September 10, 2009

Mr. Russell G. Golden  
Technicial Director  
Financial Accounting Standards Board  
401 Merritt 7  
Post Office Box 5116  
Norwalk, Connecticut 06856-5116

RE: File Reference No. 1700-100

Dear Mr. Golden:

We are pleased to submit comments on behalf of the staffs of the five federal financial institution regulatory agencies on the proposed Statement of Financial Accounting Standards, Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses. We appreciate the Financial Accounting Standards Board's (FASB) efforts to address the transparency of disclosures about the allowance for credit losses and the quality of loans. We support the concept of providing enhanced disclosures of qualitative and quantitative information about allowances and loan quality that will improve the decision-making abilities of investors as well as other users of financial statements. However, we question the relationship between some of the disclosures called for in the proposed Statement and other projects that the FASB is currently undertaking, including accounting for financial instruments and the disclosure framework.

In developing the information contained in this exposure draft, we understand that the FASB considered existing regulatory and supervisory reporting requirements as well as the information companies provide in other public disclosures. The banking agencies oppose the proposed disclosure of credit quality information by regulated institutions that would be linked to the agencies' regulatory ratings because an institution's ratings of loans may result directly from examination findings and would, in effect, reveal confidential examination-related information. The disclosure of this information also raises the possibility that financial statement users could use these disclosures to derive what would essentially be confidential supervisory information about the condition of an institution, particularly for smaller institutions whose assets are primarily loans. The agencies also have concerns that some of the other quantitative information requested in this exposure draft does not provide a complete picture of the credit risk inherent in the loan portfolio and as a result may not meet the FASB's objective of improving the transparency of financial reporting.

Given these concerns and the broad range of institutions to which the proposed standard would apply, we recommend that further analysis of some of the proposed disclosures be conducted before implementing this guidance to ensure the disclosures in any final standard are both operational from the standpoint of financial statement preparers and decision-useful from the perspective of financial statement users. The agencies suggest that a sample of public and nonpublic financial services
entities be asked to test the operationality of the proposal by preparing the disclosures requested in this exposure draft. Upon review of the results, the FASB would be better positioned to evaluate the costs that would arise from imposing the proposed disclosure requirements on all institutions, to evaluate whether the proposed disclosures would enable users of financial statements to better understand the allowance for credit losses as well as the quality of the loan portfolios held by various institutions, to provide a reliable basis for the FASB’s cost/benefit determination, and to provide reasonable justification for the FASB’s determination of an appropriate effective date for any final standard.

The comments outlined above are discussed in more detail in the sections below. Additional comments have also been provided for your consideration.

**Scope and Effective Date**

Financial institutions supervised by the agencies either currently capture and report in regulatory reports or could readily provide a portion of the quantitative information requested in the exposure draft. This information includes the amount of loans in nonaccrual status by loan type, the amount of loans 30 days or more past due and still accruing interest by loan type, and loan charge-offs and recoveries by loan type, as well as a roll-forward of changes in the overall allowance for credit losses. Institutions should also have the capability of currently providing a portion of the qualitative information that is requested in the exposure draft. This information includes the credit loss allowance methodology and policies for segmenting the loan portfolio for allowance estimation purposes, charging off loans deemed uncollectible, determining the past due status of loans, determining which loans should be individually evaluated for impairment, placing loans in nonaccrual status, recording payments received on nonaccrual loans, and restoring nonaccrual loans to accrual status. Thus, the agencies believe it would be feasible for some of the proposed disclosures, such as those described above, to be included in the required financial statement disclosures in reporting periods ending after December 15, 2009, for all entities.

However, the remaining disclosures contained in the exposure draft, such as credit quality information and the roll-forwards of loan activity by portfolio segment for individually and collectively evaluated impaired loan balances, should be reconsidered and, when or if implemented, should not take effect before reporting periods ending after December 15, 2010. The FASB should use this additional time to gain an understanding of the operationality of the remaining disclosures, including the implications for institutions’ systems, and evaluate how any additional disclosures would fit within the financial instruments accounting project and the overarching disclosure framework. In the interim, institutions should be encouraged to consider adding other information to their financial statement disclosures concerning their allowance for credit losses and loan quality that management uses if that information would be relevant to financial statement users.

Additionally, Statement of Financial Accounting Standards No. 126, *Exemption from Certain Required Disclosures about Financial Instruments for Certain Nonpublic Entities* (FAS 126), currently exempts certain nonpublic entities with less than $100 million in assets from disclosing the fair value of loans in interim and annual reporting periods. Other entities currently disclose the fair value of loans held-for-investment in the aggregate, but not by portfolio segment, pursuant to Statement of Financial Standard No. 107, *Disclosures about Fair Value of Financial Instruments*. Although loans held-for-investment represent the most significant asset category for most institutions supervised by the agencies, and particularly for those that are smaller, these institutions normally do not manage their loans held-for-investment on a fair value basis. Therefore, the agencies believe that

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1 This guidance is also found in Section 825-10-50 of the FASB Accounting Standards Codification™.
the fair value of loans held-for-investment by portfolio segment may not be a meaningful or relevant disclosure for financial institutions that are providing other more relevant credit quality information for these loans. We recommend that the proposed fair value disclosures not be required of nonpublic entities, especially those to which FAS 126 applies.

Quality of Financing Receivables

Paragraph 13(b) of the exposure draft requires that quantitative and qualitative information be presented by class of financing receivable for loans carried at amortized cost that are neither past due nor impaired. Disclosing credit quality indicators only for this population of loans will not provide an understanding of the credit quality of the loan portfolio because users would be unable to assess how the indicators for loans that are neither past due nor impaired compare to the same indicators for loans that are past due or impaired. The agencies recommend that this aspect of the requirements of paragraph 13(b) be reconsidered.

As noted, the banking agencies oppose the disclosure of credit quality information that would be linked to federal regulatory ratings. As currently proposed in this exposure draft, regulated institutions would be required to link internal credit risk ratings to the regulatory ratings defined in the Uniform Agreement on the Classification of Assets and Appraisal of Securities Held by Banks and Thrifts issued by the federal banking agencies. An institution’s ratings of loans may result directly from examination findings and the proposed disclosure would, in effect, reveal confidential examination-related information. It is also possible that financial statement users could use these disclosures to derive what would essentially be confidential supervisory information about the condition of an institution, particularly for smaller institutions whose assets are primarily loans. In addition, the banking agencies are phasing in a new regulatory framework for certain institutions (i.e., Basel II) which requires certain credit-related disclosures and may impact regulatory classifications. The banking agencies urge the FASB to eliminate credit risk disclosures linked to regulatory information and consider incorporating in its place disclosures of fact-based information about loans. For example, disclosures for commercial loan portfolios could include loan-to-value information by geographic area and type of loan as well as other measures considered and reviewed by management in analyzing credit quality and credit risk in loan portfolios.

The agencies also have concerns that some of the other quantitative information requested in this exposure draft does not provide a complete picture of the credit risk inherent in the loan portfolio and as a result may not meet the FASB’s objective of improving the transparency of financial reporting. For example, the requirement in paragraph 13(b) to disclose consumer credit scores for retail portfolios in isolation could be misleading since other important credit quality information necessary to properly assess the risks of these loans, such as loan-to-value and consumer debt-to-income ratios, would not be provided. In comparing retail portfolios by consumer credit scores, their risk characteristics could be significantly different depending on these other elements and therefore could be misinterpreted.

As a result of these concerns, we reiterate the suggestion for testing the operationality of the proposed disclosures to ensure that appropriate information can be provided by institutions, does not indirectly reveal confidential supervisory information, and will be useful and meaningful to financial statement users.

Additional Considerations

The proposed standard relates to credit quality associated with on-balance sheet exposures but is silent about off-balance sheet exposures (for example, unfunded commitments). Financial institutions
commonly estimate credit losses for off-balance sheet credit exposures such as unfunded commitments on impaired loans when they are estimating credit losses for on-balance sheet exposures. Financial statement users benefit from obtaining information related to unfunded commitments because it would enable them to better understand how future lending activities may impact the overall quality of the receivable portfolio and the allowance for credit losses; therefore, we recommend that the FASB consider disclosure requirements for allowances for credit losses on off-balance sheet credit exposures, which are recorded as a liability on the balance sheet.

Paragraph 4 of the exposure draft provides an amended definition for the “carrying amount” of a loan. As explained in this paragraph and also in paragraph B8, the FASB intends to exclude the allowance for credit losses from the determination of the “carrying amount.” However, the definition of this term in paragraph 4 is essentially the same as the existing definition of the term “recorded investment in the receivable.” Rather than redefine the term “carrying amount” for purposes of this exposure draft, the agencies recommend that the FASB replace “carrying amount” with the term “recorded investment in the receivable.”

The agencies believe that the definitions of “portfolio segment” and “class of financing receivable” provided in paragraphs 5 and 6 of this proposed standard are unclear despite the additional guidance provided in paragraphs 8 and 9. In this regard, paragraph 5 cites type of financing receivable and industry as two examples of portfolio segments, but paragraph 6 lists these same two examples as factors in determining classes of financing receivables. Furthermore, we would expect that smaller institutions with relatively limited numbers of loans in their held-for-investment portfolios would tend to view their portfolio segments and classes as being the same. The agencies recommend that information be added to these paragraphs to further explain and differentiate between these two terms so that they are more understandable and operational. Additional examples of segments and classes may be useful to help the financial statement preparer understand these concepts.

We also found the description in paragraphs 5(a) and 5(b) of the additional disaggregation that must be applied to portfolio segments for disclosure purposes to be confusing. Paragraph 5(b) indicates that one additional disaggregation of a portfolio segment would cover financing receivables “that are evaluated individually for impairment,” but then gives as an example “those financing receivables with an allowance determined in accordance with FASB Statement No. 114, Accounting by Creditors for Impairment of a Loan” (FAS 114). In applying FAS 114, a creditor may evaluate many loans individually for impairment, but typically only a percentage of these individually evaluated loans would actually be impaired, as that term is defined in FAS 114, and have their allowances measured in accordance with FAS 114. Individually evaluated loans that are not determined to be impaired are included in the assessment of the allowance under Statement of Financial Accounting Standards No. 5, Accounting for Contingencies, “if specific characteristics of the loan indicate that it is probable that there would be an incurred loss in a group of loans with those characteristics.” Thus, to eliminate the confusion between paragraphs 5(a) and 5(b), we recommend that paragraph 5(b) be

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2 This term was defined in Statement of Financial Accounting Standards No. 15, Accounting by Debtors and Creditors for Troubled Debt Restructurings, and its definition is included in the Master Glossary of the FASB Accounting Standards Codification™.

3 Emerging Issues Task Force Topic D-80, Exhibit D-80A, Question and Answer No. 10, which may be found in Paragraph 310-10-35-36 of the FASB Accounting Standards Codification™. More generally, guidance on accounting for impaired loans and allowances for credit losses is found in Section 310-10-35 of the FASB Accounting Standards Codification™.
revised to cover “[f]inancing receivables within a portfolio segment that are evaluated individually for impairment and determined to be impaired.”

The agencies support the disclosure of a roll-forward schedule for the allowance for credit losses by portfolio segment for both interim and annual periods as proposed in paragraph 11(c). For any valuation allowance, it is important to understand the transactions that occur during the period that change the account balance. This information is useful for the agencies when evaluating the appropriateness of the recorded amount of the overall allowance.

Paragraph 11(d) requires that an entity disclose the activity in the financing receivables accounts for each of the portfolio segments used for the allowance for credit losses roll-forward schedules, which may include significant changes related to “portfolio purchases.” The agencies recommend that this term be changed to the broader term “purchases” so that it covers not only portfolio purchases, for example, in business combinations, but also purchases of individual loans or small groups of loans during the period that in the aggregate are significant.

The agencies support the disclosures proposed in paragraph 13(d) of management’s analysis of the aging of past due loans, but not impaired, by class of financing receivable. This information is critical to understanding the concentration of past due accounts within the overall loan portfolio, provides insight into performance trends, and assists in determining the possible future performance of the loan portfolio. As explained above, due to existing regulatory reporting requirements, both public and non-public institutions already collect data on loans that are past due or in nonaccrual status.

It is unclear whether the information being requested in paragraph 13(f) is related solely to troubled debt restructurings or to all loan modifications. The agencies note that the language used in this paragraph is similar but not identical to that used in Statement of Financial Accounting Standards No. 15, Accounting by Debtors and Creditors for Troubled Debt Restructurings (FAS 15). For example, the proposed standard does not mention that the modification must be made in response to the financial difficulties of the borrower, which is included in FAS 15 as a necessary condition for a troubled debt restructuring. To avoid confusion and potentially duplicative but not identical recordkeeping, the agencies recommend that the FASB use definitions that are consistent with the definition of troubled debt restructurings in FAS 15. However, if the FASB intends to collect information on all loan modifications, the agencies recommend that this be clarified in paragraph 13(f).

The proposed standard in paragraph 13(f) also excludes disclosure of loans considered current at the end of the reporting period whose terms were modified during the year if the loans were current when modified. Due to the increasing volume of loan modifications requested by borrowers who are current, but are experiencing financial difficulties, the agencies believe excluding modifications of current loans from the scope of paragraph 13(f) will not accurately represent the modifications executed by institutions and the implications these modifications have on the credit quality of their loan portfolios.

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1 This revised language would then conform to the wording of the proposed disclosure requirement in paragraph 11(c). However, the wording of the final sentence of paragraph 11(d) would also need to be revised in a manner similar to the recommended revision to paragraph 5(b).

2 Guidance on accounting for troubled debt restructurings may be found in Subtopic 310-40 of the FASB Accounting Standards Codification™.
Tabular Disclosures

On page 9, the exposure draft contains language that the tabular disclosures provided in Appendix A are "simplified" and are "not intended to serve as a guide for all disclosures that may be necessary in applying this Statement." Nevertheless, the agencies believe that many institutions will view these examples as the prescribed format for providing disclosures in their financial statements and the specified portfolio segments and classes to be used for allowance estimation and disclosure purposes. The agencies recommend enhancing the language provided in Appendix A to reflect that the tabular disclosures do not mandate the use of the specific segments or classes shown in the examples, but the disclosures should instead reflect management's assessment of the appropriate information necessary to enable financial statement users to understand the credit quality of the institution's loan portfolio and its allowance for credit losses.

On page 11, the "Consumer Credit Exposure" table includes a line item to capture "Loans at LOCOM" as well as a class of loans identified as "Residential – Held for Sale." It is possible that, after reviewing this table, an entity would report residential mortgage loans held for sale, and then report the same loans in the lower of cost or market line item as part of another loan class such as "Residential – Prime" or "Residential – Subprime." In this regard, this table shows dollar amounts being reported in the line item for "Loans at LOCOM" for each class of financing receivable, not just the "Residential – Held for Sale" class. To prevent potentially duplicative reporting and to present the data clearly, the agencies propose that the information in this tabular disclosure explicitly identify loans held-for-investment measured at amortized cost to better distinguish them from loans held-for-sale.

In addition, the tabular disclosure for "Consumer Credit Exposure" on page 11 is intended to illustrate the disclosures required by paragraphs 13(b) and 13(c) of the exposure draft. These proposed disclosure requirements, which relate to an institution's internal risk ratings of loans, exclude loans that are past due or impaired from their scope. The "Consumer Credit Exposure" table presents consumer credits based on assigned risk grades of pass, special mention, and substandard. However, most consumer credits are not graded based on an individual evaluation of the loan, but are instead graded based on their delinquency status,6 which conflicts with the exclusion of past due loans from this proposed disclosure requirement. The loan classifications presented in the table are most often used in the commercial portfolio to individually evaluate and grade these loan exposures. The agencies believe the FASB should revise the "Consumer Credit Exposure" table example and replace the pass, special mention, and substandard grades with a more relevant measure of credit quality for consumer loans that are neither past due nor impaired.

The tabular disclosure on "Impaired Financing Receivables" provided on page 13 of the exposure draft applies to loans individually evaluated for impairment and determined to be impaired under FAS 114. Although this is explained in the body of the exposure draft, this is not clear in the table provided in Appendix A. The agencies recommend that the title of this table be changed to "Individually Impaired Financing Receivables." This table also presents information for loans "with no specific allowance recorded" and "with an allowance recorded." The agencies believe that this language is confusing and suggest that the FASB use terminology in the table such as "with no related allowance" and "with a related allowance" to better align with the wording of paragraph 14(c) of the exposure draft and paragraph 20(a) of FAS 114.

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6 The delinquency status of consumer credits that drives their credit grades is addressed in the Uniform Retail Credit Classification and Account Management Policy, which is available at http://www.ffiec.gov/ffiecinfo/base/resources/retail/occ-bl2000-20_ffiec_uniform_retail_credit_class.pdf.
The agencies appreciate your consideration of our comments. We would be pleased to discuss our views with you further.

Sincerely,

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