May 31, 2013

Leslie Seidman, Chairman
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856

COMMENTS RE: Financial Instruments — Credit Losses (Subtopic 825 - 15)

Dear Chairman Seidman:

The Equipment Leasing and Finance Association (ELFA) wishes to comment on the Financial Instruments — Credit Losses (Subtopic 825 - 15) Exposure Draft (ED).

ELFA is the trade association representing financial services companies and manufacturers engaged in financing the utilization and investment of and in capital goods. ELFA members are the driving force behind the growth in the commercial equipment finance market and contribute to capital formation in the U.S. and abroad. Its over 580 members include independent and captive leasing and finance companies, banks, financial services corporations, broker/packagers and investment banks, as well as service providers. The equipment finance business is estimated to be a $742 billion industry in 2013. ELFA has been equipping business for success for more than 50 years. For more information, please visit http://www.elfaonline.org.

While we support the issuance of new guidance, we do not support the ED’s proposal to require lenders/lessors to include forecasting of future economic conditions in measuring the allowance for credit losses. We believe the Board should retain the current U.S. Generally Accepted Accounting Principles (GAAP) accounting for credit impairment using the “incurred loss” model modified to improve timeliness and consistency in the recognition of credit losses. As discussed below, we support lowering the threshold from “probable” to “more likely than not” and including robust implementation guidance. We believe introducing “future events” into the accounting for credit losses represents an unwarranted exception to the existing accounting framework for contingencies and would create a conceptual inconsistency in the overall accounting model. Further, we believe the incremental cost and complexity of the expected loss model, including its auditable nature and the likely downstream effects on capital requirements, does not provide a commensurate benefit to the users of financial statements.
Specifically, we believe the following:

**The issue is a compliance issue not a rules issue.** We understand user concerns about timely reporting of credit losses. We do support robust implementation guidance to improve consistency in the application of GAAP if the Boards think current GAAP is not being followed on a timely basis. We believe the proposal to uniquely lower the accrual threshold for credit losses would create an inconsistency in the accounting for contingent losses. It does not seem logical that the triggering event to recognize a loss is the booking of a new asset. Further, we believe any observed delays by some preparers in their responsiveness to changed events and circumstances evidences an internal control deficiency and not an inadequacy in existing US GAAP.

**This proposal will result in a double count vis-a-vis capital requirements.** It is the role of equity capital to absorb losses that may occur in the future. Capital should be held in sufficient amounts for the possible losses that might exceed the probable losses that have been accrued for. It seems to be the regulators' role to establish the rules that preparers will have to comply with regarding capital levels. Basel III will increase capital requirements, add liquidity requirements and add required stress tests to force earlier recognition of credit losses. This proposed rule will either create a double count or, possibly, Basel III will then adjust its capital requirements down (reserves are a component of capital) to consider the additional reserves recorded under the proposal. We note that the Basel regulator commented on and favors the approach. It is natural that Basel regulators support accounting rules that require higher reserves; however, we would ask the following: "will users of financials have the most useful information as to values of financial instruments or will they see an overly conservative and inaccurate value?" Bank capital regulations are changing regarding the same issue for the same reasons that the FASB has initiated its project. It may be advisable to wait to see how the regulators deal with the issue.

**The proposal will create distortions in reported results rather than improvement.** We believe the proposed change to an expected loss model is more likely to create a cost without a commensurate benefit and distort, rather than improve, financial reporting for credit risk. We believe credit providers who have diligently applied the "as incurred" model and thereby established a representationally faithful historical track record would either find no material change in the accrued amounts or a distorted pattern of earnings with the incremental decrease in near-term earnings resulting in an unrepresentative increase to future earnings. Further, the "expected loss" model could reduce the net carrying value of loans and receivables measured at amortizing cost below the corresponding fair value amount as disclosed on the face of the balance sheet or in the footnotes. We do not believe this anomalous relationship between the carrying amount and the disclosed amount would benefit users of financial statements. As an alternative, the Boards should consider lowering the threshold to "more likely than not" (vs. "probable") in the interest of preserving the "as incurred" model.

**The cost to comply will be high, yet the results will not be accurate** as they will be based on estimates of the future, farther out in time than can be known with reasonable certainty. The consequences of moving from an accounting based on "events as they occur" to "future events" will add volatility to earnings as expected losses are booked and subsequently are
adjusted as actual losses occur or fail to occur. Different entities will have different views that will affect comparability among peers. Banks and regulated financial services companies will need to spend excessive time and effort in the coming months to understand the impact of the impairment exposure draft on their existing loss recognition methodologies, forecasting tools, and third-party software solutions. Larger institutions may have the data and systems but small and medium sized entities will not. Auditing of the results will be difficult especially when using third-party solutions.

The proposed standard does not address the accounting for recoveries and would create an inconsistency between the loss and recovery thresholds. Currently, US GAAP allows for recovery of previously recognized credit losses under the same recognition threshold—probable. We do not support lowering the threshold for accruing credit losses while leaving the threshold at a higher threshold for recoveries. We also note that, if the Board decides to change the threshold for recoveries from “probable” to “expected,” for consistency purposes, it would also need to make a conforming amendment to the accounting for recoveries of environmental liabilities (Section 410).

If the Board chooses to continue with the proposed approach that accelerates the recognition of costs, we believe that there are distortive consequences to P&L and EPS and to deferred tax accounting (which are hard for readers to understand and a source of difficulties for regulated financial institutions as there are special capital requirements for deferred tax assets) that make financials less useful to users.

We suggest an alternate method to lessen the immediate negative impact to earnings such as changing the measurement for expected losses in a manner consistent with Concept Statement No. 7. Two possible approaches are either discounting such losses at a higher discount rate than implicit rate in the lease (particularly when such rate is tax-advantaged, since most leases are “true” leases for tax purposes) or probability weight the loss amount and discount it at the risk-free rate.

We value the relationship built over the years with the FASB. The Board and staff have always given us access and allowed us to provide our views and those of our membership on various accounting and financial reporting matters. We hope that our input here is valuable to furthering the mission of the FASB to help improve transparency in financial reporting in the United States.

We look forward to continuing to work with the Boards and staff on this matter and stand ready to assist in any way we can.

Sincerely,

William G. Sutton, CAE
President and CEO