Via Email: director@fasb.org.
File Reference No. 2012-260

Thank you for the opportunity to comment on Subtopic 825-15. Credit loss accounting has gained considerable attention in recent years due to economic events that led to losses on a broad range of assets. It is important to account for losses in a manner that allows financial statements to be decision-useful, auditable, and reflective of the financial state of reporting entities.

The Proposed Accounting Standards Update may move U.S. GAAP into better alignment with international standards. Nonetheless, our comments evaluate the proposal through the lenses of the principles of matching, objectivity, and historical cost.

From the perspective of matching, the recognition of future losses to the event of acquisition is arguably not appropriate. Presumably, assets are priced in a manner that considers inherent credit risk and the revenues associated with this pricing are recognized over the life of the asset. Similarly, the events that ultimately result in credit losses typically occur during the life of assets rather than at the time of acquisition.

Projecting losses on financial assets, especially long lived financial assets, can require a significant degree of subjectivity and this subjectivity increases as the time covered by the projection increases. Simply put, given more time, more events can occur that either improve or degrade credit performance and the level of objectivity in predicting losses diminishes and the affects of subjectivity increase. As proposed, the rule would dramatically increase the subjectivity of credit loss accounting and substantially reduce objective measurement of allowances for credit losses.

By including future credit losses, the carrying value of financial assets will no longer follow the historical cost principle. This will distort income across reporting periods and degrade the decision-usefulness of financial statements.

We have answered each of the 24 questions within the proposal. However, we strongly encourage the FASB to reconsider the affects that it would have on the matching, objectivity and historical cost principles before adopting it in its current form.

There will be unintended adverse consequences from adopting the proposal. Many financial institutions of various types in the U.S. including insurance companies, banks, and credit unions have legislatively mandated capital levels that are tied to GAAP based equity. The acceleration of the recognition of credit losses will artificially deplete their capital positions. It will also cause credit to be more expensive and less available. For example, unsecured open end lines of credit may become prohibitively expensive given their comparatively high loss rates and long lives. Issuing entities would be required to recognize substantial credit losses up front even though the losses and the revenue to offset them may not occur for many years. More directly stated, many institutions will need to raise more capital and many
businesses and consumers will not be able to obtain credit due to the abandonment of the matching, objectivity and historical cost principles.

Sincerely,

Brad Miller
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CC:
Credit Union National Association
National Association of Federal Credit Unions
National Credit Union Administration
Orth, Chakler, Murnane & Company, CPAs

Appendix:

Question for All Respondents

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

Answer 1: It is our belief that utilizing consistent methods for the accounting of impaired financial assets is beneficial to users, preparers and auditors. From a user perspective it improves comparability between entities as, for example, the same method would be used whether an asset is acquired via purchase or origination. It is also more user friendly as the number of “rules” to consider is reduced. For these reasons, we support the scope of financial assets covered by the ASU.

Recognition and Measurement

Questions for Users

Question 2: The proposed amendments would remove the initial recognition threshold that currently exists in U.S. GAAP and, instead, view credit losses as an issue of measurement as opposed to an issue of recognition because the credit losses relate to cash flows that are already recognized on the balance sheet. Do you believe that removing the initial recognition threshold that currently exists in U.S. GAAP so that credit losses are recognized earlier provides more decision-useful information?

Answer 2: The change from recognition to measurement would actually diminish substantially the usefulness of information, perhaps to the point that it would render the information unusable. For example, when a financial asset is issued there are several factors that determine the contractual rate. These include a risk free rate, credit risk, liquidity risk, and the presence of embedded options, if any.
The additional rate earned for credit risk is recognized over the life of the instrument. The ASU would force the entire present value of the cost of credit risk to be recognized at time of acquisition. This serves to accelerate the cost associated with credit losses from the recognition of the associated revenue stream.

Because the cost is recognized in a manner that doesn’t match recognition of the associated revenue, the financial statements would not reflect the economic substance of financial instruments. For financial institutions this would cause frequent situations where the financial statements are misrepresentative in order to comply with GAAP.

One of the worst adverse unintended consequences of the proposed change is that federal and state regulators, and users of financial statements, are typically required by legislation to follow GAAP in determining if institutions have sufficient capital (net worth). For example, the Federal Credit Union Act defines it in the following terms; “with respect to any insured credit union, (net worth) means the credit union’s retained earnings balance, as determined under generally accepted accounting principles”. Clearly, any change in GAAP that results in misrepresentation of the economic substance of a financial institution’s balance sheet will have dramatic and adverse implications. To be clear, if the change goes into effect it could cause devastating results for our nation’s financial services sector and could make credit difficult to obtain for either businesses or consumers.

**Question 3:** As a result of the proposed amendments, the net amortized cost on the balance sheet (that is, net of the allowance for expected credit losses) would reflect the present value of future cash flows expected to be collected, discounted at the effective interest rate. Do you agree that the net amortized cost (which reflects the present value of cash flows expected to be collected) results in more decision-useful information than currently exists under U.S. GAAP?

**Answer 3:** The decision-usefulness of the financial statements would be eliminated by this update. Because the interest cash flows associated with credit risk are recognized over the life of the instrument and the credit losses are largely recognized at time of acquisition, any decision-usefulness would be eliminated. This is not likely the goal of the FASB and we would recommend that it be avoided by not adopting the ASU.

**Question 4:** The Board has twice considered credit loss models that would permit an entity not to recognize certain expected credit losses. In the January 2011 Supplementary Document, the Board considered a model that would permit an entity not to recognize some credit losses expected to occur beyond the foreseeable future. In the recent discussions on the three-bucket impairment model, the Board considered a model that would permit an entity only to recognize lifetime credit losses for loss events expected to occur within a 12-month horizon. Instead, the proposed amendments would require that at each reporting date an entity recognize an allowance for all expected credit losses. Do you believe that recognizing all expected credit losses provides more decision-useful information than recognizing only some of the expected credit losses? If not, how would you determine which expected credit losses should not be recognized (for example, 12 months or similar foreseeable future horizon, initial recognition threshold, and so forth)?

**Answer 4:** Following the matching principal, it would make sense to recognize losses where an event has likely occurred that will lead to an eventual loss. This would seem to favor a 12 month horizon which is consistent with current practice for many preparers. Trying to extrapolate losses into the distant future would turn financial statements into subjective projections which is not an appropriate use.
Question 5: The proposed amendments would require that an estimate of expected credit losses be based on relevant information about past events, including historical loss experience with similar assets, current conditions, and reasonable and supportable forecasts that affect the expected collectibility of the financial assets’ remaining contractual cash flows. Do you believe that expected credit losses based on this information provide decision-useful information?

Answer 5: If it were possible to accurately predict credit losses over long time horizons with meaningful accuracy, this would be very useful. As the events during and subsequent to the so called “Great Recession” illustrated, events that have no precedent can and do occur. They can reduce the usefulness of long term projections of things such as credit losses and cause the decision usefulness to be called into question. On the other hand, disclosures about the magnitude and nature of credit risks provide highly decision useful information. These are already required for many types of assets.

Question 6: For purchased credit-impaired financial assets, the proposed amendments would require that the discount embedded in the purchase price that is attributable to expected credit losses at the date of acquisition not be amortized into and recognized as interest income over the life of the asset. To achieve this result, upon acquisition the initial estimate of expected credit losses would be recognized as an adjustment that increases the cost basis of the asset. Apart from this requirement, purchased credit-impaired assets would follow the same approach as non-purchased-credit-impaired assets. That is, the allowance for credit losses would always be based on management’s current estimate of the contractual cash flows that the entity does not expect to collect. Changes in the allowance for expected credit losses (favorable or unfavorable) would be recognized immediately for both purchased credit-impaired assets and non-purchased-credit-impaired assets as bad-debt expense rather than yield. Do you believe that using the same approach to recognize changes in the credit impairment allowance for purchased credit-impaired assets and non-purchased-credit-impaired assets provides decision-useful information? Do you believe that this is an improvement from the current model used for purchased credit-impaired assets?

Answer 6: We believe that this change is an improvement as it simplifies the rules around loss accounting. Nonetheless, the shortcomings of attempting to forecast long term loss experience and the lack of matching losses to the event that triggers their occurrence are still significant issues.

Question 7: As a practical expedient, the proposed amendments would allow an entity not to recognize expected credit losses for financial assets measured at fair value with qualifying changes in fair value recognized in other comprehensive income when both (a) the fair value of the individual financial asset is greater than (or equal to) the amortized cost amount of the financial asset and (b) the expected credit losses on the individual financial asset are insignificant. The proposed amendments would require an entity to disclose the amortized cost basis of assets that apply this practical expedient each period. Do you believe that the practical expedient for some financial assets measured at fair value with qualifying changes in fair value recognized in other comprehensive income is reasonable? Why or why not?

Answer 7: We believe this to be reasonable. The requirement that the losses be “insignificant” brings materiality into play.

Question 8: The proposed amendments would require that an entity place a financial asset on nonaccrual status when it is not probable that the entity will receive substantially all of the principal or substantially all of the interest. In such circumstances, the entity would be required to apply either the
cost-recovery method or the cash-basis method, as described in paragraph 825-15-25-10. Do you believe that this approach provides decision-useful information?

**Answer 8:** We support this approach. While not a current requirement, it reflects current practice for most financial institutions. Because the chances of eventual collection of interest on a loan that has become severely delinquent diminish with time, it more appropriately reflects the recognition of interest income.

**Questions for Preparers and Auditors**

**Question 9:** The proposed amendments would require that an estimate of expected credit losses be based on relevant information about past events, including historical loss experience with similar assets, current conditions, and reasonable and supportable forecasts that affect the expected collectability of the financial assets’ remaining contractual cash flows. Do you foresee any significant operability or auditing concerns or constraints in basing the estimate of expected credit losses on such information?

**Answer 9:** There are considerable operability and auditing concerns and constraints in basing estimates of credit losses on historical loss experience with similar asset classes. Loss experience is typically dependent upon several interacting factors, many of which are simply not possible to predict in a consistently and reasonably accurate manner over long time horizons. Further adding complexity is that each economic, credit and business cycle tends to unfold in a manner that is substantially different than preceding cycles and the factors causing one cycle may not be relevant to future cycles. For example, the last housing cycle was arguably caused by an excessive build up and subsequent correction in the amount and terms of credit used to finance residential housing. Previous housing cycles were more correlated to levels of interest rates. More simply stated, the causes of the last crisis will be different from the causes of the next crisis.

Even if it were possible to retain data on the credit performance of financial assets over a period of a few decades, the conditions and events that led to historical losses will not be the same as those that occur in the future. As with any forecast, the further into the future that they reach, the less accurate they are likely to be. Forecasting credit losses, especially for long lived financial assets, virtually guarantees a lack of supportability and/or reasonableness.

**Question 10:** The Board expects that many entities initially will base their estimates on historical loss data for particular types of assets and then will update that historical data to reflect current conditions and reasonable and supportable forecasts of the future. Do entities currently have access to historical loss data and to data to update that historical information to reflect current conditions and reasonable and supportable forecasts of the future? If so, how would this data be utilized in implementing the proposed amendments? If not, is another form of data currently available that may allow the entity to achieve the objective of the proposed amendments until it has access to historical loss data or to specific data that reflects current conditions and reasonable and supportable forecasts?

**Answer 10:** We have historical loss data by asset type for the past few years. Most financial institutions likely do. However, we cannot assume that other types of reporting entities have this data. As stated in other answers, the factors and interaction of factors that drive credit losses in the future will likely be different than what has driven losses in past cycles. Simply utilizing historical data isn’t enough to provide reasonable and supportable assumptions of future losses, especially for long lived financial assets.
Question 11: The proposed amendments would require that an estimate of expected credit losses always reflect both the possibility that a credit loss results and the possibility that no credit loss results. This proposal would prohibit an entity from estimating expected credit losses based solely on the most likely outcome (that is, the statistical mode). As described in the Implementation Guidance and Illustrations Section of Subtopic 825-15, the Board believes that many commonly used methods already implicitly satisfy this requirement. Do you foresee any significant operability or auditing concerns or constraints in having the estimate of expected credit losses always reflect both the possibility that a credit loss results and the possibility that no credit loss results?

Answer 11: We see no operability or auditing issues with this requirement.

Question 12: The proposed amendments would require that an estimate of expected credit losses reflect the time value of money either explicitly or implicitly. Methods implicitly reflect the time value of money by developing loss statistics on the basis of the ratio of the amortized cost amount written off because of credit loss and the amortized cost basis of the asset and by applying the loss statistic to the amortized cost balance as of the reporting date to estimate the portion of the recorded amortized cost basis that is not expected to be recovered because of credit loss. Such methods may include loss-rate methods, roll-rate methods, probability-of-default methods, and a provision matrix method using loss factors. Do you foresee any significant operability or auditing concerns or constraints with the proposal that an estimate of expected credit losses reflect the time value of money either explicitly or implicitly? If time value of money should not be contemplated, how would such an approach reconcile with the objective of the amortized cost framework?

Answer 12: It is our opinion that the proposed amendments would require most reporters to implement new systems with which to calculate loss allowance and expense. This would prove to be expensive, especially for smaller entities when costs such as training and additional audit fees are factored in. These systems will have a much higher degree of complexity in that they will need to project the timing, magnitude and probability of default over the entire life of each financial asset with credit risk in addition to simply calculating time value. This level of complexity will also cause auditing concerns as it will require additional audit steps and expertise. All of these issues will increase operating expense for reporting entities.

Question 13: For purchased credit-impaired financial assets, the proposed amendments would require that the discount embedded in the purchase price that is attributable to expected credit losses at the date of acquisition not be recognized as interest income. Apart from this proposal, purchased credit-impaired assets would follow the same approach as non-purchased-credit-impaired assets. That is, the allowance for expected credit losses would always be based on management’s current estimate of the contractual cash flows that the entity does not expect to collect. Changes in the allowance for expected credit losses (favorable or unfavorable) would be recognized immediately for both purchased credit-impaired assets and non-purchased-credit-impaired assets as bad-debt expense rather than yield. Do you foresee any significant operability or auditing concerns or constraints in determining the discount embedded in the purchase price that is attributable to credit at the date of acquisition?

Answer 13: This question presents an interesting dilemma. Because of the volatility of credit losses, an asset expected to have credit losses would have a discount for those losses that should exceed the expected credit losses. As a result, the discount attributable to credit risk would actually overstate expected losses at the time of purchase. Because risk free rates are observable and the effects of other
factors effecting valuation such as embedded options are also observable, it should be possible to reasonably estimate credit discounts. The question that the board should answer is how to treat the difference between the credit discount and expected credit losses.

**Question 14:** As a practical expedient, the proposed amendments would allow an entity to not recognize expected credit losses for financial assets measured at fair value with qualifying changes in fair value recognized in other comprehensive income when both (a) the fair value of the individual financial asset is greater than (or equal to) the amortized cost basis of the financial asset and (b) the expected credit losses on the individual financial asset are insignificant. Do you foresee any significant operability or auditing concerns or constraints in determining whether an entity has met the criteria to apply the practical expedient or in applying it?

**Answer 14:** We have no operability or auditing concerns with this expedient.

**Question 15:** The proposed amendments would require that an entity place a financial asset on nonaccrual status when it is not probable that the entity will receive substantially all of the principal or substantially all of the interest. In such circumstances, the entity would be required to apply either the cost-recovery method or the cash-basis method, as described in paragraph 825-15-25-10. Do you believe that this proposal will change current practice? Do you foresee any significant operability or auditing concerns with this proposed amendment?

**Answer 15:** As a financial institution, we are already required to meet this requirement by regulation. For that reason, we do not foresee any operability or auditing concerns.

*Questions for All Respondents*

**Question 16:** Under existing U.S. GAAP, the accounting by a creditor for a modification to an existing debt instrument depends on whether the modification qualifies as a troubled debt restructuring. As described in paragraphs BC45–BC47 of the basis for conclusions, the Board continues to believe that the economic concession granted by a creditor in a troubled debt restructuring reflects the creditor’s effort to maximize its recovery of the original contractual cash flows in a debt instrument. As a result, unlike certain other modifications that do not qualify as troubled debt restructurings, the Board views the modified debt instrument that follows a troubled debt restructuring as a continuation of the original debt instrument. Do you believe that the distinction between troubled debt restructurings and nontroubled debt restructurings continues to be relevant? Why or why not?

**Answer 16:** It remains relevant. In the case of a non troubled restructuring the creditor could have likely found similar terms from another lender. In the case of a troubled debt restructuring the issuer is making the concession to avoid a credit loss and these two types of assets have very different expected future credit performances among other differences such as propensity to refinance.

*Disclosures*

*Questions for Users*

**Question 17:** Do you believe the disclosure proposals in this proposed Update would provide decision-useful information? If not, what disclosures do you believe should (or should not) be required and why?
Answer 17: The credit quality indicators would be decision useful. All else being equal, lower credit quality instruments tend to have more volatility to changes in economic factors than higher credit quality instruments. It provides some level of information that would be helpful in dimensioning overall loss volatility.

Questions for Preparers and Auditors

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

Answer 18: The most significant operability and auditing concern surrounding the disclosure is the expense associated with compliance. Re-evaluating the credit quality of the balance sheet can be a major undertaking for entities that do not already perform such evaluations.

Implementation Guidance and Illustrations

Questions for All Respondents

Question 19: Do you believe that the implementation guidance and illustrative examples included in this proposed Update are sufficient? If not, what additional guidance or examples are needed?

Answer 19: It is unlikely that the implementation guidance is sufficient. Because of the dramatic nature of the change the guidance will need to go into more depth. Specifically more guidance is needed around how to develop reasonable and supportable estimates of the lives of instruments that could extend for decades.

Transition and Effective Date

Questions for All Respondents

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

Answer 20: No, we do not believe this ASU should be adopted as it provides users with a false sense of confidence in the carrying amount of allowance for losses. Similarly, it forces preparers to make estimates about future events, the outcomes of which may be dramatically different than is discernable from historical experience, current conditions and reasonable and supportable estimates.

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

Answer 21: Again, we do not support adoption of the ASU.

Question 22: Do you believe that the effective date should be the same for a public entity as it is for a nonpublic entity? If not, why?

Answer 22: If it is to be adopted we believe that non public entities should have a much later adoption date. Lessons learned during adoption by public entities will benefit non public companies.
Questions for Preparers and Auditors

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

Answer 23: There is simply no way to provide decision useful loss estimates for some financial instruments. This is especially true for those with longer lives as well as for those with more volatile potential future results. We do not support transition or adoption.

Question 24: How much time would be needed to implement the proposed guidance? What type of system and process changes would be necessary to implement the proposed guidance?

Answer 24: Again, it should not be implemented due to its significant shortcomings. Chief among these are the abandonment of the matching, objectivity and historical cost principles and the lack of representational faithfulness that the required estimates would cause in financial statements.