May 23, 2013

Leslie Seidman
Chairman
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Submitted via email to: director@fasp.org


Dear Chairman Seidman:

Capitol Federal Financial, Inc. appreciates the opportunity to provide comments on the Financial Accounting Standards Board ("FASB") Proposed Accounting Standards Update entitled “Financial Instruments-Credit Losses (Subtopic 825-15)” (the “proposal”).

Capitol Federal Financial, Inc., headquartered in Topeka, Kansas, is a bank holding company with over $9 billion in total assets. Capitol Federal Financial, Inc. provides a full range of retail banking services through its wholly-owned subsidiary, Capitol Federal Savings Bank (the “Bank”). The Bank primarily serves eastern Kansas and a portion of the metropolitan area of greater Kansas City through 46 branch locations. The Bank is one of the largest residential portfolio lenders in the state of Kansas. Over 95% of the Bank’s loan portfolio is composed of one- to four-family loans, the majority of which are originated to be held to maturity.

The proposal would replace the current incurred loss impairment model for loans and the other than temporary impairment ("OTTI") accounting for certain debt securities with a ‘current expected credit loss’ ("CECL") impairment model for financial assets and loan commitments. The CECL model would be used to calculate an estimate of lifetime contractual cash flows not expected to be collected on financial assets at each reporting date. Additionally, the estimate of expected credit losses would be based on historical loss experience, current conditions, and ‘reasonable and supportable forecasts that affect the expected collectability of the assets’ remaining contractual cash flows’.
Date: May 23, 2013  
To: Technical Director  
Subject: File Reference No. 2012-260: Financial Instruments – Credit Losses

The current incurred loss impairment model delays the recognition of credit losses until losses are probable or are incurred. Rather than focusing on the timing of the recognition of credit losses, the CECL model focuses on the measurement of expected losses. I have several concerns regarding the measurement approach within the CECL model. My primary concerns are as follows:

1) The CECL model appears to be a ‘life of loan’ impairment model which requires a large estimate of ‘day 1 losses’ on newly originated loans and will likely require an increase in the allowance for credit losses for performing loans in the loan portfolio at the time of adoption. 
2) Determining ‘reasonable and supportable’ adjustments to historical losses to arrive at a credit loss expectation would be quite costly and time intensive. The time and cost to prepare forecasts and gather the required supporting documentation that would withstand audit scrutiny would be significant.
3) It is unclear what past economic cycles an institution should use to determine the forecasted economic cycles under which losses should be estimated. It is unlikely that we have sufficient historical information to develop economic cycle experience data from which to derive expected credit loss estimates. In light of these challenges, consistent application of forecasting to the credit loss model will be very difficult.
4) The current OTTI accounting for debt securities is operational and provides investors with superior information, as compared with the CECL model.

The life of loan concept will result in large ‘day 1 losses’ due to recording life of loan credit loss estimates at the time a loan is originated. This concept could cause either of two results: 1) All loans will be treated equally for loss or 2) The preparation of model estimates becomes so cumbersome as to increase risk of error in the estimates. An increase in the allowance for credit losses on performing loans in the portfolio at the time of adoption is also likely if the life of loan concept is implemented. Requiring entities to recognize estimated credit losses on loans, which may or may not occur until later in the life of the loan, resembles forecasting rather than reliable accounting and will provide misleading information to the readers of the financial statements. In our experience, as primarily a single-family lender, loans do not experience loss the day they are recorded.

The proposal states that an estimate of expected credit losses should be based on ‘internally and externally available information. That information includes ‘reasonable and supportable forecasts and their implications for expected credit losses’ along with ‘an evaluation of both, the current point in, and the forecasted direction of, the economic cycle’. Typically, our loans will go through several economic cycles from origination to pay-off. Primary dependence on such long-term economic cycle data, which appears to be required by the CECL model, would result in significant judgment, inconsistency of such data within the industry, and inaccuracies. Asking financial statement preparers to prepare forecasts of the long-term economic cycle is similar to analysts and professional economists predicting the stock market, interest rates or the economy with any degree of precision that would qualify as sufficiently reliable and auditable for use in the financial statements. I believe both long-term and short-term data should be considered when
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Subject: File Reference No. 2012-260: Financial Instruments – Credit Losses

evaluating the allowance for credit losses. However, the time period for such long-term data should be reliably estimable and predictable and it should be such that it can be audited and examined by auditors and regulators without undue burden to all parties involved. It would take a significant amount of time, resources, and judgment to prepare such long-term economic cycle data for the CECL model, as appears to be required by the proposal. There will also likely be large differences and inconsistencies in what financial statement preparers, auditors, and regulators view as ‘reasonable and supportable’ evidence for the long-term economic cycle forecasts and related adjustments to historical losses, as well as, widely different expectations about the future direction and timing of economic cycles.

Debt securities are normally evaluated on an individual basis for OTTI due to the structure of the financial asset. The CECL model can be applied to individual financial assets; however, the CECL model primarily addresses credit impairment related to pools of financial assets. Recording a ‘life of loss’ estimate for unimpaired debt securities does not reflect how the banking industry or the market views credit risk. The current accounting for OTTI provides the transparency necessary for financial statement users to evaluate credit risk within debt securities. Based on the items outlined above, debt securities should not be included in the proposal. However, a change is needed to the current OTTI accounting methodology. That change is the opportunity to immediately recognize improvements in credit quality through income.

I do not believe the troubled debt restructurings (“TDR”) notation is necessary under the expected credit loss approach. The TDR designation is a source of significant misunderstanding and confusion for investors, along with being operationally difficult to administer internally, especially after the borrower’s financial issues have been sufficiently remediated. There are also differing views of the TDR notation among regulators, external auditors, and within the banking industry as a whole. The TDR designation should be discontinued and consideration should be made to the financial statement disclosures related to modified loans in order to simplify the processing and administration of loan modifications and give investors more relevant and understandable information.

I am very supportive of providing relevant information to our investors and regulators. Some of the disclosures within the proposal are already included in existing GAAP or are disclosed within Management’s Discussion and Analysis for publicly-held companies, such as Capitol Federal Financial, Inc. Disclosures of particular concern in the proposal are the qualitative disclosures, specifically related to ‘reasonable and supportable forecasts about the future’. Such qualitative disclosures may present potential auditing problems and could be interpreted as forward-looking guidance. I would ask that you reevaluate the disclosures, specifically the qualitative disclosures; within the proposal to ensure the information would not overload investors and that the disclosures will provide valuable information to investors and regulators.
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Subject: File Reference No. 2012-260: Financial Instruments – Credit Losses  

In summary, I believe that changes to the current incurred loss impairment model should be considered. However, I do not believe the CECL model is the appropriate impairment model as currently proposed. An impairment model should record all relevant losses within an entity’s loan portfolio. Relevant losses should be estimated for loans, with no individual impairment, based on losses that are foreseeable (based on risks that already exist at the reporting date) and over a period of time that is reliably estimable and predictable. Detailed guidance on defining a ‘loss event’ should also be provided. Additionally, any changes to the impairment model should take into consideration current processes at banks such that the operational changes required in calculating the allowance for credit losses are not too significant or burdensome. The impairment model should be structured such that is will provide transparency regarding how management evaluates credit risk and tie changes in credit metrics to changes in the allowance for credit losses. The impairment model should also be sufficiently transparent for auditors and regulators to audit and examine the model and supporting schedules without expending excessive time and resources, as well as not putting auditors and regulators in the position of evaluating management’s economic forecasts.

Thank you for considering our views. Please feel free to contact me at (785) 231-6360 if you would like to discuss our concerns regarding the proposal.

Sincerely,

[Signature]

Kent G. Townsend  
Executive Vice President, Treasurer and CFO