May 31, 2013

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

Re: Comments on Proposed Accounting Standards Update: Financial Instruments – Credit Losses; File Reference No. 2012-260

Dear Chairman Seidman:

The Ohio Credit Union League (OCUL) appreciates the opportunity to comment on the Financial Accounting Standards Board’s (FASB) Proposed Accounting Standards Update on —Financial Instruments – Credit Losses (Subtopic 825-15).”

OCUL is the trade association for credit unions in Ohio and advocates on behalf of Ohio’s 358 federal-and state-chartered credit unions, serving their 2.7 million members. The comments reflected in this letter represent the recommendations and suggestions that OCUL believes would be in the best interests of Ohio credit unions.

Summary of OCUL’s position

OCUL strongly opposes the proposal and urges the FASB not to proceed with the accounting standards update as issued for comments. The key points of our comment letter are:

• Credit unions are not-for-profit financial cooperatives. They do not have “investors” who would require detailed predictions of future losses in deciding whether to invest in the corporate entity. The primary “consumer” of a credit union’s financial statements are its examiners, who already possess expertise in understanding the exact financial position of the credit union. OCUL urges the FASB to recognize the differences between credit unions and other providers, particularly the largest banks who actively participated in activities that contributed to the financial crisis.

• OCUL further urges the FASB to allow credit unions to continue reporting under the current methodology, which has not been shown to be problematic for the credit union system. If that is not feasible, OCUL urges FASB to work with the credit union system to develop credit loss reporting standards for credit unions, separate from those for publicly traded companies, which reflects the unique business model of credit unions while ensuring credit loss issues are reported appropriately.
The proposal would be detrimental to the credit union system, and could have serious, unintended consequences for borrowers and the economy. Making the adjustment that would be required will cause an immediate drastic increase in the allowance for loan and lease losses (ALLL), reducing retained earnings and funds available for lending to credit union members.

The costs of implementation will be unduly burdensome on many small credit unions and may result in the further consolidation of the financial services industry, including credit unions, leading to reduced consumer choice without a significant benefit derived from the change in credit loss recognition.

The predictive model requires a high degree of subjectivity in determining the correct level of reserving for ALLL. Depending upon the use of estimates without sufficient predictive modeling based on reasonably accurate past experience will not produce viable financial statements. The change institutes “crystal ball” accounting.

Changing the model goes against the generally accepted practice of “matching”. Losses should be recordable when the loss is probable and can be reasonably documented.

OCUL seriously questions whether the proposal will achieve the FASB’s stated objectives. Changing from the current “incurred loss” model to the “expected loss” model proposed by FASB is in reaction to the Great Recession; those circumstances were an extreme occurrence, unlikely to be repeated in the same way.

OCUL also questions how the proposal will be reconciled with the proposed approach from the International Accounting Standards Board (IASB).

Accounting Standards Should Be Tailored to Address the Unique Organization of Credit Unions

It is imperative that the FASB understand the unique structure of our nation’s credit unions. There are some important differences between credit unions and publicly traded institutions, which affect the impact of this proposal on stakeholders such as credit unions.

Because of their organization as not-for-profit cooperative financial institutions, the credit union’s regulators and members – who are more analogous to bank depositors than to bank stockholders – are the stakeholders for their financial information, not investors. In particular, the credit union’s regulator, tasked with examining the safety and soundness of the institution, has in place processes for reviewing both actual and potential future losses. FASB’s proposal does not enhance the safety and soundness review, but instead injects elements of subjectivity in forecasting future losses.

The end users of a credit union’s financial statements are not interested in credit loss estimates that are based on subjective projections regarding cash flows. (In fact, they may question why the credit
union is making the loan in the first place if the credit union projects that payments will not be made.) They are interested in the credit union's reasonable analysis of the performance of its loans based on analytical components, such as under the current incurred loss model, and the extent to which the credit union has provisioned its Allowance for Loan and Lease Losses (ALLL) account to reflect loan nonperformance. Current modeling and statistical analysis provides these projections. Development of new modeling to implement the standards outlined in FASB's Current Expected Credit Losses (CECL) significantly adds to the cost of doing business, while lacking the objectivity provided by the models currently in use.

Credit unions differ from other financial institutions in this country in another significant way. Under the Federal Credit Union Act (FCU Act), a credit union's net worth is limited to its retained earnings. Because of the provisions in the FCU Act regarding the composition of credit unions' net worth, the ability of NCUA as the supervisor of all federally insured credit unions to adjust its regulations on net worth requirements in response to changes in accounting standards is not allowed, even though it is possible for other federal financial regulators to make such adjustments under their rules.

The net worth of a credit union represents its capital. Under the regulations governing credit unions, they are reliant on deposits and loans to members as their sole source of capital. Reducing this capital by requiring a higher reserve for expected credit losses reduces their ability to make loans to members, reducing available credit for many low- to moderate-income consumers.

This is significant considering the proposal's likely impact on credit unions' ALLL, which is addressed in greater detail below.

In light of these important and highly relevant distinctions between credit unions and publicly traded institutions, and in order to facilitate financial reporting that is the most accurate, credit unions' financial statements and financial reporting should reflect the uniqueness of credit unions and who the end users of their financial statements are, rather than requiring credit union reporting to meet standards designed to address problems presented by the for-profit bank model.

Moreover, credit unions should not be required to conform to accounting standards that are more appropriate for publicly-traded banks and other stockholder companies when such standards will impose significant costs and hardships on credit unions and their communities as the current proposal would do, if adopted.

For these reasons, OCUL urges FASB to reconsider application of the proposed standards to credit unions. The current methods have not been shown to provide misleading information to the primary stakeholders of a credit union's financial statements, and OCUL therefore urges FASB to continue to allow their use. Alternatively, FASB should develop accounting standards which are more specific to member-owned cooperative financial institutions in recognition of the inherent differences between credit unions and publicly-held banks.
Potential Impact on Credit Unions

The proposal would be detrimental to the credit union system, and could have serious, unintended consequences for borrowers and the economy. As discussed above, the net worth of a credit union is limited to its retained earnings, as dictated by the provisions of the FCU Act and the various state credit union acts implementing the credit union system. The FCU Act also dictates the standards used to determine whether a credit union should be subject to Prompt Corrective Action due to changes in net worth based on percentages laid out in the FCU Act and its implementing regulations. These standards cannot be changed by NCUA simply because new accounting standards have been issued.

Making the adjustment that would be required will cause an immediate drastic increase (perhaps doubling or even tripling) in the ALLL, reducing retained earnings and funds available for lending to credit union members. There is also a concern that the proposed CECL approach could result in quarterly adjustments in expected loss projections, possibly resulting in even more volatility in reported earnings. Another possible result of the proposal is that reporting entities could take large one-time charges at first signs of distress in their loan portfolios, and then look for opportunities to smooth earnings’ out over time through reserve releases or reverse provisions.

In addition to the concerns raised by accounting for the drastic increase in ALLL, OCUL also notes that the majority of credit unions are smaller entities, with almost 60% of Ohio credit unions holding assets less than $50 million. Implementation of the proposed standards will be extremely burdensome on these smaller entities, adding to the regulatory stresses placed on them. Inability to comply with changes to credit loss accounting may force many of these smaller credit unions to seek merger with larger credit unions or even liquidation, reducing consumer choices for financial services.

Other Potential Impacts of Implementing the Current Expected Credit Loss (CECL) Model

The proposed CECL model effectively requires entities to predict the extent and timing of future impairments. Given the long time horizon of some type of loan, there is no current method of predicting such future losses, which may occur decades into the future, with any degree of accuracy, or even objectivity. Attempting to predict credit loss for the life of a loan will inherently be affected by the subjectivity of and assumptions made by the reporting entity. The predictions used in the CECL model will not lead to more informative financial statements.

In addition, the proposed CECL model is inconsistent with the accounting principle of matching, which states that expenses should be recorded in the same period as the revenues that relate to those expenses. The proposal is inconsistent since it requires expected future loan losses to be recorded immediately. In addition to its impact on the reporting entity, this inconsistency will likely cause challenges/trepidation within the audit community.
The Proposal Will Not Prevent Future “Great Recessions”

FASB’s proposal seems to be created to deal with the perception that the current methodology for recognizing credit losses did not identify such losses at the largest financial institutions soon enough leading up to and during the financial crisis. While this may be the case, there is no evidence that the proposed model will do a better job of predicting such losses, given its subjectivity. Additionally, there is no evidence that the current system is not working well for smaller institutions, including credit unions. Therefore, the proposed model does not enhance the overall safety and soundness of the U.S. financial services industry.

FASB’s Proposed Model Conflicts with the IASB Model

While the FASB has indicated its intention to achieve a convergence of standards with those of the International Accounting Standards Board (IASB), including on credit losses, it is unclear how this will occur since the IASB’s and the FASB’s credit losses proposals are very different.

Unlike the FASB proposal, which does not include a trigger for recognizing certain losses, the IASB proposal provides that an entity would only recognize a portion of expected credit losses until a specific recognition trigger has been met. The IASB’s credit losses model utilizes the following “two bucket” approach:

- 12-month expected credit loss (Bucket 1): This category would require a full expected loss recognition only when there is a significant increase in credit risk since a loan was originated or acquired.
- Lifetime expected credit loss (Bucket 2): For all other assets, credit losses would be recorded based on the probability of a default occurring in the next twelve months.

There is concern among some within the accounting industry that the CECL model has the potential of driving U.S. entities to report asset values more conservatively than their international counterparts applying the IASB’s proposed credit loss standard.

Conclusion

OCUL strongly urges FASB to withdraw the proposed CECL model. The subjectivity of the predictions required under the model will not enhance safety and soundness of the U.S. financial services sector, but will rather introduce uncertainty based on their lack of an objective standard which might be used to accurately predict future potential credit losses. In addition, the model goes against the generally accepted principle of “matching” where expenses are recorded when they occur or are reasonably expected.

Further, the proposed model will have a disastrous impact on credit unions by implementing changes which adversely affect the credit union’s net worth as defined by the statute, while not
adding meaningful information for the consumers of the credit union’s financial statements – its regulator and members.

If the proposal cannot be withdrawn, OCUL urges FASB to modify its standards be determining how best to recognize the unique organization of credit unions as member-owned, not-for-profit cooperative financial institutions. Although standardization can add predictability in comparisons of like entities, credit unions are not organized the same way as banks, and implementing a “one size fits all” method of recognizing credit losses distorts the financial statement of a credit union.

The Ohio Credit Union League appreciates the opportunity to provide comments on CFPB’s proposed delay on the implementation of its rules prohibiting the financing of credit insurance and is available to provide additional comments or information on this proposal if so requested. If you have any questions, please do not hesitate to contact me at (800) 486-2917 or jkozlowski@ohiocul.org.

Respectfully submitted,

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cc: Mary Dunn, Credit Union National Association General Counsel  
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