI. In addition, our proposed model would allow an entity to irrevocably elect at initial recognition to measure a financial asset at FV-NI if measuring the financial asset at amortized cost would result in an accounting mismatch.

We believe that our proposed approach would simplify and improve the accounting for financial assets by (1) better reflecting how management manages the financial instrument, (2) providing a clearer and more operational criterion for evaluating an entity’s business strategy for a financial instrument, and (3) eliminating the complexities associated with both assessing and measuring embedded derivatives in hybrid financial assets because such model would require such instruments to be measured at FV-NI if they fail the cash flow characteristic condition.

### *Reclassifications*

Like IFRS 9, our proposed approach requires reclassification when the business model of an entity changes if the classification criteria for the other classification category are met. This reclassification approach ensures that the classification of a financial instrument reflects an entity’s current business model rather than some past, historical business model. Accordingly, a debt instrument would be reclassified on the basis of the business model as of the date of reclassification and would be accompanied by detailed disclosures. Further, this reclassification would be prospective; an entity would not restate prior periods. We view the business model as (1) representing a formally established business strategy for a business unit that is approved and implemented by key management personnel and (2) including regular reporting to key management personnel in accordance with the business model’s objective. We would expect changes in the business model to be infrequent.

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<sup>3</sup> Managing an instrument on a fair value basis implies that the instrument is bought and held principally for selling in the near term and thus held only for a short period. Trading would generally involve active buying and selling, with the objective of generating profits on short-term price differences.

<sup>4</sup> We do not support the elective fair value through OCI (FV-OCI) category in IFRS 9 for equity investments, particularly because we do not believe it is meaningful to recognize fair value gains and losses on equity investments in OCI without subsequent recognition in the income statement.

### *Application of the Cash Flow Characteristic to Beneficial Interests*

We believe that in the application of the proposed model to contractually linked subordinated interests in an underlying pool of financial instruments, a look-through approach is appropriate in the determinations of whether the investment in a tranche meets the cash flow characteristics criterion. Therefore, we would support convergence with IFRS 9 in this area.

### *Nonderivative Financial Liabilities*

Under our proposed approach, a nonderivative financial liability (or a portion thereof) would be measured at amortized cost unless the entity's business strategy is to manage the financial liability on a fair value basis or the entity elects to measure a financial liability at fair value because measuring the financial liability at amortized cost would result in an accounting mismatch. Consequently, financial liabilities that are held for trading would be measured at fair value with changes in fair value recognized in net income. Other financial liabilities (or a portion thereof) would be measured at amortized cost. Retaining amortized cost as the principal measurement attribute for financial liabilities addresses potential concerns about reflecting changes in an entity's credit standing in the measurement of its liabilities. Further, to ensure that embedded features are given appropriate accounting recognition, we propose to retain the embedded derivative requirements in ASC 815-15 for financial liabilities. That is, an entity would be required to assess, on the basis of certain criteria, whether an embedded feature should be bifurcated and accounted for separately from the host contract at fair value with changes in fair value recognized in net income. However, we encourage the Board to consider how the existing criteria in ASC 815-15 can be simplified, for example, by the development of a more robust principle for use in evaluating whether an embedded feature is clearly and closely related to its host contract.

### *Fair Value Option*

Because our proposed model retains amortized cost as a principal measurement attribute for financial assets and financial liabilities, such model would allow an entity to irrevocably elect at initial recognition to measure a financial asset or financial liability at FV-NI if measuring the financial asset or financial liability at amortized cost would result in an accounting mismatch. That is, an entity would be permitted to measure a financial asset or financial liability at fair value if doing so eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise from measuring assets or liabilities or from recognizing the gains or losses on them on different bases. In such cases, the entity would disclose in notes to the financial statements why it has chosen to measure a particular financial asset or financial liability at fair value with changes in fair value recorded though net income.

### **Credit Impairment**

We support the Board's efforts to revise the current credit impairment model and to prevent the delay in recognition of known credit losses, as may occur under the incurred loss model. We support the Board's objective of recognizing and measuring credit impairment of financial assets on the basis of an entity's expectations about the collectibility of cash flows. In addition, we agree with the Board's decision to develop a single, comprehensive impairment model for loans, debt securities, beneficial interests in securitized financial assets, and purchased loan assets with evidence of credit deterioration. Further, we believe that the impairment model for written loan commitments not measured at FV-NI should be consistent

with the impairment model applied to the underlying loan when it is also not measured at FV-NI. However, we do not fully support the model as currently proposed. Below, we discuss the aspects of the proposed ASU we find most problematic.

The impairment model in the proposed ASU does not have a minimum threshold for recognition of impairment losses. Accordingly, losses may be recorded on assets that have a relatively low risk of default, such as certain highly rated debt securities, short-term receivables due from entities whose credit is highly rated, or intergroup debt guaranteed by a parent whose credit is highly rated. Because the impairment model requires an entity to incorporate low-probability events into loss estimates, application would be more complex, particularly because the proposed model requires continuous reestimation of impairment losses. The addition of a recognition threshold for impairment (or a common confidence level for use in assessing the collectability of contractual or expected cash flows) would reduce diversity in application of the impairment model, reduce the model's burden, and limit the recognition of impairment to cases in which a minimum threshold is breached. This threshold could limit an impairment loss to cases in which it is more likely than not that the entity will not collect all contractual cash flows when due. We acknowledge that a recognition threshold would be more relevant for the assessment of impairment of financial assets on an individual basis because the threshold is likely to be met at the portfolio level in most circumstances; however, for the reasons stated above, we believe the Board should introduce a threshold.

We do not agree with the Board's requirement that an entity (1) assume that the economic conditions existing at the end of the reporting period would remain unchanged for the remaining life of the financial asset(s) and (2) not forecast future events or economic conditions that did not exist as of the reporting date. We believe that when entities are determining the implications of past events and existing conditions for a financial asset's cash flow collectability, it is unrealistic and overly prescriptive to require them to assume that existing conditions would remain *unchanged* for the remaining life of a financial asset. Impairment estimates are inherently forward-looking, even if they are based on information about past events and existing conditions; accordingly, we recommend that the FASB clarify that an entity is not precluded from using forward-looking information that is currently available and objectively verifiable.

We do not support the proposal that entities calculate interest income by using a *credit-loss-adjusted* amortized cost balance. Instead, we prefer that entities calculate interest income by applying the effective interest rate (i.e., not adjusted for future credit losses) to the amortized cost balance of the financial asset before deducting any allowance for credit losses because this method will result in increased transparency of actual credit losses in the income statement. For many entities, calculating interest income by using a credit-loss-adjusted amortized balance is likely to be overly burdensome and may not be operational. The challenge for many entities in applying any requirement that uses a credit-loss-adjusted amortized cost balance would be to integrate credit-risk data with, or link it to, their accounting systems. Current accounting systems are not equipped to calculate interest income for loans that use a credit-loss-adjusted amortized cost balance, and therefore the calculation of such amounts will be overly burdensome and may not be operational.

Finally, we note that the impairment approach of the proposed ASU differs in many significant respects from the impairment approach that the IASB proposed in its exposure draft ED/2009/12 *Financial Instruments: Amortised Cost and Impairment*. Because the financial instruments project is one of the key convergence projects on the IASB's and FASB's joint agenda, we strongly encourage the two boards to achieve convergence in all the phases of the project, including the impairment phase. Moreover, we understand that the boards' Expert Advisory Panel (EAP) has explored a model that decouples interest and credit

loss determination. We encourage the boards to consider such a model and expose it for comment if it can be sufficiently developed.

### **Hedge Accounting**

We support the Board's effort to simplify the accounting for hedging activities and to resolve major practice issues in its application. However, without significant amendments to the proposed ASU, we do not support the contemplated changes to existing hedge accounting requirements because we do not believe that the benefits will outweigh the costs or that the proposed changes will simplify hedge accounting. Instead we believe that the changes will replace existing complexities with other complexities that may prove equally or more challenging in practice.

Below we address certain aspects of the hedging accounting proposal that we find most problematic.

#### *Hedge Effectiveness Assessment Requirements*

The proposed ASU lowers the threshold for hedge qualification from "highly effective" to "reasonably effective," stating that effectiveness must be assessed only at the inception of a hedging relationship unless "circumstances suggest that the hedging relationship is no longer reasonably effective in offsetting."

In principle, we support lowering the hedging threshold from highly effective to reasonably effective. However, we are concerned that (1) the proposed ASU does not clearly establish a principle that one can uniformly apply to determine whether a hedging relationship is "reasonably effective" and (2) the absence of such a principle is likely to cause diversity in practice. For example, the proposed ASU does not clearly indicate when a qualitative assessment alone is sufficient to support an assertion that a hedging relationship will be reasonably effective. Without guidelines that explain what type or volume of evidence is sufficient to support a qualitative effectiveness assessment, preparers that seek to ensure that their hedge accounting strategies are able to withstand regulatory challenge are likely to continue to use today's parameters for highly effective (80–125 percent) in the absence of further clarifying guidance from regulators. In continuing to use these parameters, they would not realize the intended benefits of the proposed modification. In addition, requiring a qualitative effectiveness assessment at inception, and only when circumstances suggest that the hedging relationship is no longer reasonably effective, calls into question the primary objective of hedge accounting. Except when the terms of the instrument perfectly match, it is unclear what type of a qualitative assessment can be performed without any quantitative factors. Further, an entity will need to determine the change in fair value or cash flows of both the hedging instrument and the hedged item to make appropriate hedge accounting adjustments. Therefore, we propose that an assessment related to current measurements be required each reporting period.

#### *Hedge Effectiveness Measurement*

The proposed ASU introduces a requirement for entities to recognize ineffectiveness for "under hedges" with the accounting for cash flow hedges. We believe that when the cumulative change in fair value of the hedging instrument is less than the cumulative change in the hedged item, no ineffectiveness should be recognized in earnings related to the under hedge because the effect of recognizing such ineffectiveness in earnings would be to defer in accumulated OCI (AOCI) a nonexistent gain or loss on the hedging instrument and to recognize in earnings a nonexistent loss or gain on the hedged item.

### *Dedesignation*

The proposed ASU eliminates an entity's ability to electively dedesignate a hedging relationship. The rationale outlined for this elimination in the Basis for Conclusions is not persuasive. We are unaware of practice issues or abuses arising from elective dedesignation and do not support changing current practice in this area. Any concerns about entities abusing their ability to voluntarily dedesignate a hedging relationship could be addressed through enhanced disclosure requirements.

### *Hedgable Risk — Nonfinancial Items*

The Board should consider whether financial reporting could be improved by extending the ability to bifurcate, by risk, to hedges of certain forecasted purchases or sales of nonfinancial items with explicitly indexed components. Paragraph 416 of the Basis for Conclusion of Statement 133<sup>5</sup> (superseded by ASC 815) notes that hedging price risks associated with components of a nonfinancial item is not permitted because "changes in the price of an ingredient or component of a nonfinancial item generally do not have a predictable, separately measurable effect on the price of the item." For certain nonfinancial assets, however, we believe explicit or observable pricing elements may have predictable and separately measurable effects on the overall pricing of the nonfinancial assets. Furthermore, the fact that a determinable portion of a contract price, or a price of a forecasted transaction for certain commodities, is explicitly based, in part, on an established exchange index appears to overcome the Board's concern that changes in the price of a component of a nonfinancial hedged item would not have a predictable, separately measurable effect on the price of the item. For hedges of such nonfinancial items, the Board should consider permitting bifurcation by risk to better reflect the effects on the financial statements and to simplify the current hedge accounting model for nonfinancial items. Further, we note that the IASB has agreed, as part of its tentative decisions to date in formulating its exposure draft on hedge accounting, to explicitly permit hedge accounting of nonfinancial items in which the variability in price is an explicit separable component.

### **Other Issues**

#### *Due Process*

As of the date of this comment letter, the Board had not made publicly available its proposed amendments to Codification referred to in Appendix C of the proposed ASU. We strongly encourage the Board to release these proposed amendments for public comment and to provide interested parties with adequate time (e.g., 90 days) to review them and submit comments to the Board. As recognized by the Board in paragraph C2 of the proposed ASU, "the proposed guidance would have a pervasive effect on the existing guidance for financial instruments in the Accounting Standards Codification." Without information about the actual details of these proposed amendments, it is not possible to fully analyze and evaluate all the ramifications of the changes contemplated by the Board in connection with the proposed ASU. For example, we understand that the Board may be contemplating making certain clarifying amendments to ASC 815-20 that would have the effect of precluding certain intercompany foreign currency hedging strategies that are somewhat common in practice today.

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<sup>5</sup> FASB Statement No. 133, *Accounting for Derivatives and Hedging Activities*.

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Deloitte & Touche LLP appreciates the opportunity to comment on the proposed ASU. If you have any questions concerning our comments, please contact Bob Uhl at (203) 761-3152 or Magnus Orrell at (203) 761-3402.

Yours truly,

Deloitte & Touche LLP

**APPENDIX A**  
**Deloitte & Touche LLP**  
**Responses to Questions on Classification & Measurement**

**Question 8: Do you agree with the initial measurement principles for financial instruments? If not, why?**

The proposed ASU requires financial instruments classified as (1) FV-NI to be initially measured at fair value and (2) FV-OCI to be measured at the transaction price unless (a) the transaction price differs significantly from the fair value and (b) the entity determines that the difference is at least partially due to the existence of other elements in the transaction. We agree with the initial measurement principle for financial instruments classified in the FV-NI category; however, the conceptual basis for the initial measurement guidance for financial instruments classified as FV-OCI is not clear. In addition, the requirements in paragraph 14–17 of the proposed ASU add unnecessary complexity to financial reporting.

**Question 9: For financial instruments for which qualifying changes in fair value are recognized in other comprehensive income, do you agree that a significant difference between the transaction price and the fair value on the transaction date should be recognized in net income if the significant difference relates to something other than fees or costs or because the market in which the transaction occurs is different from the market in which the reporting entity would transact? If not, why?**

As discussed in our response to Question 8, we believe that the proposed ASU’s model would increase complexity by requiring entities to determine and compare fair value and transaction price at initial recognition to evaluate whether the difference between the fair value and transaction price is significant.

**Question 10: Do you believe that there should be a single initial measurement principle regardless of whether changes in fair value of a financial instrument are recognized in net income or other comprehensive income? If yes, should that principle require initial measurement at the transaction price or fair value? Why?**

Refer to our responses to Questions 8 and 9.

**Question 11: Do you agree that transaction fees and costs should be (1) expensed immediately for financial instruments measured at fair value with all changes in fair value recognized in net income and (2) deferred and amortized as an adjustment of the yield for financial instruments measured at fair value with qualifying changes in fair value recognized in other comprehensive income? If not, why?**

We believe that transaction fees and costs should be recognized immediately in net income for financial instruments classified in the FV-NI category and that they should be deferred and amortized as a yield adjustment for financial instruments classified in the FV-OCI category. Before finalizing guidance, however, we recommend that the FASB consider any income statement presentation issues that may arise under this approach, in particular for investment companies that currently report transaction costs within net income in the “realized and unrealized gain or loss from investments” category and not as part of “investment income and expenses.”

**Question 12: For financial instruments initially measured at the transaction price, do you believe that the proposed guidance is operational to determine whether there is a significant difference between the transaction price and fair value? If not, why?**

The fair value measurement requirements in ASC 820-10 provide guidance and examples of when transaction price may or may not reflect fair value. Since entities have been applying the fair value measurement guidance in ASC 820 for a couple of years, we believe that establishing fair value as the initial measurement attribute and conforming the guidance in the proposed ASU to ASC 820-10 would be a better and more operational solution than requiring entities to assess and quantify any differences between transaction price and fair value.

**Question 13: The Board believes that both fair value information and amortized cost information should be provided for financial instruments an entity intends to hold for collection or payment(s) of contractual cash flows. Most Board members believe that this information should be provided in the totals on the face of the financial statements with changes in fair value recognized in reported stockholders' equity as a net increase (decrease) in net assets. Some Board members believe fair value should be presented parenthetically in the statement of financial position. The basis for conclusions and the alternative views describe the reasons for those views. Do you believe the default measurement attribute for financial instruments should be fair value? If not, why? Do you believe that certain financial instruments should be measured using a different measurement attribute? If so, why?**

We do not support fair value as the default measurement attribute for all nonderivative financial instruments. We support a mixed measurement attribute model for financial assets and financial liabilities in which some financial instruments are measured at fair value and others at amortized cost on the basis of a consistent and robust set of criteria. As discussed previously, we believe that if a financial asset has certain cash flow characteristics and is held in a business model whose objective is not to manage financial assets on a fair value basis (or evaluate their performance on a fair value basis), then amortized cost is the most relevant measure unless the entity elects to measure the financial asset at fair value because measuring the financial asset at amortized cost would result in an accounting mismatch. If these criteria are not met, then the financial asset should be measured at fair value with changes in fair value recognized in earnings. Further, we believe that financial liabilities should be measured at amortized cost unless the entity manages the financial liability on a fair value basis or elects to measure it at fair value because of an accounting mismatch that would otherwise arise. In addition, we support retaining the existing embedded derivative requirements for financial liabilities to ensure that embedded features are given appropriate accounting recognition.

Although we believe that a mixed measurement attribute model is superior to the Board's proposed approach, we share the Board's view that the fair value of financial instruments also is relevant and useful information to users of the financial statements. Thus, for financial instruments whose measure is amortized cost (i.e., most relevant measure), information about fair value is still warranted. Accordingly, when financial instruments are measured at an amount other than fair value on the face of the financial statements, comprehensive and prominent disclosure of supplemental fair value information in the notes to the financial statements is important to complement the information provided in the financial statements. Further, we recognize that some U.S. investors are seeking more fair value information. Accordingly, we recommend that the Board consider enhancing existing disclosure requirements about the fair values of financial instruments to include comprehensive information not only about the fair values as of the reporting date by class of financial

instruments but also about changes in fair values during the period for each class. Such an approach should give financial statement users an additional view of how the financial statements would have looked had all financial instruments been accounted for at fair value.

We acknowledge that fair value disclosures in the notes to the financial statements are often presented on a later date than an entity's earnings announcements. However, we do not believe that this in itself is a valid reason for the Board to require presentation of both fair value and amortized cost information on the face of the financial statements because specifying what information entities should provide in their earnings announcements is beyond the Board's purview. The Board may raise concerns about the timeliness of fair value information released outside of the financial statements with the SEC and other relevant parties.

**Question 14: The proposed guidance would require that interest income or expense, credit impairments and reversals (for financial assets), and realized gains and losses be recognized in net income for financial instruments that meet the criteria for qualifying changes in fair value to be recognized in other comprehensive income. Do you believe that any other fair value changes should be recognized in net income for these financial instruments? If yes, which changes in fair value should be separately recognized in net income? Why?**

We believe that if the Board were to retain the FV-OCI classification, gains and losses arising from changes in foreign currency exchange rates should be separately recorded in net income. We disagree with the Board's proposal to defer gains and losses associated with changes in foreign currency exchange rates in OCI until realized or settled. The Board's proposed approach is inconsistent with the spot remeasurement model for monetary items in ASC 830-20-35-1 and 35-2, which generally requires a change in exchange rate between the functional currency and the currency in which a transaction is denominated to be included in the determination of net income in the period in which the exchange rate changes. This approach is based on the view that a change in exchange rates between the functional currency and the currency in which a transaction is denominated increases or decreases the expected amount of functional currency cash flows upon settlement of the transaction. We acknowledge that ASC 820-20-35-6 currently contains an exception to this approach for available-for-sale debt securities, but we do not believe this exception has strong conceptual merit. While unrealized changes in the market price of a debt instrument typically tend to reverse as the time to maturity decreases (in the absence of impairment), this "pull-to-par" effect applies in the instrument's currency of denomination and does not extend to unrealized changes in fair value due to changes in foreign exchange rates. Under the Board's approach, therefore, entities could be forced to recognize significant deferred foreign currency gains or losses in net income upon realization or settlement, even though those gains and losses arose in prior periods. If the Board retains its FV-OCI category, we would thus favor an approach in which foreign currency gains and losses are separately recognized in net income (like the approach in IAS 39.AG83) in the period in which they arise. Such separation is all the more important since some entities may classify most of their financial assets and financial liabilities in the FV-OCI category (e.g., a bank that classifies its loan portfolio, issued debt, and core deposits in the FV-OCI category). Accordingly, we believe that an entity should be required to report foreign currency transaction gains or losses on a foreign-currency-denominated financial instrument in net income as they arise rather than deferring them until realized or settled.

**Question 15: Do you believe that the subsequent measurement principles should be the same for financial assets and financial liabilities? If not, why?**

As discussed previously, we are concerned about an increase in own credit risk recognized in comprehensive income through increased use of fair value for nonderivative financial liabilities that are not managed on a fair value basis, including the counterintuitive result that an entity would recognize a gain in net income when it experiences deteriorating credit quality on liabilities that it cannot or will not settle at fair value. Accordingly, we do not support the use of the same criteria for determining the measurement basis of both financial assets and financial liabilities at this time. Retaining amortized cost as the principal measurement attribute for most financial liabilities addresses potential concerns about reflecting changes in an entity's credit standing in the measurement of its liabilities.

**Question 16: The proposed guidance would require an entity to decide whether to measure a financial instrument at fair value with all changes in fair value recognized in net income, at fair value with qualifying changes in fair value recognized in other comprehensive income, or at amortized cost (for certain financial liabilities) at initial recognition. The proposed guidance would prohibit an entity from subsequently changing that decision. Do you agree that reclassifications should be prohibited? If not, in which circumstances do you believe that reclassifications should be permitted or required? Why?**

We do not support the proposed ASU's prohibition of reclassification between categories. We believe that if there is a change in the entity's business model, an entity should reclassify and disclose the financial instruments in a manner consistent with IFRS 9 as long as the classification criteria for the other category are met. If the business model criterion is a matter of fact, and is not generally expected to be subject to change, it is reasonable to require reclassification if there is a change in the business model to ensure that the accounting reflects an entity's current business model and not some past, historical business model. We view the business model as (1) representing a formally established business strategy for a business unit that is approved and implemented by key management personnel and (2) including regular reporting to key management personnel. Thus, we expect changes in the business model to be infrequent.

**Question 17: The proposed guidance would require an entity to measure its core deposit liabilities at the present value of the average core deposit amount discounted at the difference between the alternative funds rate and the all-in-cost-to-service rate over the implied maturity of the deposits. Do you believe that this remeasurement approach is appropriate? If not, why? Do you believe that the remeasurement amount should be disclosed in the notes to the financial statements rather than presented on the face of the financial statements? Why or why not?**

We are not convinced that the proposed remeasurement approach for core deposit liabilities would represent an improvement to financial reporting for financial instruments. It is unclear what benefit or information the proposed remeasurement attribute for core deposit liabilities provides to the users of the financial statement. The remeasurement attribute is neither a cost measurement nor a fair value measurement because it does not incorporate the value of customer relationships and involves using a discount rate that is derived in part from a discount rate related to the next available source of funds rather than a market-based discount rate for the liability actually being measured.

We recommend that the FASB staff perform outreach to financial statement users and preparers to determine whether there is a need to change from the current measurement basis for demand deposits.

**Question 18: Do you agree that a financial liability should be permitted to be measured at amortized cost if it meets the criteria for recognizing qualifying changes in fair value in other comprehensive income and if measuring the liability at fair value would create or exacerbate a measurement attribute mismatch? If not, why?**

As stated previously, we do not believe that fair value should be the default measurement for nonderivative financial instruments. We believe that a financial liability should be measured at amortized cost unless the entity's business strategy is to manage the financial liability on a fair value basis or an entity elects to measure the liability at fair value because measuring the financial liability at amortized cost would result in an accounting mismatch. In addition, we support retaining the existing embedded derivative requirements for financial liabilities to ensure that embedded features are given appropriate accounting recognition. However, we encourage the Board to consider how the existing criteria in ASC 815-15 can be simplified, for example, by the development of a more robust principle for use in evaluating whether an embedded feature is clearly and closely related to its host contract.

**Question 19: Do you believe that the correct financial instruments are captured by the criteria in the proposed guidance to qualify for measurement at the redemption amount for certain investments that can be redeemed only for a specified amount (such as an investment in the stock of the Federal Home Loan Bank or an investment in the Federal Reserve Bank)? If not, are there any financial instruments that should qualify but do not meet the criteria? Why?**

A goal of the proposed ASU is to reduce complexity in the accounting for financial instruments. However, we believe that incorporating additional measurement attributes other than amortized cost or fair value will increase complexity in accounting for financial instruments. We also believe that all equity investments (excluding those accounted for under the equity method) should be measured consistently at fair value with changes in fair value recorded in earnings. As noted in paragraph BC148 of the proposed ASU, redemption value may "approximate fair value." Thus, introduction of this additional measurement attribute may be unnecessary.

**Question 20: Do you agree that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to a debt instrument measured at fair value with qualifying changes in fair value recognized in other comprehensive income in combination with other deferred tax assets of the entity (rather than segregated and analyzed separately)? If not, why?**

We do not support the proposal's requirement that an entity consider its deferred tax assets related to debt instruments for which qualifying changes in fair value are recognized in other comprehensive income in combination with its other deferred tax assets in evaluating the need for a valuation allowance as part of this proposed ASU. We are concerned that the FASB is addressing this one area of income tax accounting guidance in isolation and not fully considering the judgments an entity must make in evaluating the need for a valuation allowance on a deferred tax asset related to such investments in debt instruments.

The rationale for the approach the FASB is proposing to eliminate is based on the premise that if an entity has the intent and ability to hold the debt instrument until the recovery of its amortized cost basis (which may be at maturity), increases and decreases in the debt instrument's fair value will reverse out of other comprehensive income over the contractual life of the investment. This results in no cumulative change in the entity's comprehensive income or future taxable income over that contractual life. In this respect, the temporary differences associated with unrealized gains and losses on debt instruments are unlike other types of temporary differences because they do not affect the income statement or the tax return if held until recovery of the debt securities' amortized cost. This approach is limited to debt instruments with contractual maturity dates.

We believe that assessing the realizability of deferred tax assets requires the use of much judgment. ASC 740-10-30-18 states, "Future realization of the tax benefit of an existing deductible temporary difference or carryforward ultimately depends on the existence of sufficient taxable income of the appropriate character (for example, ordinary income or capital gain) within the carryback, carryforward period available under the tax law." That paragraph also includes numerous examples of the types of information that entities consider in making such realization assessments. We believe that if an entity has the ability to hold an investment in a debt security until its recovery or maturity, the recovery of the fair value of the debt instrument and the corresponding reversals of the deferred tax asset can be viewed as a realization of the tax benefit. Alternatively, some have taken the view that a deferred tax asset related to a debt instrument should be considered in combination with other deferred tax assets but that the entity may assert that it has a tax planning strategy such that any future increases in the value of the debt instrument to the maturity date of the instrument can be considered when it determines whether its deferred tax assets are realizable. This approach could be considered to be in compliance with the rule proposed in the proposed ASU, but it may produce results that are similar to the approach described above. It is unclear whether the proposal in the proposed ASU was intended to disallow this "tax planning strategy" approach or whether the FASB considered this current practice in coming to its conclusion.

For these reasons, we believe that if the FASB desires to eliminate the diversity in practice regarding income tax accounting, it should do so in a comprehensive income tax accounting project. This proposal has little to do with the accounting changes being proposed for financial instruments in the proposed ASU. If the FASB rejects our recommendation to remove this proposal from the proposed ASU, it should consider the issue more completely and determine whether it should include more guidance on how the phenomenon of holding a debt instrument measured at fair value with certain changes being recorded in other comprehensive income should be considered in the assessment of the related deferred tax assets for realizability.

**Question 21: The Proposed Implementation Guidance section of this proposed Update provides an example to illustrate the application of the subsequent measurement guidance to convertible debt (Example 10). The Board currently has a project on its technical agenda on financial instruments with characteristics of equity. That project will determine the classification for convertible debt from the issuer's perspective and whether convertible debt should continue to be classified as a liability in its entirety or whether the Board should require bifurcation into a liability component and an equity component. However, based on existing U.S. GAAP, the Board believes that convertible debt would not meet the criterion for a debt instrument under paragraph 21(a)(1) to qualify for changes in fair value to be recognized in other comprehensive income because the principal will not be returned to the creditor (investor) at maturity or other settlement. Do you agree with the Board's application of the proposed subsequent measurement guidance to convertible debt? If not, why?**

We agree that an investment in a convertible debt instrument should be accounted for at fair value with changes in fair value recognized in net income. Under our proposed approach for financial liabilities, and in a manner consistent with IFRSs, an issuer of a convertible debt instrument would assess whether the embedded conversion option is required to be separated either as an embedded derivative or as an equity component. If the issuer concludes that it is required to account for the conversion feature separately from the host debt contract, either as an embedded derivative or an equity component, we believe the host debt contract should be eligible for amortized cost measurement as long as it meets the criteria for such classification. We recommend that the Board coordinate its consideration of this issue as it relates to financial liabilities with its project on financial instruments with characteristics of equity.

**Question 28: Do you believe that the proposed criteria for recognizing qualifying changes in fair value in other comprehensive income are operational? If not, why?**

As previously stated, we do not support establishing a separate classification category for financial instruments measured at fair value with changes in fair value recognized in OCI. We believe that there should be two classification categories: fair value through net income and amortized cost.

While we would support the use of criteria somewhat similar to those in the proposed ASU in the determination of whether a financial asset should be accounted for at amortized cost, we recommend that the Board make certain revisions to those criteria. The proposed criteria, particularly the criterion related to assessment of embedded derivatives in paragraph 21(c) of the proposed ASU, retain the accounting literature's considerable complexity. The retention of such complexity conflicts with one of the key goals of this project. We believe the Board would be able to eliminate the need for the criterion in paragraph 21(c) by further developing the cash flow characteristics criterion in paragraph 21(a) in a manner consistent with IFRS 9.

Further, we believe that the criterion in paragraph 21(b) about collecting or paying "the related contractual cash flows rather than to sell . . . or settle . . . with a third party" is likely to raise difficult interpretation issues in practice, in particular since the proposed ASU indicates that entities are permitted to have some level of sales or settlements without violating this criterion. If the intent of the proposed ASU is to identify financial instruments that require management decisions that are primarily based on what an asset or liability is worth (i.e., its fair value), we suggest that this criterion be amended to read as follows: "The asset is not held within a business model whose objective is to manage financial assets on a fair value basis<sup>6</sup> or evaluate their performance primarily on a fair value basis."

Under our proposed approach, therefore, a financial asset would be measured at amortized cost if **both** of the following criteria are met:

1. *Cash flow characteristics* — The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

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<sup>6</sup> Managing an instrument on a fair value basis implies that the instrument is bought and held principally for selling in the near term and thus held only for a short period. Trading would generally involve active buying and selling, with the objective of generating profits on short-term price differences.

2. *Business model* — The asset is not held within a business model whose objective is to manage financial assets on a fair value basis or evaluate their performance primarily on a fair value basis.

If the Board were to finalize the criteria in the proposed ASU in its current form, we believe additional implementation guidance would be needed to interpret and apply it consistently. In particular, it is unclear under the proposed ASU how to evaluate the proposed business strategy criterion, which allows an occasional sale or settlement of financial instruments held in a portfolio to occur without tainting the FV-OCI classification criterion. While it may be clear how to apply this criterion to a portfolio of instruments that are held for active trading or always held to maturity, it is less clear how to apply it to a portfolio that is generally held for the long term but for which sales occur from time to time. This is particularly relevant for assets held in a liquidity portfolio in which sales may occur before the asset's maturity to fund capital or operating expenditure or will be sold to reinvest in alternative debt instruments with a higher yield. For both entities and auditors, this will create operational challenges related to how many instruments may be sold before the business strategy is deemed to have changed for any new financial instruments acquired or incurred in the portfolio. We recommend that the Board provide additional implementation guidance to address this concern. Situations in which we believe that sales should be allowed would include, for example, when the entity is managing a mismatch in duration of assets and liabilities or if, per an entity's policy, the credit rating of the security is downgraded below investment grade. In addition, we also encourage the Board to consider whether an exemption from the cash flow characteristics criterion is warranted for nonsubstantive or immaterial features embedded in a financial asset.

**Question 29: Do you believe that measuring financial liabilities at fair value is operational? If not, why?**

The proposed ASU would result in a significant number of financial liabilities being measured at fair value when such financial liabilities were previously measured at cost or subject to the embedded derivative bifurcation requirements in ASC 815. However, fair value may not provide the most meaningful information to users of the financial statements because of the impact of own credit. Further, although measuring fair value of financial liabilities may be operational, componentizing the whole change in fair value by risk (e.g., interest, credit, liquidity) may not be. We suggest that the staff perform further outreach to better understand existing valuation techniques and operational challenges associated with measuring financial liabilities at fair value. Further, measuring financial liabilities at fair value would not be meaningful for investment companies since entities determine the equity redemption value or net asset value used for redemptions by using the amortized cost (rather than the fair value) of any outstanding debt.

**Question 30: Do you believe that the proposed criteria are operational to qualify for measuring a financial liability at amortized cost? If not, why?**

The proposed ASU permits an entity to elect to measure certain financial liabilities at amortized cost if certain criteria are met. We believe that the proposed criteria in paragraph 30 may be operationally challenging and complex to implement because an entity would need to evaluate the liability as of each reporting period to determine whether the financial liability qualifies for amortized cost measurement. In addition, we believe that it would be preferable to have a clear principle rather than a "bright-line" threshold (i.e., 50 percent) for the identification of financial liabilities eligible for amortized cost measurement. We believe our

proposed model for financial liabilities provides more operational criteria for identifying financial liabilities to be accounted for at amortized cost. Under this approach, a nonderivative financial liability would be measured at amortized cost unless the entity's business strategy is to manage the financial liability on a fair value basis or the entity elects to measure a financial liability at fair value because measuring the financial liability at amortized cost would result in an accounting mismatch.

**Question 31: The proposed guidance would require an entity to measure its core deposit liabilities at the present value of the average core deposit amount discounted at the difference between the alternative funds rate and the all-incost-to-service rate over the implied maturity of the deposits. Do you believe that this remeasurement approach is operational? Do you believe that the remeasurement approach is clearly defined? If not, what, if any, additional guidance is needed?**

We have concerns about the operationality of this approach in practice. Please refer to our response to Question 17.

**Question 32: For financial liabilities measured at fair value with all changes in fair value recognized in net income, do you agree that separate presentation of changes in an entity's credit standing (excluding changes in the price of credit) is appropriate, or do you believe that it is more appropriate to recognize the changes in an entity's credit standing (with or without changes in the price of credit) in other comprehensive income, which would be consistent with the IASB's tentative decisions on financial liabilities measured at fair value under the fair value option? Why?**

We support a principle that requires changes in the fair value of certain financial liabilities to be disclosed separately in the statement of comprehensive income to the extent that those changes are attributable to the credit risk of that financial liability. However, we believe that the Board needs to articulate clearly the principle that underlies the mechanics of identifying the changes that would be presented separately. For instance, we believe further guidance is needed to address more complex fact patterns, such as liabilities that are collateralized or guaranteed, when the credit risk of the liability could be significantly different from the credit standing of the issuer because of credit enhancements or subordination arrangements. We believe it would be inappropriate to identify the change that would be presented separately on the basis of the entity's credit standing if the liability's credit risk is different from that of the entity (e.g., if the entity is rated BBB, but the liability is rated AAA because of credit enhancements). Further, we believe the change that would be presented separately should exclude asset-specific risk in asset-backed obligations when an amount is not owed to the counterparty if the assets do not generate sufficient cash flows.

**Question 33: Appendix B describes two possible methods for determining the change in fair value of a financial liability attributable to a change in the entity's credit standing (excluding the changes in the price of credit). What are the strengths and weaknesses of each method? Would it be appropriate to use either method as long as it was done consistently, or would it be better to use Method 2 for all entities given that some entities are not rated? Alternatively, are there better methods for determining the change in fair value attributable to a change in the entity's credit standing, excluding the price of credit? If so, please explain why those methods would better measure that change.**

We believe that when entities separate credit from other changes in the fair value of a financial liability in a statement of comprehensive income, such presentation can provide

useful information to financial statement users. However, more guidance will be needed on the separation of credit risk that addresses different components of fair value and whether meaningful practical expedients can be employed by preparers in isolating one's own credit standing. Further, we believe that guidance is needed to address (1) more complex fact patterns, such as liabilities that are collateralized, guaranteed, or otherwise credit enhanced and (2) asset-linked obligations issued through consolidated special-purpose entities.

**Question 34: The methods described in Appendix B for determining the change in fair value of a financial liability attributable to a change in an entity's credit standing (excluding the changes in the price of credit) assume that the entity would look to the cost of debt of other entities in its industry to estimate the change in credit standing, excluding the change in the price of credit. Is it appropriate to look to other entities within an entity's industry, or should some other index, such as all entities in the market of a similar size or all entities in the industry of a similar size, be used? If so, please explain why another index would better measure the change in the price of credit.**

Please refer to our response to Questions 32 and 33.

**APPENDIX B**  
**Deloitte & Touche LLP**  
**Responses to Questions on Credit Impairment**

**Question 37: Do you believe that the objective of the credit impairment model in this proposed ASU is clear? If not, what objective would you propose and why?**

The objective of the credit impairment model as described in the first sentence of paragraph 36 is clear, namely, that the impairment model is based on an entity's expectations about the collectibility of cash flows. However, we believe that the second sentence of paragraph 36 needs clarification. That sentence states that an entity's expectations about collectability of cash flows includes all available information about past events and existing conditions but does not take into account potential future events beyond the reporting date. While we agree that an entity should not be required to consider all potential future scenarios in estimating future cash flows, we believe that it should not be precluded from using the best information available to it about the collectability of future cash flows, even though such information may be forward-looking (e.g., current trend information and current forward curves). As discussed in more detail in our response to Question 46, we recommend that the FASB clarify that an entity is not precluded from using forward-looking information that is currently available and objectively verifiable.

**Question 38: The proposed guidance would require an entity to recognize a credit impairment immediately in net income when the entity does not expect to collect all contractual amounts due for originated financial asset(s) and all amounts originally expected to be collected for purchased financial asset(s).**

**The IASB Exposure Draft, Financial Instruments: Amortised Cost and Impairment (Exposure Draft on impairment), would require an entity to forecast credit losses upon acquisition and allocate a portion of the initially expected credit losses to each reporting period as a reduction in interest income by using the effective interest rate method. Thus, initially expected credit losses would be recorded over the life of the financial asset as a reduction in interest income. If an entity revises its estimate of cash flows, the entity would adjust the carrying amount (amortized cost) of the financial asset and immediately recognize the amount of the adjustment in net income as an impairment gain or loss.**

**Do you believe that an entity should immediately recognize a credit impairment in net income when an entity does not expect to collect all contractual amounts due for originated financial asset(s) and all amounts originally expected to be collected for purchased financial asset(s) as proposed in this Update, or do you believe that an entity should recognize initially expected credit losses over the life of the financial instrument as a reduction in interest income, as proposed in the IASB Exposure Draft on impairment?**

As previously stated, we support the Board's objective of recognizing and measuring credit impairment of financial assets on the basis of an entity's expectations about the collectibility of cash flows. However, we do not fully support either the FASB's or the IASB's model as currently proposed.

The impairment model in the proposed ASU does not have a minimum threshold for recognition of impairment losses. Accordingly, losses may be recorded on assets that have a relatively low risk of default, such as certain highly rated debt securities, short-term receivables due from entities whose credit is highly rated, debt guaranteed by a parent whose credit is highly rated. The incorporation of low-probability events into loss estimates makes the application of the proposed impairment model more complex and increases the subjectivity of reported amounts, in particular because the proposed model requires continuous reestimation of impairment losses. For example, consider the highest-rated debt security, in which the chance of not collecting all cash flows may be only 1 percent. Assuming this security is not part of a larger portfolio, it does not make sense to recognize an impairment only to reverse it in the future when, in almost all probability, collection of all cash flows occurs. The addition of a recognition threshold for impairment (or a common confidence level for use in assessing the collectability of contractual or expected cash flows) would reduce diversity in application of the impairment model, reduce its burden, and limit the recognition of impairment to cases in which a minimum threshold is breached. This threshold could limit an impairment loss to cases in which it is more likely than not that the entity will not collect all contractual cash flows when due. We acknowledge that a recognition threshold would be more relevant for the assessment of impairment of financial assets on an individual basis because the threshold will likely be met at the portfolio level in most circumstances; however, for the reasons stated above, we believe the Board should introduce a threshold.

The IASB's expected loss model attempts to convert a contractual interest return into a credit-risk-free interest return and remeasure the relative opportunity cost or benefit of fixing the compensation for credit risk at the contractual credit margin. This approach introduces considerable complexity and subjectivity in the determination of interest income and credit losses because of its reliance on the development of expectations about potential future events and their impact on future cash flows. We understand the conceptual argument for determining an effective interest rate (EIR) that is lower than the contractual interest rate because of the compensation demanded from the borrower for the risk of nonpayment. However, the challenge for many entities in applying a credit impairment model that requires the use of a credit-risk-adjusted EIR would be to integrate credit-risk data with, or link it to, their accounting systems. Please refer to our discussion below further detailing our concerns regarding the use of a credit-risk-adjusted EIR. Thus, we believe that the evaluation of credit and computation of an EIR should be performed separately (i.e., decoupled), except for loans that are purchased with an existing credit deterioration (i.e., expected cash flows are less than contractual).

We recognize that by not building into the EIR expected losses at inception and by recording impairments immediately on assets that are added to portfolios in which it is more likely than not that all cash flows for the portfolio will not be collected, loss recognition will be accelerated compared with the incurred loss model. We also recognize that in this model, as compared with the IASB model, losses would be recognized sooner and interest income would be higher over the life of the instrument. We do not see this as an inappropriate result. However, we understand that the Boards' Expert Advisory Panel (EAP) has explored a model that decouples interest and losses and would recognize losses over the period until the loss is manifested. We encourage the boards to consider such a model and, if it can be sufficiently developed, expose the model for comment.

**Question 39: Do you agree that a credit impairment should not result from a decline in cash flows expected to be collected due to changes in foreign exchange rates, changes in expected prepayments, or changes in a variable interest rate? If not, why?**

While we support the Board's decision that a credit impairment should not result from a decline in cash flows expected to be collected because of changes in (1) foreign exchange rates, (2) expected prepayments, or (3) a variable interest rate, we disagree with the Board's proposal to defer foreign currency gains and losses in OCI until realized or settled. Please refer to our response to Question 14.

**Question 40: For a financial asset evaluated in a pool, the proposed guidance does not specify a particular methodology to be applied by individual entities for determining historical loss rates. Should a specific method be prescribed for determining historical loss rates? If yes, what specific method would you recommend and why?**

Because entities' circumstances vary (e.g., the nature of their pool of assets and the design of their credit risk, management systems), we support the Board's decision not to prescribe a particular method for determining historical loss rates. However, although no specific method should be prescribed, we believe it would be useful if the Board were to provide certain overall guidelines to promote comparability in the development and application of historical loss rates in the recognition and measurement of credit impairment. For example, we believe it would be useful if the Board were to address the following positions:

1. Adjustments to historical loss rates should (a) reflect the effects of current and objective forward-looking economic factors and conditions that did not affect the period on which the historical loss rate is based and (b) remove the effects of factors and conditions in the historical loss period that do not exist currently.
2. Adjustments to historical loss rates should reflect and be directionally consistent with changes in relevant economic factors and conditions used in the entity's impairment assessment.
3. Entities should review the method and assumptions used in adjusting loss rates regularly to reduce differences between loss estimates and actual loss experience.
4. The process of adjusting historical loss rates may take into account both quantitative and qualitative factors as appropriate in the circumstances.

**Question 41: Do you agree that if an entity subsequently expects to collect more cash flows than originally expected to be collected for a purchased financial asset, the entity should recognize no immediate gain in net income but should adjust the effective interest rate so that the additional cash flows are recognized as an increase in interest income over the remaining life of the financial asset? If not, why?**

We agree that an increase in a financial asset's expected cash flows should be recognized as an adjustment to the asset's EIR if the expected cash flows exceed what the entity originally expected to collect for a purchased financial asset when a credit impairment existed at acquisition. Unlike other increases in expected cash flows, which are recognized immediately as recoveries in earnings, there is no previous impairment loss that can be reversed through net income when the expected cash flows exceed those expected upon initial recognition. Therefore, an entity should instead account for such increases prospectively over the remaining life of the asset by adjusting the EIR. We acknowledge that this results in a difference in the treatment of increases in expected cash flows depending on whether the entity initially expected to collect less than the full amount of the contractual cash flows on a purchased financial asset. However, this treatment is necessary since an increase in expected cash flows for such an asset does not represent a recovery of previously recorded credit impairments.

**Question 42: If a financial asset that is evaluated for impairment on an individual basis has no indicators of being individually impaired, the proposed guidance would require an entity to determine whether assessing the financial asset together with other financial assets that have similar characteristics indicates that a credit impairment exists. The amount of the credit impairment, if any, would be measured by applying the historical loss rate (adjusted for existing economic factors and conditions) applicable to the group of similar financial assets to the individual financial asset. Do you agree with this requirement? If not, why?**

Yes, we support this requirement. Requiring entities to assess credit impairment on a pool or collective basis for assets that have not been individually identified as impaired reflects the economic reality that the pricing of financial assets is often based on a certain amount of losses on a total pool, even though an entity expects to collect on each individual asset. In addition, when historical experience suggests that it is more likely than not that a credit loss exists in a pool of financial assets, an entity should not delay in recognizing an impairment even though it has yet to specifically identify the individual financial assets that have experienced the credit loss. Because this process requires an entity to exercise discipline regarding a portfolio assessment, we believe the Board should provide additional guidance about how an entity considers and develops its historical loss rates (as discussed in our response to Question 40).

We note that the proposed ASU requires an entity to measure at present value the expected cash flows of a financial asset when assessing and measuring credit impairment on an individual basis. However we also note that it does not require the entity to consider the time value of money when assessing and measuring credit impairment on a collective or pool basis through the use of historical loss rates. We believe that the measurement approach the entity uses should incorporate the effect of the time value of money for both individual assets and pools of assets. Conceptually, the entity should recognize a similar credit impairment regardless of whether the impairment comprises the total of impairments of individually measured financial assets or the impairment measured on a collective portfolio basis. Accordingly, we believe that an entity should consider the time value of money in applying historical loss rates to assess and measure credit impairments on a collective portfolio basis.

As a separate matter, we believe an individual assessment should be required when the asset is individually significant and that a further portfolio assessment should be required when the individual assessment does not result in impairment recognition. Financial assets that are not individually significant should at a minimum be subject to a portfolio assessment if the items in the portfolio are similar.

Further, we recommend that the Board clarify and provide additional guidance on how an entity would apply the proposed impairment model when the entity does not have a pool of similar assets. In particular, the Board should clarify whether its proposed approach requires or permits an entity to include financial assets in a hypothetical pool of similar assets (that it does not hold) to ensure that the recognition of measurement of credit losses does not depend on whether the entity holds one or more similar assets. We read paragraph 65 of the proposed ASU to suggest that an entity should apply such a “hypothetical pool” approach, but we believe further clarification and guidance is warranted. For instance, if an entity holds one single corporate debt security and no other similar assets, is the entity required to recognize and measure impairment on that debt security, if not individually identified as impaired, by applying a loss rate appropriate for a pool of similar “hypothetically” held debt securities?

**Question 46: The proposed guidance would require that in determining whether a credit impairment exists, an entity consider all available information relating to past events**

**and existing conditions and their implications for the collectibility of the cash flows attributable to the financial asset(s) at the date of the financial statements. An entity would assume that the economic conditions existing at the end of the reporting period would remain unchanged for the remaining life of the financial asset(s) and would not forecast future events or economic conditions that did not exist at the reporting date. In contrast, the IASB Exposure Draft on Impairment proposes an expected loss approach and would require an entity to estimate credit losses on basis of probability-weighted possible outcomes.**

**Do you agree that an entity should assume that economic conditions existing at the reporting date would remain unchanged in determining whether a credit impairment exists, or do you believe that an expected loss approach that would include forecasting future events or economic conditions that did not exist at the end of the reporting period would be more appropriate? Are both methods operational? If not, why?**

As previously stated, we believe that when entities are determining the implications of past events and existing conditions for a financial asset's cash flow collectability, it is unrealistic and overly prescriptive for them to be required to assume that existing conditions would remain *unchanged* for the remaining life of a financial asset. For example, we believe that an entity should not be precluded from considering trend information that indicates that existing economic conditions are likely to change (e.g., if the current unemployment rate is low but trending upwards). Impairment estimates are inherently forward-looking, even if they are based on information about past events and existing conditions. We recommend that the FASB clarify that an entity is not precluded from using forward-looking information that is currently available and objectively verifiable.

However, we do not support the IASB's proposed approach either, which requires an entity to consider all potential future scenarios in estimating future cash flows. The incorporation of all potential future economic environments in estimating impairment losses would be extremely complex, costly, and burdensome to apply by preparers. We note that the IASB's exposure draft does not limit the forward-looking information that an entity might, or would have to, consider in developing its expectations of the amounts and timing of the recoverable cash flows over the life of the financial instrument. The quantity of information to be considered will be challenging for preparers, auditors, and regulators to manage.

Accordingly, we would support an approach that allows an entity to use its best estimate when determining the collectibility of expected future cash flows of a financial asset. In doing so, the entity would evaluate past events, current conditions, and forward-looking information that is currently available and objectively verifiable. For example, internally generated information on credit quality derived from the entity's experience of actual credit history may be used to support the entity's assessment of recoverable cash flows for financial assets as of the reporting period-end. Interest rate yield curves that are derived from market prices of debt instruments can provide the entity with information about the future expectations of interest rates. Further, we believe that restricting the use of forward-looking information with the addition of a verifiability parameter would foster discipline and consistency in the implementation of the new impairment model. This would strike the right balance of allowing the entity to make the best use of information that is available to it without requiring the entity to make unsupported predictions about the future economic environment. Without these limitations and sufficient guidance on the level of objectivity, verifiability, or support for the underpinnings of these inputs, significant challenges will be presented to internal auditors, external auditors, and regulators.

**Question 47: The proposed guidance would require that an appropriate historical loss rate (adjusted for existing economic factors and conditions) be determined for each individual pool of similar financial assets. Historical loss rates would reflect cash flows that the entity does not expect to collect over the life of the financial assets in the pool. Would such an approach result in a significant change in practice (that is, do historical loss rates typically reflect cash flows that the entity does not expect to collect over the life of the financial assets in the pool or some shorter period)?**

As previously stated, we support an approach that allows any entity to use its best estimate when determining the collectibility of expected future cash flows of a financial asset. In doing so, the entity would evaluate past events, current conditions, and forward-looking information that is currently available and objectively verifiable. It may therefore be appropriate for the entity to reflect loss rates that comprise cash flows not expected to be collected over the emergence period rather than the life of the pool's financial assets. In addition, because each asset in a pool has a different emergence period, using the life of the financial asset within a pool as opposed to the emergence period would ignore these differences. Accordingly, we believe that an entity should be permitted to calculate historical loss rates, when they are determinable and supportable, on the basis of a financial asset's emergence period. However, we do not believe the Board should preclude an entity from using a historical loss rate that reflects cash flows that the entity does not expect to collect over the life of the financial assets in the pool if the entity can support that loss rate on the basis of past events, current conditions, and forward-looking information that is currently available and objectively verifiable.

**Question 48: The proposed guidance would require interest income to be calculated for financial assets measured at fair value with qualifying changes in fair value recognized in other comprehensive income by applying the effective interest rate to the amortized cost balance net of any allowance for credit losses. Do you believe that the recognition of interest income should be affected by the recognition or reversal of credit impairments? If not, why?**

We do not support the proposal to use a *credit-loss-adjusted* amortized cost balance to calculate interest income. Our preference is that entities calculate interest income by applying the EIR (that is not adjusted for future credit losses) to the amortized cost balance of the financial asset before deducting any allowance for credit losses because this will result in transparency of actual credit losses in the income statement.

For many entities, using a credit-loss-adjusted amortized balance to calculate interest income is likely to be overly burdensome and may not be operational. The challenge for many entities in applying any requirement that uses a credit-loss-adjusted amortized cost balance would be to integrate credit-risk data with, or link it to, their accounting systems. Traditionally, the credit department, and not the accounting department, performs credit-risk assessment for impairment measurement. We note that the separation of information in the accounting systems and the risk systems has been referred to as "decoupling." Credit-risk professionals focus on the cash flows that they expect the borrower will not pay, and currently these expectations drive the impairment measurement; accordingly, recognition of interest income by using a credit-adjusted amortized cost balance would be particularly challenging and complex. Current accounting systems are not equipped to calculate interest income for loans using a credit-loss-adjusted amortized cost balance. This, and the fact that financial institutions may have numerous loans, will require these institutions to modify current or implement new systems to encompass these requirement changes or risk an overly burdensome and complex bookkeeping exercise.

In addition, net interest margin is a key indicator for many financial institutions. Accordingly, an interest income recognition model that is largely affected by an entity's subjective assessments of its credit losses will reduce the significance and comparability of this key indicator.

Also, it is unclear how to apply this requirement to financial assets that were evaluated for credit impairment on a pooled or collective basis. To determine the difference between interest that is contractually due and interest that is accrued, an entity must first calculate interest income for financial assets on the basis of the credit-loss-adjusted amortized cost balance. However, when impairment of financial assets is determined on a pooled basis, it is unclear (1) whether an entity is required to allocate those losses to the individual assets that the pool comprises in order to compute interest income and (2) how an entity would perform this allocation, which could be very burdensome and complex for preparers.

**Question 49: Do you agree that the difference in the amount of interest contractually due that exceeds interest accrued on the basis of an entity's current estimate of cash flows expected to be collected for financial assets should be recognized as an increase to the allowance for credit losses? If not, why?**

As highlighted previously, our preference is that entities calculate interest income by applying the EIR to the amortized cost balance of the financial asset. However, should the Board proceed with an interest income recognition model that uses a credit-loss-adjusted amortized cost balance, we believe that the difference between interest contractually due from that accrued should not be recognized as an increase to the allowance for credit losses (resulting in a subsequent reversal of impairments through net income if the need for an allowance is unchanged). It appears to be more representationally faithful for an entity to recognize cash flows it receives when the cash flows exceed an amount the entity accrues as a reduction in the financial asset's recorded amount.

**Question 51: Do you believe that the implementation guidance and illustrative examples included in this proposed ASU are sufficient to understand the proposed credit impairment and interest income models? If not, what additional guidance or examples are needed?**

We believe that the proposed ASU should state the overall principles up-front and that these principles should lay the foundation for application guidance on the credit impairment and interest income models. The inclusion of additional application guidance that provides the reader with a more detailed understanding of the concepts is beneficial and recommended. Accordingly, we would suggest adding examples illustrating the following concepts/principles:

- Hypothetical pools as discussed in detail in our response to Question 42 (i.e., situations in which an entity does not have portfolios of similar items, specifically, whether an entity should include its financial assets in hypothetical portfolios of similar items that it does not hold to ensure that the assessment of recoverable cash flows takes into account any risks arising at the portfolio level, not at the individual level).
- Interest income recognition on assets evaluated on a pool or collective basis.
- Increases in estimates of expected cash flows for originated and acquired assets that are assessed for impairment both individually and collectively.

- Applicability of both interest income and credit impairment models to debt securities.
- Historical loss rate determination and review.

**APPENDIX C**  
**Deloitte & Touche LLP**  
**Responses to Questions on Hedge Accounting**

**Question 56: Do you believe that modifying the effectiveness threshold from highly effective to reasonably effective is appropriate? Why or why not?**

In principle, we support lowering the hedging threshold from “highly effective” to “reasonably effective.” However, we are concerned that (1) the proposed ASU does not clearly establish a clear principle that one can uniformly apply to determine whether a hedging relationship is “reasonably effective” and (2) the absence of such guiding principle is likely to cause diversity in practice. For example, the proposed ASU does not clearly indicate when a qualitative assessment alone is sufficient to support an assertion that a hedging relationship will be reasonably effective. Without guidelines that explain what type or volume of evidence is sufficient to support a qualitative effectiveness assessment, preparers that seek to reduce the risk of regulatory challenge may default to using today’s parameters for highly effective (80–125 percent) when performing quantitative assessments in the absence of further clarifying guidance from regulators about how they plan to assess whether a hedge is “reasonably effective.” In addition, requiring a qualitative effectiveness assessment at inception and only when circumstances suggest that the hedging relationship is no longer reasonably effective calls into question the primary objective of hedge accounting. It is unclear what type of a qualitative assessment can be performed without any quantitative factors, except for when the terms of the instrument perfectly match.

**Question 57: Should no effectiveness evaluation be required under any circumstances after inception of a hedging relationship if it was determined at inception that the hedging relationship was expected to be reasonably effective over the expected hedge term? Why or why not?**

Determining whether a hedge effectiveness assessment should be performed after inception of the hedging relationship depends in part on the objective of hedge accounting. If the objective is to provide special accounting for certain qualifying items that have offsetting changes in cash flows or fair value, in accordance with ASC 815, then we believe that the assessment of hedge effectiveness should be required at each reporting period.

Under the proposed ASU, an entity will need to measure effectiveness each reporting period to account for the hedge. That is, an entity will need to determine the change in fair value or cash flows of both the hedging instrument and the hedged item to make appropriate hedge accounting adjustments. We believe an entity should consider that information to evaluate whether the hedge is effective. Accordingly, we believe that the requirement to assess hedge effectiveness should not be based solely on a “change in circumstance”; instead, an entity should be required to assess hedge effectiveness after hedge designation, either qualitatively or quantitatively, each reporting period. In addition, the entity should document its basis for concluding why management believes that the hedge continues to be “reasonably” effective in offsetting changes in cash flows or fair value of the risk being hedged.

**Question 58: Do you believe that requiring an effectiveness evaluation after inception only if circumstances suggest that the hedging relationship may no longer be reasonably effective would result in a reduction in the number of times hedging relationships would be discontinued? Why or why not?**

In the Basis for Conclusions of the proposed ASU, one of the reasons cited for elimination of the requirement to quantitatively assess hedge effectiveness was that the Board believes that the “cost of compliance would be reduced because an entity would not have to develop sophisticated quantitative statistical models to prove a hedging relationship is effective in situations in which it is obvious that a hedging relationship is effective.” Although in certain situations it may be obvious that a hedge relationship is reasonably effective (e.g., for hedges that are currently accounted for under the shortcut or matched-terms methods), the proposed ASU does not provide clear guidance on how an entity would determine whether a hedge relationship continues to be reasonably effective after inception of the hedging relationship. As previously stated, we recommend that the Board require an assessment of hedge effectiveness each reporting period.

**Question 61: Do you foresee any significant operational concerns or constraints in calculating ineffectiveness for cash flow hedging relationships? If yes, what constraints do you foresee and how would you alleviate them?**

We do not foresee any significant operational concerns or constraints in the calculation of ineffectiveness for cash flow hedging relationships under the proposed guidance prescribed in paragraphs 122–126 of the proposed ASU.

However, we do not agree with the proposed approach for “under hedges” and the requirement in paragraph 123 that AOCI should be adjusted “to a balance that reflects the amount necessary to offset the present value of the cumulative change in expected future cash flows on the hedged transaction from inception of the hedge less the amount previously reclassified from [AOCI] into net income.” We believe that when the cumulative change in fair value of the hedging instrument is less than the cumulative change in the hedged item, no ineffectiveness should be recognized in earnings related to the “under hedge,” since the effect of recognizing such ineffectiveness in earnings would be to defer in AOCI a nonexistent gain or loss on the hedging instrument and to recognize in earnings a nonexistent loss or gain on the hedged item. For example, if the cumulative change in fair value of a derivative hedging instrument was a loss of \$80 and the cumulative change in the present value of hedged forecasted cash flows was an increase of \$100, deferring a derivative loss of \$100 in AOCI and recognizing a gain of \$20 in net income would not be representationally faithful because the increase in the present value of the hedged forecasted cash flows conceptually does not qualify for accounting recognition, and the loss on the derivative was only \$80. We therefore recommend that the current guidance in ASC 815-30-35-3(b) be retained.

**Question 62: Do you foresee any significant operational concerns or constraints in creating processes that will determine when changes in circumstances suggest that a hedging relationship may no longer be reasonably effective without requiring reassessment of the hedge effectiveness at each reporting period? If yes, what constraints do you foresee and how would you alleviate them?**

We believe that without a guiding principle of what constitutes “reasonably” effective, it will be operationally challenging for entities to develop processes to determine when changes in circumstance suggest that the hedging relationship is no longer reasonably effective. Lack of a clear principle may result in (1) unintended consequences, such as significant derivative gains or losses being deferred in AOCI for cash flow hedges, when such hedges may not have subsequently qualified for hedge accounting; (2) significant amounts being recognized as gains or losses on hedged forecasted transactions in “under hedges” that would not have subsequently qualified for hedge accounting; or (3) entities defaulting to a “highly” effective

threshold (under current GAAP), thus invalidating the benefits the Board believes the proposed ASU provides.

**Question 63: Do you foresee any significant operational concerns or constraints arising from the inability to discontinue fair value hedge accounting or cash flow hedge accounting by simply dedesignating the hedging relationship? If yes, what constraints do you foresee and how would you alleviate them?**

As discussed previously, we do not support the requirement to eliminate the entity's ability to electively dedesignate a hedging relationship. We are unaware of practice issues or abuses arising from elective dedesignation and do not support changing current practice in this area. We are concerned that the elimination of the entity's ability to electively dedesignate a hedging relationship will make it challenging or even impossible for entities to apply hedge accounting to certain common hedging strategies. We believe the staff should consider and address in the final ASU the two examples outlined below, in particular whether such hedging strategies would be permitted under the proposed model:

- A hedging relationship for which an entity documents a defined hedging period at inception. For example, assume that an entity desires to hedge changes associated with a designated item for the first 15 days with a derivative that has a five-year term (i.e., the hedge is designated only for the first 15 days and the hedging instrument has a five-year term). If the entity could demonstrate that the hedging relationship was reasonably effective at hedge inception, would the planned termination of the hedging relationship before the maturity of the hedging derivative constitute an elective dedesignation that would require an offsetting derivative for the hedging relationship to be effectively terminated? Could that same derivative be redesignated as a hedging instrument after expiration of the initial 15-day hedge period?
- It is common practice for an electric generation owner to enter into a forward derivative transaction to effectively "lock in" the sales price on a portion of the power that it expects to generate (e.g., 65 percent of its expected generation). The entity executes this hedging strategy to ensure that the occurrence of the generation level being hedged is always "probable," as required by ASC 815. Stated differently, expected levels of electric generation will vary during the period the hedge is executed and designated until the date the forecasted transaction actually occurs. For the entity to hedge 65 percent of its expected generation, the owner must enter into additional (or offsetting) derivatives to maintain the appropriate hedged level, which may be accounted for as hedge dedesignations. How would the proposed requirements affect the application of cash flow hedge accounting for the initial hedging transaction and the additional (offsetting) derivatives? This question is further complicated by the proposed ASU's prohibition in paragraph 120 of redesignation of hedging derivatives that have been effectively terminated. Does paragraph 121 of the proposed ASU permit such hedging relationship?

**Question 64: Do you foresee any significant operational concerns or constraints arising from the required concurrent documentation of the effective termination of a hedging derivative attributable to the entity's entering into an offsetting derivative instrument? If yes, what constraints do you foresee and how would you alleviate them?**

Paragraph 120 of the proposed ASU states that an "offsetting derivative instrument shall be expected to fully offset future changes in the fair value or cash flows of the original derivative

instrument.” However, it is not clear how to apply this guidance. Does it imply that an entity may need to enter into an “off-market” derivative to “fully” offset the changes in fair value or cash flows? Would the entity include or exclude the time value of money component, or is time value considered in the assessment of whether the derivative “fully” offsets the fair value or cash flows of the original derivative? Would the credit risk on the new derivative need to be the same as the original hedging derivative (i.e., it would have to be entered into with the same counterparty)?

Further, entities may incur significant additional cost because the proposed ASU would require entities to enter into a new derivative to offset an existing hedging derivative.

**APPENDIX D**  
**Deloitte & Touche LLP**  
**Responses to Questions on Other Issues**

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

We generally agree with the proposed ASU's scope. However, we note that since it applies to all financial instruments except those specifically exempted, there will be an increased focus on whether a contract meets the definition of a financial instrument (e.g., profit sharing arrangements and maintenance deposits). We encourage the Board to consider whether to provide additional implementation guidance on the application of the definition of a financial instrument. Further, we recommend that the Board clarify the application of the following proposed scope exemptions:

*Financial Guarantees*

- Paragraphs 4(o)(6) and 4(o)(7) of the proposed ASU provide scope exemptions for financial guarantees provided to third parties of debt issued by another entity within a consolidated group. We are concerned that there may be an unintended consequence of these scope exemptions such that a subsidiary or parent could or would exclude the effect of such financial guarantees from the fair value measurement of the related debt in the consolidated financial statements. Ignoring the guarantee may misrepresent the fair value of the debt from the perspective of the consolidated group because its terms reflect not only the credit quality of the subsidiary or parent issuing the debt but also the impact of the financial guarantee. We recommend that the Board clarify this issue.
- As indicated in paragraph 20 of Interpretation 45,<sup>7</sup> financial guarantees issued or modified before December 31, 2002, were exempted from the application of the initial recognition/measurement provisions of the Interpretation. However, it appears that the grandfathered financial guarantees now fall within the scope of the proposed ASU (i.e., require fair value accounting) unless they qualify for an exception under paragraph 4(o). We recommend that the Board clarify whether these financial guarantees are now within the scope of the proposed ASU or whether the grandfathering provision remains in effect.

*Contingent Consideration Arrangements*

- For contingent consideration arrangements that include multiple triggers (i.e., based on both on an observable market or observable index and unobservable inputs), it is unclear whether such arrangements are excluded from the scope of the proposed ASU under paragraph 4(m). For such arrangements, is the evaluation based on the predominant trigger (which may be observable or unobservable)? In addition, the Board should clarify what would be deemed an observable index. For example, would sales, revenue, EBITDA, or net income of the issuer be considered an observable index?

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<sup>7</sup> FASB Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*.

*Derivatives*

- Unless otherwise exempted, freestanding financial instruments that do not meet the definition of a derivative in ASC 815 are included in the scope of the proposed ASU because they do not have one or more of the required characteristics of a derivative. Therefore, certain financial instruments not currently accounted for as derivatives (e.g., a physically settled option to purchase or sell a security not traded on an exchange or a loan) will now be measured at fair value with changes in fair value recognized in net income. This represents a significant change in practice for such contracts (e.g., certain options or forwards on private equity shares). We recommend that the Board explain its reasoning for this change in the Basis for Conclusions.

**Question 2: The proposed guidance would require loan commitments, other than loan commitments related to a revolving line of credit issued under a credit card arrangement, to be measured at fair value. Do you agree that loan commitments related to a revolving line of credit issued under a credit card arrangement should be excluded from the scope of this proposed Update? If not, why?**

We believe that the accounting for written loan commitments should be consistent with that of the underlying originated loans. Therefore, if a written loan commitment will result in a debt instrument that is measured at amortized cost, the loan commitment should not be measured at fair value. However, should the FASB proceed with requiring all written loan commitments to be measured at fair value, we support the Board's decision to exclude loan commitments related to a revolving line of credit issued under a credit card arrangement from the scope of the proposed ASU to reduce the operational and implementation challenges that occur when these types of loan commitments are accounted for at fair value (particularly given the generally small balances of associated credit card receivables, the revolving nature, and the high volume of these lines of credit). Further, we note that there may be similar operational challenges with other loan commitments that are not specific to revolving lines of credit under credit card arrangements (e.g., revolving unsecured personal loan arrangements that are not technically credit cards). Accordingly, we recommend that the Board consider whether other loan commitments that have similar features should also be exempted from fair value accounting.

**Question 3: The proposed guidance would require deposit-type and investment contracts of insurance and other entities to be measured at fair value. Do you agree that deposit-type and investment contracts should be included in the scope? If not, why?**

We understand the conceptual argument for treating such contracts as financial instruments when they do not contain a direct insurance element or involve an insurable interest. We encourage the Board to clearly delineate between financial instruments that would fall within the scope of the Board's insurance project and those that would fall within the scope of the proposed ASU.

**Question 4: The proposed guidance would require an entity to not only determine if they have significant influence over the investee as described currently in Topic 323 on accounting for equity method investments and joint ventures but also to determine if the operations of the investee are related to the entity's consolidated business to qualify for the equity method of accounting. Do you agree with this proposed change to the criteria for equity method of accounting? If not, why?**

We do not believe that the Board should revise the criteria for equity method accounting as part of this project. Introducing a “similar operations” criterion is likely to lead to challenging interpretive and operational issues in practice, in particular for large diversified entities. We note that the proposal to incorporate a similarity criterion in the evaluation of whether the equity method should be applied runs counter to the Board’s conclusion in Statement 94<sup>8</sup> to eliminate the previously existing “dissimilar” operations criterion in the consolidation of subsidiaries. Instead, we encourage the FASB to work jointly with the IASB to more broadly reexamine the scope and application of equity method accounting. We believe that until such a review takes place, an entity should continue to be permitted to apply the fair value option to equity method investments as long as the related eligibility criteria are met.

However, if the FASB moves forward with the requirements as proposed, we note the following:

- An entity may have a 3–5 percent interest in certain limited partnerships, which under current GAAP (see ASC 323-30-S99-1, formerly Topic D-46<sup>9</sup>) may be accounted for under the equity method. The current requirements deemphasize the concept of significant influence for such investments. It is unclear whether the guidance in the proposed ASU affects the accounting for interests in such limited partnerships (e.g., whether it would preclude the use of the equity method going forward). We recommend that the Board clarify whether and how the proposed ASU applies to such investments.
- Consider a conglomerate group with separate insurance and real estate subsidiaries. If the insurance subsidiary has a real estate investee, would the operations of the investee be considered related to the investor’s consolidated operations? One view is that different conclusions could be reached at the level of the insurance subsidiary and at the conglomerate level. We recommend that in such circumstances the Board clarify the application of the criterion in paragraph 130 of the proposed ASU when determining whether the operations of the investee are related to the investor’s consolidated operations.
- ASC 323-740-05-2 (formerly Issue 94-1<sup>10</sup>) specifies that investors in entities operating qualified affordable housing projects receive tax benefits in the form of tax deductions from operating losses and tax credits. Corporate investors generally purchase an interest in a limited partnership that operates the qualified affordable housing projects. It is unclear whether the guidance in the proposed ASU affects the accounting for interests in these limited partnerships. We recommend that the Board clarify whether and how the proposed ASU applies to such investments.

## Disclosures

### **Question 65: Do you agree with the proposed disclosure requirements? If not, which disclosure requirement do you believe should not be required and why?**

As previously stated, our proposed approach is a mixed measurement model whereby a financial asset would be measured at amortized cost if certain criteria are met. We believe that amortized cost is the most meaningful measurement attribute for certain financial instruments in certain circumstances but should still be accompanied by fair value disclosures. Focusing on whether financial instruments have certain cash flow characteristics and how the entity

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<sup>8</sup> FASB Statement No. 94, *Consolidation of All Majority-Owned Subsidiaries*.

<sup>9</sup> EITF Topic No. D-46, “Accounting for Limited Partnership Investments.”

<sup>10</sup> EITF Topic No. 94-1, “Accounting for Tax Benefits Resulting From Investments in Affordable Housing Projects.”

manages those instruments is a meaningful approach to determining whether an instrument can be measured at amortized cost.

When financial instruments are measured at an amount other than fair value, the disclosure of fair value is an important one that complements the measurement in the statement of financial position. We propose that existing disclosure requirements about the fair values of financial instruments be enhanced to include information not only about the fair values on the reporting date by class of financial instruments but also about changes in fair values during the period for each class, thereby permitting financial statement users to understand how the financial statements would have looked had all financial instruments been accounted for at fair value.

### **Effective Date and Transition**

**Question 68: Do you agree with the transition provision in this proposed Update? If not, why?**

Yes, we support the transition provisions of the proposed ASU.

**Question 69: Do you agree with the proposed delayed effective date for certain aspects of the proposed guidance for nonpublic entities with less than \$1 billion in total consolidated assets? If not, why?**

Yes, we support the proposed delayed effective date for certain aspects of the proposed guidance for nonpublic entities with less than \$1 billion in total consolidated assets. However, it is unclear whether a nonpublic entity that is subject to the extended four-year deferral is permitted to adopt the provisions of the proposed guidance (1) at the same time as public and certain nonpublic entities with assets in excess of \$1 billion and (2) on any subsequent date during the four-year deferral period, even if the nonpublic entity has assets of less than \$1 billion. The Board should clarify whether such an entity is permitted to adopt the proposed ASU at the beginning or during the deferral period.

In addition, the deferral requirements require that a nonpublic entity measure loans at amortized cost during the deferral period. The definition of loans in the Codification's master glossary encompasses debt securities. We question whether it was the Board's intent to require amortized cost accounting during the deferral period for investments in debt securities that are currently accounted for as available-for-sale securities at fair value with changes in fair value recognized in OCI under ASC 320-10.

**Question 70: How much time do you believe is needed to implement the proposed guidance?**

We encourage the Board to seek input from preparers regarding this question. We note that the FASB may identify an effective date that is earlier than the potential effective date of any decision by the SEC to move public companies in the U.S. to IFRSs. We are concerned that if convergence is not achieved in this project, U.S. GAAP registrants would be required to implement (1) the significant changes proposed in this ASU when it becomes effective and then (2) the accounting requirements of IFRS 9 if and when SEC registrants are required to adopt IFRSs. Thus, this is another reason convergence in this area is vital.

**Question 71: Do you believe the proposed transition provision is operational? If not, why?**

We believe that the proposed transition provision is operational; however, we encourage the Board to seek input from preparers regarding this question.

**APPENDIX E**  
**Deloitte & Touche LLP**  
**Other Comments**

**Definition of All-in-Cost-to-Service Rate**

- For entities to understand and consistently apply the remeasurement requirements for core deposit liabilities, it is essential that the staff provide a description of what types of costs and fees are included in (1) “the expense of maintaining a branch network” and (2) “fee income earned on the deposit accounts” in the definition of the all-in-cost-to-service rate. For example, it is unclear whether back-office costs and costs of providing Internet banking capabilities would qualify. It is also unclear whether all costs of maintaining a branch network should be reflected when branches provide additional services (e.g., originating loans). Also, should fee income reflect historical, current, or future expected fee income?

**Definition of Effective Interest Rate**

- This definition does not contemplate that the EIR may be recalculated after initial recognition for reasons other than variations in the contractual interest rate. Therefore, this definition contradicts other guidance (e.g., paragraph 79 of the proposed ASU) that indicates that the effective interest would be recalculated after initial recognition for reasons other than variations in the contractual interest rate in certain circumstances (e.g., certain changes in prepayments and certain changes in cash flows expected to be collected when no allowance for credit losses had been established since acquisition). The definition of EIR should be clarified to note that, in certain circumstances, the EIR would be recalculated after initial recognition for reasons other than variations in the contractual interest rate.

**Definition of Amortized Cost**

- Amortized cost should reflect adjustments related to the effects of hedge accounting. Accordingly, we recommend the following wording addition as the fifth bullet under the amortized cost definition: “Increased or decreased by the adjustments for the effects of hedge accounting.”

**Implementation Guidance**

- The proposed ASU should incorporate examples of hedge accounting.

**Paragraph BC34**

- This paragraph notes that IAS 39 provides guidance on the recognition of changes in fair value between trade date and settlement date when an entity applies settlement date accounting. However, there is no reference to the existing U.S. GAAP guidance addressing this issue, that is, the guidance formerly in Issue 96-11,<sup>11</sup> codified in, for example, ASC 815-10-25-17 and 815-10-35-5. The Board should clarify whether the proposed ASU would nullify this guidance.

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<sup>11</sup> EITF Issue No. 96-11, “Accounting for Forward Contracts and Purchased Options to Acquire Securities Covered by FASB Statement No. 115.”

### **Money Market Funds**

- The proposed ASU would require money markets funds that may have measured financial instruments at amortized cost under Rule 2a-7 of the Investment Company Act of 1940 to instead measure them at fair value if certain conditions are met. We recommend that before finalizing guidance, the Board reach out to preparers, in addition to users, to understand the practical issues associated with the proposal.

### **Equity Investments**

- We support FV-NI for equity investments (except those accounted for under the equity method of accounting). We do not support the elective FV-OCI category in IFRS 9 for equity investments, particularly because we do not believe it is meaningful to recognize fair value gains and losses on equity investments in OCI without subsequent recognition in net income. Although our preference is for equity investments to be measured at FV-NI, should the FASB in conjunction with the IASB pursue an alternative to FV-NI for investments in equity instruments that are not held for trading, as is already prescribed in IFRS 9, our preference would be to retain the current available-for-sale category for such investments under which dividends and realized gains and losses would be recognized in net income and not permanently deferred in equity.