May 31, 2013

Ms. Susan M. Cosper
Technical Director
Financial Accounting Standards Board
401 Merritt 7
P. O. Box 5116
Norwalk, Connecticut 06856-5116

RE: File Reference No. 2012-260 — Financial Instruments-Credit Losses (Subtopic 825-15)

Dear Ms. Cosper:

The staffs of the federal financial institution regulatory agencies (the Agencies) appreciate the opportunity to comment on the Exposure Draft, Financial Instruments-Credit Losses (Exposure Draft), issued by the Financial Accounting Standards Board (FASB). The measurement of credit losses is exceptionally important to the Agencies as it is one of the most significant accounting estimates for the nearly 14,000 financial institutions we supervise. We trust that our comments will help the FASB further refine and clarify the Exposure Draft, thereby leading to an Accounting Standards Update that improves the quality of financial reporting.

The Agencies support the FASB’s decision to move from an incurred loss model to an expected loss model for measuring impairment, which responds to one of the lessons learned from the financial crisis. We commend the FASB for the priority it has given the impairment project, its consideration of the G20 mandate\(^1\) during the project deliberations, and its attention to due process. We believe the Current Expected Credit Loss (CECL) model proposed in the Exposure Draft is consistent with the fundamental principles necessary to address the defects identified during the financial crisis in the current impairment models. We also agree with the Financial Crisis Advisory Group (FCAG) that “identifying appropriate trigger points for loss recognition” resulted in “delayed recognition for losses on loan portfolios.”\(^2\) Thus, the Agencies support the FASB’s efforts to construct an impairment model that addresses weaknesses in existing accounting standards identified during the financial crisis and avoids triggers for recognizing expected credit losses.

Earlier Recognition of Credit Losses
The proposed CECL model addresses the “too-little, too-late” criticisms of loan loss allowances that arose during the financial crisis by eliminating the “probable incurred loss threshold” for recognizing credit losses and instead measuring credit losses expected at the balance sheet date. Further, by removing a “trigger” for recognizing impairment and incorporating reasonable and

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\(^1\) G20 Communiqué from the London Summit, April 2, 2009.
supportable forecasts that affect the expected collectibility of financial assets into the estimation process, the measurement of credit loss in the financial statements under the proposed CECL model will enable institutions to fully consider all relevant information from the credit risk management function. As a consequence, impairment estimates should more appropriately reflect the effects of changes in the credit quality of the portfolio of debt instruments.

**International Convergence**
We commend the FASB for undertaking outreach activities in 2012 as part of its due process to consider comments regarding the operationality of the three-bucket impairment model then under discussion and deciding to develop an alternative approach based on the feedback received. The Agencies believe the work performed on impairment and the due process efforts by the International Accounting Standards Board and the FASB to date have been beneficial and thorough. We also believe there is potentially meaningful common ground between the two proposals, and we encourage the Boards to jointly deliberate the comments each receives to explore whether such common ground can be reached while still achieving earlier loss recognition in all jurisdictions. Consequently, we support the decision of both Boards to work to resolve their differences and meet the intent of the G20 Leaders’ call for a single set of high-quality global accounting standards.

**Application by Smaller and Less Complex Entities**
The Agencies support all reporting entities applying the principles set forth in the Exposure Draft to their methods for measuring credit losses consistently and in a manner that is appropriate and practical for their circumstances. Additionally, although institutions will face challenges in moving to an expected loss approach to impairment measurement, we believe the CECL model is ultimately scalable to entities of all sizes and degrees of complexity and can be implemented in a reasonable manner by the full range of entities. Consistent application of the principles in the CECL model by all entities will achieve increased comparability between regulated and non-regulated entities. However, smaller entities and those with less complex financial asset portfolios may be able to achieve the objectives of the CECL model through estimation practices that are less burdensome and costly than those that may be used by larger and more complex entities. To accommodate the resource constraints faced by smaller institutions, the proposed standard could be modified to include additional practical expedients that satisfy the intended measurement objective, a transition period that considers the time and effort necessary to implement the new model, and condensed disclosure requirements.

**“Day-one” Loss Recognition**
The Agencies are aware that some constituents have voiced concerns related to the day-one recognition of credit losses under an expected credit loss model. We have observed that credit losses typically emerge relatively early in the life of loans and do not occur ratably over a financial instrument’s life. Accordingly, as the FASB has proposed, we believe it is appropriate to separate credit loss recognition from interest income recognition for financial instruments that are not reported at fair value through net income (FV-NI). The Agencies support this decoupling approach because it provides more decision-useful information for financial statement users by presenting a balance sheet that more accurately reflects future cash flows expected to be collected. It also aligns with how financial institutions generally monitor credit risk and engage in sound credit risk management. The Agencies believe that after the transition to, and initial
adoption of, the proposed CECL model, the ongoing day-one recognition of credit losses for stable, open portfolios should not significantly affect earnings. We believe the estimates of large day-one losses cited by some constituents are erroneously based upon historical loss rates experienced during highly stressed economic environments. However, the Agencies acknowledge that in certain situations, such as de novo institutions and portfolios of new loan products, day-one recognition of credit losses may result in a significant charge to earnings or be interpreted as requiring institutions to use an unreasonable estimate of credit losses. The Agencies suggest that the FASB explore the consequences of applying the proposed standard in these narrow circumstances and consider adding relevant examples to the implementation guidance.

**Single Approach to Impairment**
The Agencies believe the existing accounting standards governing credit impairment recognition and measurement should be simplified. Ideally, similar financial assets should receive similar accounting treatment without regard to the legal form of the asset. Therefore, the Agencies support the Exposure Draft’s establishment of a single impairment model for all debt instruments measured at amortized cost or fair value through other comprehensive income (FV-OCI). Although we support one model for all debt instruments, the FASB should provide further illustrative guidance on the application of the model to debt securities, including individual instruments and groups of debt securities that have similar risk characteristics, and all debt instruments carried at FV-OCI.

Additionally, the Agencies believe it is important to use the same approach to measuring the allowance for expected credit losses for all financial assets classified as debt instruments, including purchased credit-impaired (PCI) financial assets. The Agencies’ comment letter addressing a past proposal on accounting for business combinations criticized the accounting model now set forth in Accounting Standards Codification (ASC) Subtopic 310-30 for not providing sufficient transparency in the balance sheet and not assisting financial statement users in understanding the credit quality of an entity’s entire portfolio of financial assets. The Agencies support the proposed CECL model’s treatment of PCI assets because it eliminates the need for separate analyses to measure and evaluate the expected losses of originated assets and PCI assets.

**Addition of Nonaccrual and Writeoff Principles**
The Agencies’ regulatory reporting guidance includes well established nonaccrual and writeoff principles. We support the introduction of nonaccrual and writeoff principles into U.S. generally accepted accounting principles (U.S. GAAP). The application of such principles by all entities will provide decision-useful information by creating greater comparability in accounting practices between regulated and non-regulated entities. Existing practice for regulated financial institutions, which is long-standing and well understood by preparers, auditors, and users, is driven by the guidance for regulatory filings by financial institutions. The Agencies do not believe that the FASB intended for the application of the nonaccrual and writeoff principles, as articulated in the Exposure Draft, by our supervised financial institutions to change their current

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4 Receivables – Loans and Debt Securities Acquired with Deteriorated Credit Quality.
practices. The Agencies recommend that the nonaccrual and writeoff principles in the proposed standard be aligned with existing guidance for regulatory filings or further clarified to ensure existing practice is not changed. Additional comments addressing these two principles are included in our response to Question 8 in the appendix.

Troubled Debt Restructurings
The Agencies encourage the FASB to consider alternatives to the existing troubled debt restructuring (TDR) designation requirements, such as targeted or expanded disclosures, as it moves to an expected credit loss impairment framework. The Agencies understand it is important to provide financial statement users with transparent and useful information concerning a financial institution’s restructuring activities with troubled borrowers. However, it is also important to balance the costs of identifying and labeling financial assets as TDRs with the disclosure benefits of such labeling to users.

The Agencies appreciate your consideration of our comments. We have attached responses to selected questions in the Exposure Draft in the appendix to this letter. We would be pleased to further discuss our views with you.

Sincerely,

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Appendix

Responses to Certain Questions for Respondents to the Exposure Draft of the Proposed Accounting Standards Update (ASU) to Financial Instruments – Credit Losses (Subtopic 825-15)

General: The Agencies believe the FASB staff’s Frequently Asked Questions document issued March 25, 2013, provided additional clarity to certain concepts within the Exposure Draft. We encourage the FASB to include relevant aspects of this guidance within the implementation guidance in its final standard on credit losses.

Question 2: The proposed amendments would remove the initial recognition threshold that currently exists in U.S. GAAP and, instead, view credit losses as an issue of “measurement” as opposed to an issue of “recognition” because the credit losses relate to cash flows that are already recognized on the balance sheet. Do you believe that removing the initial recognition threshold that currently exists in U.S. GAAP so that credit losses are recognized earlier provides more decision-useful information?

Answer: The Agencies strongly agree that removing the initial recognition threshold for credit impairment that currently exists in U.S. GAAP to promote earlier recognition of credit losses provides more decision-useful information.

The Agencies agree the financial crisis exposed the current initial recognition threshold as a weakness in accounting standards that resulted in credit loss recognition that was “too little, too late.” Under existing standards, entities must not recognize a credit loss until the likelihood that the loss had been incurred rises to the threshold of probable. This requirement enabled credit deterioration in financial institutions’ portfolios of financial assets to reach significant levels prior to and during the credit crisis before the deterioration was recognized in the financial statements. Because the proposed CECL model requires credit loss “measurement” without a predicate recognition event, entities would now record an allowance for credit losses based on their current estimate of contractual cash flows not expected to be collected. The Agencies believe this model will better meet the needs of financial statement users while, at the same time, assisting the Agencies in better achieving their safety-and-soundness objectives for supervised institutions.

Question 3: As a result of the proposed amendments, the net amortized cost on the balance sheet (that is, net of the allowance for expected credit losses) would reflect the present value of future cash flows expected to be collected, discounted at the effective interest rate. Do you agree that the net amortized cost (which reflects the present value of cash flows expected to be collected) results in more decision-useful information than currently exists under U.S. GAAP?

Answer: The Agencies agree that reporting a net amortized cost on the balance sheet that reflects the present value of expected cash flows results in more decision-useful information than reporting a financial asset net of an allowance determined in accordance with the existing
incurred loss standard. This is due to improvements the Exposure Draft would make to current U.S. GAAP, such as the removal of the initial recognition threshold and the requirement to consider reasonable and supportable forecasts. These improvements make the measurement of credit losses in the financial statements more sensitive to changes in credit risk and thus better reflect in the financial statements the results of changes in credit risk in the portfolio of debt instruments.

However, the Agencies believe the FASB should provide clear direction on the unit of measurement for the application of the CECL model. This guidance should be supported by clear examples, understanding that, for financial assets that share predominant risk characteristics, credit loss information generally may be measured most effectively at the pool level. The Agencies are concerned that a lack of clear direction regarding the unit of measurement for purposes of measuring expected credit losses may result in unintended consequences or even manipulation of the measurement of impairment. For instance, we are concerned that an entity could distort its historical loss experience, which is an integral element of the estimation process under the CECL model.

**Question 4:** The Board has twice considered credit loss models that would permit an entity not to recognize certain credit losses. In the January 2011 Supplementary Document, the Board considered a model that would permit an entity not to recognize some credit losses expected to occur beyond the foreseeable future. In the most recent discussion on the three-bucket impairment model, the Board considered a model that would permit an entity only to recognize lifetime credit losses for loss events expected to occur within a 12-month horizon. Instead, the proposed amendments would require that at each reporting date an entity recognize an allowance for all expected credit losses. Do you believe that recognizing all expected credit losses provides more decision useful information than recognizing only some of the expected credit losses? If not, how would you determine which expected credit losses should not be recognized (for example, 12 months or similar foreseeable future horizon, initial recognition threshold, and so forth)?

**Answer:** The Agencies believe recognizing all expected credit losses provides more decision-useful information than recognizing only a portion of expected credit losses. The incurred loss model currently in use in effect recognizes only a portion of expected credit losses, which is an approach now acknowledged to be flawed. We support an impairment model based on current estimates of cash flows not expected to be collected that requires consideration of assumptions and judgments based on reasonable and supportable forecasts. The Agencies do not favor creating an arbitrary time horizon or threshold that would restrict an entity’s ability to report its current estimate of expected credit losses. We believe proposed paragraph 825-15-25-3 in the Exposure Draft provides a sound principle with regard to determining current expectations of credit loss not reflected in historical experience.

The Agencies recognize that implementing the CECL model will require smaller and less complex entities to make changes to systems and processes to track and analyze the data necessary to calculate expected credit losses and may require a suitable transition period. We
also believe that with reasonable implementation by preparers and appropriate interpretation by auditors and regulators, combined with practical expedients that achieve the Exposure Draft’s intended recognition and measurement objectives, the benefits of applying the CECL model will outweigh its costs. To this end, the Agencies believe the FASB may benefit from consultation with the Private Company Council about reasonable accommodations for smaller and less complex entities in a final impairment standard, including condensed disclosure requirements.

**Question 5:** The proposed amendments would require that an estimate of expected credit losses be based on relevant information about past events, including historical loss experience with similar assets, current conditions, and reasonable and supportable forecasts that affect the expected collectibility of the financial assets’ remaining contractual cash flows. Do you believe that expected credit losses based on this information provide decision-useful information?

**Answer:** The Agencies agree that when expected credit loss measurements include consideration of the effect on collectibility of future conditions derived from reasonable and supportable forecasts, these estimates will provide more decision-useful information than estimates produced under existing U.S. GAAP. Under current U.S. GAAP, entities are limited to considering past events and current conditions when estimating credit losses. However, consideration of reasonable and supportable forecasts about future conditions are fundamental to sound credit risk management practices, and the Agencies believe all information used for credit risk management purposes is relevant to making an estimate of expected credit losses. The Agencies believe relevant information about changes in credit risk in the portfolio of debt instruments, such as changes in underwriting standards, should be considered in the determination of the allowance for credit losses rather than being prohibited from consideration.

The Agencies also believe that, for many financial assets, consideration of the assets’ effective life may be more appropriate than contractual life when measuring impairment. Thus, expected prepayments by borrowers that shorten the life of a debt instrument compared to its contractual life, and anticipated rollovers or extensions that lengthen the life of a debt instrument compared to its original contractual life at initial recognition (for example, construction and commercial loans), should be appropriately taken into account when measuring expected credit losses. This would better align the measurement of credit losses with sound credit risk management practices, making the financial statements more decision-useful to users of the financial statements. It is important for the FASB to clarify whether it is appropriate to consider an instrument’s effective life, which would incorporate renewals and expected prepayments, when measuring expected credit losses. In this regard, the Agencies do not believe it is appropriate to view the rollover of some or all of a loan balance at maturity as the collection of a contractual cash flow. If the effective life of an asset, when longer than its contractual life, should not be considered, the FASB should explain why in the basis for conclusions.
Question 6: For purchased credit-impaired financial assets, the proposed amendments would require that the discount embedded in the purchase price that is attributable to expected credit losses at the date of acquisition not be amortized into and recognized as interest income over the life of the asset. To achieve this result, upon acquisition the initial estimate of expected credit losses would be recognized as an adjustment that increases the cost basis of the asset. Apart from this requirement, purchased credit-impaired assets would follow the same approach as non-purchased-credit-impaired assets. That is, the allowance for credit losses would always be based on management’s current estimate of the contractual cash flows that the entity does not expect to collect. Changes in the allowance for expected credit losses (favorable or unfavorable) would be recognized immediately for both purchased credit-impaired assets and non-purchased-credit-impaired assets as bad-debt expense rather than yield. Do you believe that using the same approach to recognize changes in the credit impairment allowance for purchased credit-impaired assets and non-purchased-credit-impaired assets provides decision-useful information? Do you believe that this is an improvement from the current model used for purchased credit-impaired assets?

Answer: We agree the proposed changes to the accounting for purchased credit-impaired (PCI) assets represent an improvement over current U.S. GAAP and provide more decision-useful information. The Agencies believe it is important to use the same approach to estimating and reporting the allowance for expected credit losses for all financial assets, including PCI assets. Having a single approach to measuring credit losses for all debt instruments not accounted for at FV-NI provides improved transparency in accounting for PCI financial assets and assists financial statement users in understanding the credit quality of and the expected cash flows on the reporting entity’s portfolio of financial assets.

The Agencies encourage the FASB to consider ways to reduce incentives to overstate expected credit losses at acquisition for PCI assets followed in later periods by overstatements of earnings resulting from reductions in estimates of contractual cash flows not expected to be collected. These may include additional implementation guidance, enhanced disclosure requirements, or separate presentation of allowances related to such assets.

Question 8: The proposed amendments would require that an entity place a financial asset on nonaccrual status when it is not probable that the entity will receive substantially the entire principal or substantially all of the interest. In such circumstances, the entity would be required to apply either the cost-recovery method or the cash-basis method, as described in paragraph 825-15-25-10. Do you believe that this approach provides decision-useful information?

Answer: The Exposure Draft introduces nonaccrual and writeoff principles into U.S. GAAP. The Agencies support the inclusion of a nonaccrual principle in U.S. GAAP and believe it provides decision-useful information and will improve comparability in accounting practices between regulated and non-regulated financial institutions. However, the Agencies recommend
that the articulated principle be aligned with existing nonaccrual guidance for regulatory reporting by the financial institutions we supervise, which these institutions typically also follow for other financial reporting purposes. Such an alignment would prevent a change in current practice for those financial institutions, which is currently robust. Also, the nonaccrual principle in the Agencies' regulatory reporting guidance already includes a "probable" threshold. The introduction of the qualifier "substantially" may represent an additional threshold, the combined effect of which may be a potential reduction in the number of financial assets placed on nonaccrual as compared to current practice.

The nonaccrual principle in the Exposure Draft does not adequately consider the timing of cash receipts, but focuses exclusively on the amount. We believe consideration of the timing and amount of cash receipts is important for recognizing interest income on an accrual basis. Furthermore, the Exposure Draft does not define the term "principal" within the Glossary. The currently articulated nonaccrual principle in proposed paragraph 825-15-25-10 could be interpreted as requiring all PCI assets to be placed on nonaccrual immediately upon purchase because the entity does not expect to collect "substantially all" of the principal and interest for such assets. We do not believe this is the FASB’s intention and therefore suggest the final standard be clarified.

Further, the Agencies are concerned that the language in the Exposure Draft would change well-established industry practice regarding "cost recovery" and "cash basis" income recognition for loans that are not eligible for income recognition on an accrual basis. Specifically, we are concerned that the application of the proposed standard will result in fewer financial assets classified as "cost recovery" and more as "cash basis." Under current regulatory guidance, a nonaccrual asset is eligible for "cash basis" income recognition only when the remaining recorded investment in the asset is deemed to be fully collectible. We believe this is a higher threshold than "it is not probable that the entity will receive payment of substantially all of the principal."

With regard to writeoffs, we recommend the FASB align its definition as much as possible to the current regulatory guidance where the writeoff principle is mature and well understood or otherwise clarify that existing practice is not expected to change. The Agencies are concerned that the writeoff principle as set forth in the Exposure Draft could be interpreted as a change in current practice for the entities we supervise. The Agencies are concerned that "no reasonable expectation of future recovery" could be interpreted in such a way as to delay the timing of writeoffs compared to current practice.

Also, the Exposure Draft states that a recovery of a financial asset previously written off is not recognized unless "consideration" is received in satisfaction of some or all of the contractually required payments. We agree that a recovery of an amount previously written off should not be recognized based on an increase in expected future cash flows or an increase in the fair value of underlying collateral. However, we are concerned the term "consideration" is not defined in the Exposure Draft and therefore may be too broadly construed. Specifically, the Agencies believe the receipt of the existing debtor's promise to pay (for example, upon the execution of a new note), which may be considered "consideration" in certain legal contexts, should not be treated as "consideration" for purpose of recognizing a recovery.
Question 16: Under existing U.S. GAAP, the accounting by a creditor for a modification to an existing debt instrument depends on whether the modification qualifies as a troubled debt restructuring. As described in paragraphs BC45–BC47 of the basis for conclusions, the Board continues to believe that the economic concession granted by a creditor in a troubled debt restructuring reflects the creditor's effort to maximize its recovery of the original contractual cash flows in a debt instrument. As a result, unlike certain other modifications that do not qualify as troubled debt restructurings, the Board views the modified debt instrument that follows a troubled debt restructuring as a continuation of the original debt instrument. Do you believe that the distinction between troubled debt restructurings and nontroubled debt restructurings continues to be relevant? Why or why not?

Answer: The Agencies recognize it is important to provide financial statement users with transparent and useful information concerning an institution's restructuring activities with troubled borrowers and the subsequent performance of debt instruments modified in troubled debt restructurings. The Agencies encourage the Board to consider alternatives to the existing troubled debt restructuring (TDR) designation requirements, such as targeted or expanded disclosures. This could include incorporating the current disclosures about TDRs into the broader credit quality disclosures proposed in the Exposure Draft.

Question 17: Do you believe the disclosure proposals in this proposed update would provide decision-useful information? If not, what disclosures do you believe should (or should not) be required and why?

Answer: The Agencies recognize the high degree of management judgment required in measuring expected credit losses on financial assets. Therefore, we stress the importance of robust disclosures. Such disclosures are not only critical in providing transparency about an entity's provisioning policies and practices, but also for maintaining consistency and discipline internally within the reporting entity. For example, the entity's management must fully understand the impact of factors, such as unit of measurement, prepayments, ratings transition or credit migration, and historical loss experience, before using loss rates to estimate allowances. It also will be necessary for management to disclose changes in forecast periods and assumptions and underwriting standards, and the impact on the allowance for credit losses of those changes.

Overall, we believe the disclosure proposals in the Exposure Draft provide decision-useful information. However, the Agencies suggest the FASB incorporate the following enhancement to the proposed disclosures.

Under the Exposure Draft, there is no requirement for entities to disclose whether and why they have used the fair value of collateral method as a practical expedient to measure expected credit losses. The disclosure requirements for collateralized financial assets as prescribed under proposed paragraphs 825-15-50-19 and 50-20 of the Exposure Draft should specifically require
entities to disclose their policy for estimating expected credit losses based on the fair value of the collateral as a practical expedient.

Additionally, please refer to our response to Question 6 on disclosure for PCI financial assets, and our response to Question 16 on disclosure for TDRs.

**Question 19: Do you believe that the implementation guidance and illustrative examples included in this proposed Update are sufficient? If not, what additional guidance or examples are needed?**

**Answer:** The Agencies agree the implementation guidance provides some useful examples. However, additional clarification or examples may further assist preparers, auditors, and users.

First, the implementation guidance does not include a debt securities example. Since debt securities are within the scope of the proposed update, the application of the CECL model to debt securities should be better illustrated in the final standard. This should include clear guidance on the unit of measurement because impairment of debt securities is evaluated only at the individual instrument level under current accounting standards. Further implementation guidance and illustrative examples on the application of the CECL model to assets that would be carried at FV-OCI under the proposed Recognition and Measurement standard also would be helpful. For such assets, illustrative examples should depict how the effects of changes in fair value and credit deterioration flow through the financial statements on an individual and pool basis.

Second, the term “collateral dependent” is defined in the Glossary and referred to in the implementation guidance (proposed paragraph 825-15-55-4), but the concept is not discussed in the principles. The Agencies believe constituents would benefit from additional clarification within the principles on the concept of collateral dependency, and when and how it should be used under the CECL model. Additionally, it is not clear what the FASB intended by specifying that a loan is collateral dependent if its repayment is dependent upon the operation of the collateral “by the lender.” The Agencies favor replacing the phrase “by the lender” with “by the borrower,” because the proposed definition would change current well-established financial institution industry practice. If the FASB’s intent is to remove operation “by the borrower” from the meaning of collateral dependent, the FASB should explain why in the basis for conclusions.