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

Via E-mail to director@fasb.org

File Reference: 2011-150

Dear Technical Director:

We are pleased to comment on the Financial Accounting Standards Board's ("FASB") Supplementary Document - *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities – Impairment* ("Supplementary Document"). While we support the Board's objective to improve accounting for the allowance for credit losses, we do not support the proposal.

Although we commend the Board for seeking preliminary views with the issuance of the Supplementary Document, we believe it is difficult to respond fully without understanding the comprehensive impairment model FASB contemplates. We believe there are many unanswered questions in the proposal, including the proposed accounting for transfers between the "good" and "bad" books, the impairment model for "bad" assets as well as purchased assets.

While we understand the Board believes the Supplementary Document serves "as a step preceding the development of an Exposure Draft of a proposed Accounting Standards Update," it is uncertain whether the Board will issue a revised exposure draft on impairment. We acknowledge the original exposure draft, *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities*, included the complete impairment model. However, we believe the Board has substantially deviated from that original exposure draft. For these reasons, we recommend the Board expose for comment the complete impairment model for all loans and debt securities, either as a stand-alone proposal or as part of the broader financial instruments project.

We also understand the Board has an objective of issuing a final standard, jointly with the International Accounting Standards Board (IASB), for financial instruments this year. While we appreciate the Board's objective and the 60-day comment period, the exposure draft was outstanding during a period when many of the Board's constituents are focused on calendar year end financial reporting deadlines, particularly for those in or serving the financial institution industry, which is the industry most impacted by this proposal. Because of the timing, we are concerned that constituents may not be able to adequately address the specific issues for which the Board seeks input and assess whether the proposal is operational. If the Board is going to issue a proposal during the busiest quarter of the year for many constituents, we recommend extending the comment letter deadline for at least an additional 30 days. The timing of the issuance of the Supplementary Document and the comment letter deadline is another reason to expose the complete impairment model for comment.

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We are supportive of convergence and commend the Board's efforts to that end. However, as drafted, we do not believe the two Boards have achieved convergence. Rather, the proposal appears to represent two different models which, in all likelihood, yield very different results. Using two models, one of which includes a "floor," does not appear to result in convergence and adds unnecessary complexity to the process of determining the allowance for credit losses. Instead, we believe there should be one model which would better achieve the objective of improving financial reporting.

Our responses to certain questions in the Supplementary Document follow.

Question 1

Do you believe the proposed approach for recognition of impairment described in this supplementary document deals with this weakness (i.e. delayed recognition of expected credit losses)? If not, how do you believe the proposed model should be revised and why?

While the proposal may deal with a perceived weakness in practice, we have not observed that entities feel constrained to recognize losses due to the existence of the incurred loss trigger. We concur with removing the probable threshold, as the Board proposed in the initial exposure draft, because it adds unnecessary complexity to the model, particularly for loans which are evaluated in pools. For purposes of determining a trigger for impairment, we believe the triggering events in paragraph 43 of the original exposure draft are sufficient in identifying when the asset is impaired.

The proposed model(s) in the Supplementary Document is (are) moving from the incurred loss model towards an expected loss model. We have several concerns with this change.

First, we do not believe the primary measure for financial assets, managed through a lending or customer financing activity which are held for collection (typically loans), should be fair value, consistent with the Board's tentative conclusions on classification and measurement reached in re-deliberations. As such, we do not believe the associated allowance should be based on fair value concepts such as losses for the foreseeable future. In addition, we believe it will be difficult for entities to predict, and for their auditors to audit, "expected losses in the foreseeable future" with a reasonable level of precision or consistency from entity to entity.

Secondly, such a model would be counter to the long-standing view that the act of lending is not in and of itself a credit loss event (unless there is faulty underwriting). Further, such a model suggests that "cookie-jar reserving" is acceptable, which also would be counter to existing U.S. generally accepted accounting principles ("GAAP"). Rather, we believe that applying adjusted historical annualized loss rates to pools of loans appropriately captures losses. However, we believe the existing model in U.S. GAAP today should be improved.

Rather than use a foreseeable future concept, we recommend using a loss emergence period concept. The loss emergence period, also referred to as a loss confirmation period, represents the time horizon from incurrence of a credit loss (i.e., deterioration in the borrower's financial condition) to the confirmation of that loss (i.e., identification of the individual loan as impaired). One of the most challenging and controversial points in current practice is determining how much "coverage" should be provided for pools, after determining the annualized loss rate. In other words, at issue is the amount by which the annualized loss rate should be multiplied, or for short term loans, divided. These techniques are attempts to identify losses which have been incurred, but have not yet surfaced for more precise measurement, similar to the measurement of incurred but not reported losses in the insurance industry. We believe that addressing this component of the methodology would be helpful in practice as the question of coverage is simply not addressed. Without providing additional guidance in this area and using an annualized loss rate, the default answer is one year, which may have resulted in the perceived constraint of not being able to

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recognize losses or not recognizing losses soon enough. As such, we recommend the Board address this issue and consider introducing a loss emergence period concept to the model.

Lastly, we believe that considering current trends and conditions and evaluating their impact on foreseeable collections is appropriate and that such guidance would be consistent with a market participant view of expected cash flows without forecasting economic cycles. As such, we recommend including the guidance from the December 13, 2006, *Interagency Policy Statement on the Allowance for Loan and Lease Losses*, issued by federal financial institution regulatory agencies,¹ which states (underlining added):

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

In summary, we recommend the Board retain the incurred loss model but remove the probable threshold and retain the impairment triggers as proposed in paragraph 43 of the original exposure draft. Further, we recommend the Board address the concept of a loss emergence period as well as clarify existing U.S. GAAP to indicate that changes in trends, conditions, and other relevant factors affecting repayment should be considered. These improvements may address the issue of timely recognition.

Question 2

Is the impairment model proposed in the supplementary document at least as operational for closed portfolios and other instruments as it is for open portfolios? Why or why not?

Although the supplementary document seeks views on whether the proposed approach is suitable for open portfolios, the boards welcome any comments on its suitability for single assets and closed portfolios and also comments on how important it is to have a single impairment approach for all relevant financial assets.

Although we are not addressing the appropriateness of the proposed model to closed pools, we offer our perspective on the suitability of a single impairment model for all financial assets. The Supplementary Document, under FASB's model, appears to also apply to debt securities. Paragraph BC11 states that:

For the FASB, the proposals in the supplementary document would apply to loans and debt instruments that would not be measured at fair value with changes in value recognized in net income and that are managed on an open portfolio basis.

We do not believe that debt securities should be included in pool evaluations. There are unique characteristics that are different between loans and debt securities, particularly in the resolution of the asset upon impairment. For debt securities, the disposition typically occurs over a much longer time horizon than for loans, particularly for non-single issuer debt.

As the Board recently concluded as part of classification and measurement, the relationship differs between "financial assets for which an entity's business activity is investing with a focus on managing risk exposures and maximizing total return" and "financial assets managed through a lending or customer financing activity." When a debt security reaches the point where collection of contractual cash flows is

¹ The federal financial institution regulatory agencies include the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the National Credit Union Administration, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision.

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uncertain, we believe impairment should be considered on an individual basis. We further note that in paragraph BC24:

“The FASB decided that there are insufficient reasons for prohibiting the evaluation of debt securities in a pool if they have similar risk characteristics. However, the FASB believed that debt securities will more often have unique risk characteristics that will result in their being evaluated individually.”

The distinction the Board has tentatively made with respect to classification and measurement recognizes the conceptual difference between debt securities and loans held for collection. We acknowledge the Board’s belief that more often debt securities will be evaluated individually. However, we believe the distinction made for classification and measurement is a sufficient reason for requiring individual evaluation. As such, we suggest the Board limit pool evaluation to those loans which are managed through a lending or customer financing activity.

Question 3

Do you agree that for financial assets in the ‘good book’ it is appropriate to recognize the impairment allowance using the proposed approach described above? Why or why not?

Please see our response to Question 1.

Question 8

Do you agree with the proposed requirement to differentiate between the two groups (i.e. ‘good book’ and ‘bad book’) for the purpose of determining the impairment allowance? If not, what requirement would you propose and why?

We do not agree with distinguishing between the “good book” and the “bad book.” Conceptually, we are concerned with the suggestion that “good” loans need an allowance for credit losses. This seems to suggest that “cookie jar reserving” is an acceptable practice – which runs counter to long-standing U.S. GAAP. Rather, we believe the differentiation should be based on assets evaluated individually and assets evaluated in pools, which is consistent with existing practice.

Further, we believe that determining whether an asset is “good” or “bad,” based on the triggers as proposed in the Supplementary Document, adds an unnecessary step. Rather, we believe the triggers can serve to identify when an asset should be individually evaluated. We believe that some of the proposed triggers, as described in paragraph B3, would be too late to appropriately identify an asset as having credit deterioration. We recommend the Board reconsider those triggers.

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Please contact James A. Dolinar or Sydney K. Garmong should you have any questions.

Very truly yours,



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