Dear Director,

I appreciate FASB’s efforts to improve the process of reserving for credit losses; however, I am in opposition to FASB’s proposal regarding financial instruments / credit losses (Subtopic 825-15) for the reasons many others have already noted.

Contrary to the matching principal, it will cause us to reflect multiple year’s expense in the first year of a loan, while reflecting only the current year’s revenue. This is not generally accepted accounting. Most loans will be unprofitable in the year originated. This will also make financial statements more confusing and less accurate relative to financial performance.

It’s unreasonable to project future loan losses for the life of almost any loan. Projections become less accurate the farther into the future they are, and there is no way to forecast with any degree of certainty or confidence over the life of even a 5-6 year loan, much less a 15-30 year loan.

The failures in adequately reserving for loan losses over the past five years are to a great extent the result of an inadequate response to deteriorating economic factors, and this could have easily been resolved through greater emphasis on economic factors. We have learned valuable lessons during the Great Recession and should be able to incorporate reasonable economic factors that allow us to adjust loan loss estimates more effectively than we have in the past.

The proposed change will have a significant negative financial impact on financial institutions and particularly credit unions. The additional reserve requirement could wipe out all or most of an entire year’s profit, only to inflate the ALLL beyond what’s reasonable. Credit unions did not contribute to the recent financial crisis, and would suffer disproportionately by this new requirement. The average bank has assets of over $2 billion, while the average credit union has assets of roughly $150 million. Any significant decrease in capital can have a dramatic impact on financial institutions, particularly in this day of increasing compliance costs.

It’s also important to note the impact this proposal will have on the consumer, businesses, and the economy. Financial institutions will be less inclined to loan to near-prime or sub-prime borrowers, and if they do, it will be at much higher rates. They will be motivated offset the higher reserve requirement and minimize the likelihood of loans being unprofitable in the first year. This reduction in borrowing may have a severe impact on the economy and GDP through a slow-down in purchasing.

In addition, long-term loans will be significantly more unprofitable because the life-of-loan loss could be much more significant. It may dissuade financial institutions from even offering long-term loans at all, or if they do, increasing the rate considerably. For example, if mortgage originations are $1 billion and loan losses are 1% per year on an average life of seven years, for simplistic illustration purposes we would reserve 3.5% (one-half of 7% assuming a straight-line amortization). If the average interest rate is 3.5%, we are already at a break-even before considering cost of funds and operating / servicing costs. Including these components, the first-year loss could be over 2% ($20
million in this example). It is unlikely financial institution would offer today’s interest rates knowing that every loan they book will show a significant loss in the first year. This is a tremendous depletion of capital. Increased rates will harm borrowers, particularly those who can least afford to pay higher rates on loans.

This will make it more difficult or impossible for many consumers to get a loan. Institutions may offer long-term loans only to those borrowers with the best FICO scores which present the lowest level of risk.

For all of the reasons stated above, I strongly oppose the proposal.

Sincerely,

Randy Baldwin | EVP & Chief Financial Officer
Arizona Federal Credit Union
Phone: (602) 683-1150 | ArizonaFederal.org
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