April 18, 2013

Technical Director
File Reference No. 2012-260
FASB
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

Via Email to director@fasb.org

Dear Director:

Thank you for the opportunity to comment on the Proposed Accounting Standards Update on Financial Instruments-Credit Losses (Subtopic 825-15).

System United Corporate Federal Credit Union (SunCorp) is a wholesale credit union, providing payment and investment services to over 200 natural person credit unions. SunCorp does not have the complexities of international or public reporting, but understands the concerns that two different reporting standards represent for those with that reporting challenge. SunCorp only reports to and for the benefit of our member/owners and regulators.

SunCorp not only asks that the FASB reconciles the reporting and accounting from the two standard setting bodies into one acceptable practice, but more importantly, align the reporting for impairment of credit related securities with the reporting for the underlying collateral on which those securities are based, and, remove the requirements related to guessing about future losses based on complex and inaccurate models. Therefore, we recommend that this proposal not be approved and instead a thoughtful and common-sense approach be adopted. We encourage the FASB to 1) establish the same accounting principles for the loan level as at the security level, when the security is collateralized by those loans; 2) re-introduce an allowance type accounting change for Other Than Temporary Impairment (OTTI) on securities collateralized by loans; and 3) drop the requirement to guess about future losses based on factors other than historical performance adjusted for common sense and pertinent factors and not rely exclusively on inaccurate models.

When the FASB adopted the current rule related to OTTI, (which is similar to what FASB is proposing for loan impairment) financial institutions with securities portfolios immediately knew that the consequences would be a dire distortion of financial reality because of the forward predicting models based on single current events. Some of the responses to your exposure draft immediately reflect that concern. Through this current exposure draft, FASB appears to be applying many of these same standards of
guessing to the consumer loan level. The “pro-cyclical” impact of FASB’s required reporting during the global financial downturn was a terrible change, and I regret to say that the FASB’s decision may have contributed to the deterioration, if not actual default, of financial institutions. It is inappropriate to apply these same forward looking guesses to consumer loans as proposed in this Exposure Draft. In fact, while all available information should be allowed in determining a loan allowance, the “incurred loss” model does not need to be totally replaced.

The impact of the existing “future guess” FASB rule on security portfolios was to immediately and permanently record the maximum possible future estimated losses, due to a current shortfall of cash flow based on the worst possible current market values, while adjusting the yields upward to a distorted value. The impact was not only to permanently distort balance sheets downward (at that time there was no concept of a market bottom, the fear being that all mortgage related securities would or could fully default, unless proven otherwise), not recognizing that the market values could significantly return, but distorted the security yield’s upward, recording a higher current yield based on the lower and distorted carrying values. These distortions do not get reconciled nor corrected until many years later, when the security either completely defaults as modeled or predicted, pays off in full as many securities have done, or partially repays principal and defaults on the rest and only after the actual cash is received and the revenue recognized. The current exposure draft does appear to reduce the permanency of the OTTI adjustment on securities by allowing for an allowance type adjustment, but it does not remove the forward guessing and reliance on expensive, complex models that are never right.

Practitioners know that it is impossible to project future cash losses for a 10, 20, 30 or more year period and that all the best models, prepared by all the best firms, are wrong despite being the best estimates at any single point in time. By requiring similar principles to be implemented and similar models used at the consumer loan level, significant financial distortions now reported for securities along with a permanent reliance on complex, expensive and inaccurate models will result that will have to be examined and audited. Since all models return different results, with the same exact input, because of the likes and dislikes or “opinions” of the “black box” modelers, there is often a significant and material distortion in results that have to be addressed and if one model is relied on more than another model, some may consider this manipulation of results reporting.

SunCorp understands why retail financial institutions with consumer loan portfolios do not want to account for their future consumer loan losses with the same level of complexity and stupidity that is currently required for securities, whose underlying collateral is consumer loans. The current methodology prohibits the accurate matching of revenue and expense, a core principle in sound accounting world-wide. It also relies on less than accurate guessing for a permanent recording of OTTI, or future loan losses, and further distorts the inaccuracy for the duration of the loan or security because of the lack of an “allowance” type of accounting allowing for interim and multiple adjustments related to economic changes.
SunCorp applauds FASB’s effort to change the reporting to allow the same treatment for the loan as for the security on which a loan is based and for allowing bond accounting for OTTI to be an allowance type account, versus a onetime downward adjustment based on erroneous guesses that cannot change as the models output changes (monthly).

We welcome a thoughtful and common-sense approach and encourage the FASB to 1) establish the same accounting principles for the loan level as at the security level, when the security is collateralized by those loans, and 2) establish a change to re-introduce an allowance type accounting change for securities collateralized by loans. This will immediately improve financial reporting, simplify the information that is reported, and allow the excessive and distortive amounts of OTTI currently recorded and now unjustified to be immediately reversed into income to reflect the current fair values, and not the arbitrary values established at the worst possible point in the financial crises.

We look forward to your quick resolution of these critically important issues.

Sincerely,

Thomas R. Graham
President and CEO
SunCorp