May 31, 2013

FASB Technical Director  
Financial Accounting Standards Board  
401 Merritt 7  
P.O. Box 5116  
Norwalk, CT 06856-5166

File Reference: 2012-260  
Proposed Accounting Standards Update, Financial Instruments – Credit Losses (Subtopic 825-15)

Dear Director:

On behalf of the management and Board of Directors of Navy Federal Credit Union, please accept these comments to the above referenced FASB proposal. The impairment of financial instruments is of significant importance to Navy Federal Credit Union, and we appreciate this opportunity to comment on the proposed standard.

Navy Federal Credit Union is a member-owned, not-for-profit financial institution formed in 1933 to provide a variety of savings and lending programs to those individuals in its field of membership, which includes military and civilian personnel who are or were employed by the Department of Defense and their families. Today, we serve over 4 million members and financially account for over $54 billion in assets.

The proposal’s stated main objective is to provide financial statement users with “more decision-useful information.” It also indicates that it would “reduce complexity” by replacing multiple impairment models in current U.S. Generally Accepted Accounting Principles (GAAP) with a single impairment model approach. We have significant concerns that this proposal would not accomplish either objective.

More decision-useful information: The proposal shifts current GAAP away from the “probable incurred loss at financial statement date” approach to a “life-of-instrument expected loss” approach (known as the Current Expected Credit Loss, or “CECL” model). Under the CECL model approach we have fundamental concerns about the quality and accuracy of information that would be provided to our financial statements users, external auditors and Board of Directors. Our own experience can confirm for the FASB that projecting life-of-instrument credit losses involves significant judgment and complex calculations that rely on numerous underlying assumptions and data points.
Especially as related to out-year expected loss cash flows on long-term instruments, the results are often subjective and volatile. There is a direct negative correlation between reliability and the forecast horizon due to inherent difficulties in accumulating and back testing sufficient historical loss data which is needed for control, validation and to avoid over reliance on external factors.

We do not believe that such inherent uncertainty should be recognized directly in the financial statements. Consistent with FAS 5 (currently ASC 450) principles, information about expected credit losses can only be “decision-useful” if based on reliable estimates. Paragraph 8 of FAS 5 requires that a loss contingency be accrued if two separate conditions are met:

(i) That it is probable that a loss has been incurred as of the date of the financial statements; and
(ii) That the amount of loss can be reasonably estimated.

Setting the first condition aside, we strongly agree with the principle long-established by the second condition of FAS 5. The basis for its conclusion was explained by the FASB in 1975: “The requirement that the loss be reasonably estimable is intended to prevent accrual in the financial statements of amounts so uncertain as to impair the integrity of those statements” (FAS 5, Paragraph 59).

If the probable incurred loss threshold contained within the first condition were to be moved out in time past the report date (as suggested in this proposal), it is our view that the time horizon must be determined based on strict consideration of the need to record estimates in the financial statements that are reliable. Internally, our own ability to meet this condition is generally thought to be limited to 12 months.

Reduce complexity: We understand and agree that this proposal would simplify codified GAAP by reducing multiple impairment models to a single, consistent model. However, we do not believe that this benefit outweighs the significant increase in operational cost and complexity. The added complexity is inherent in the proposal since the CECL model would broadly apply to loans, debt securities, trade receivables, lease receivables, loan commitments, reinsurance receivables, and any other receivables that represent a contractual right to receive cash. Furthermore, the CECL model is more complex, requiring the incorporation of multiple possible outcomes, period-by-period supportable forecasts and a corresponding increased need for management judgment. The considerations afforded by the FASB in the proposal, such as allowing flexibility in the methods chosen and not requiring a discounted cash flow analysis for individual securities, are not viewed as having a significant simplifying impact.

The various impairment models under current GAAP make economic sense as they typically incorporate fair value as a threshold, which is noted as giving consideration to life-of-instrument expected credit losses. The need for variation in methodology is also seemingly warranted due to nature of the assets (securitized versus non-securitized, equity versus non-equity, etc.) and the availability of critical data needed to inform the
analysis. In practice, for example, when applying the current requirements of ASC 320 to our debt securities (either classified as available-for-sale or as held-to-maturity), the trigger point for impairment (i.e., when fair value is below amortized cost) and the subsequent evaluation of "other than temporary impairment" is clear, intuitive, and relatively easy for us to implement since the analysis is primarily informed by readily obtainable third-party or market inputs (e.g., security level pricing and credit ratings).

The ease of this process is in great contrast to the complexity we experience in the area of measuring loan impairment under ASC 310/450 where our process is highly dependent on internal data, assumptions, judgments, and sophisticated cash flow modeling systems. In short, this proposal would effectively increase the complexities of applying ASC 310/450 for measuring loan impairment and expand its application to most all other receivables that are either carried at cost or fair value through other comprehensive income.

Thank you for the opportunity to provide these comments; we appreciate the Board's efforts to provide more information earlier about life-of-instrument expected credit losses. However, we have significant concerns with this proposal and request that it be withdrawn or significantly modified and resubmitted for public comment.

Please feel free to contact me directly to discuss any of our concerns or comments. I can be reached at 703-255-8720, or by email at Lauren_Lloyd@navyfederal.org.

Sincerely,

Lauren Lloyd
Chief Financial Officer