May 29, 2013

Technical Director
File Reference No. 2012-260
FASB
401 Merritt 7
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Re: Financial Instruments – Credit Losses (Subtopic 825-15)

To Whom It May Concern:

Kohler Credit Union appreciates the opportunity to submit comments to the Financial Accounting Standards Board regarding the proposed Accounting Standards Update, Financial Instruments – Credit Losses (Subtopic 825-15).

Kohler Credit Union is a $269 million asset, member-owned, community chartered credit union, headquartered in Kohler, Wisconsin. Kohler Credit Union maintains six (6) full service branches and three (3) in-school branches serving approximately 35,000 members in Sheboygan, Calumet, Manitowoc, Ozaukee, Washington and Fond du Lac Counties of Wisconsin.

Kohler Credit Union appreciates FASB extending the public comment period in response to industry input and recognizes the efforts put forth by FASB to update its standards to adjust to the changing marketplace and needs for clearer disclosure. As FASB continues to work on its credit losses proposal, it is critical that FASB understand the unique structure of credit unions as not-for-profit financial cooperatives that operate for the purpose of promoting thrift.

FASB has proposed credit loss reporting changes that would utilize a single “expected loss” measurement for the recognition of credit losses. This would replace the multiple existing impairment models in U.S. generally accepted accounting principles that primarily use an “incurred loss” approach. The positive aspects of the proposal are that it more accurately measures the market value of loans and loan loss reserves and is a more conservative measure. However, we strongly encourage FASB to not implement the proposal as it stands currently.

The proposal advocates a current expected credit loss approach, which calculates the total losses over the lifetime of the loan. It uses the amortized cost method, which reflects the present value (PV) of all future cash flows expected to be collected, effectively reporting the loan loss reserves at market value. The proposal advocates an interest income approach that reflects the expected yield on cash flows, including loan losses and requires an estimate and immediate recognition of total losses for the life of the loan. It is not clear whether this means that credit unions would report both loans and loan losses at market value using PV discount analysis.

We ask the question as to the ultimate purpose of the allowance for loan losses – is it for safety and soundness or to calculate the present value of the cash flows for investor transparency and convenience? How does the proposal help from a safety and soundness perspective? We believe it would be inappropriate to apply the proposed changes to credit unions, based on their unique structure as private, not-for-profit, cooperatively owned, financial institutions. The primary user of the credit union’s financial statements is our regulators, who are not likely to benefit from the
proposed changes since they already have a well-developed understanding of the operations of the credit unions they regulate. FASB clearly states that their reason for proposing this methodology is that investors are asking for it as the best way to analyze the value of a financial institution. They argue that this transparency is important as an investor, versus a safety and soundness measure. Credit unions don’t have investors.

The FASB proposal 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. It recognizes all estimated future costs immediately. The FASB proposal causes an inconsistency in how we treat balance sheet instruments. It requires loans and loan loss reserves to be recognized at market value but other balance sheet instruments to be recognized at book value.

Predicting losses beyond one year with a reasonable degree of accuracy will be challenging and less reliable, if not impossible. Our core system and accounting system do not allow for these calculations at present. Economic conditions drive loan losses, yet economists are notoriously poor, at best, in forecasting longer-term economic conditions. Aren’t we better off evaluating short term when the economy is more easily predicted? If the economy were to worsen, say five years from now, as we got closer we would be able to more accurately adjust to that.

In addition, FASB doesn’t clarify what is meant by lifetime losses; they don’t tell us how to calculate lifetime losses; and they offer no standard methodology to project lifetime losses. The proposal maintains that historical experience is still a valid indicator of future losses, but doesn’t this depend on how much history we use and how many future periods this would accurately predict? The question and answer for #13 in the Frequently Asked Questions (issued by FASB on March 25, 2013) does not make sense and only seems to confuse the issue further.

Lastly, the FASB proposal is inconsistent with the International Accounting Standards Board (IASB). The IASB model uses a two-bucket approach: 12 month expected credit loss and lifetime expected credit loss for loans experiencing significant increased credit risk since origination. This more closely resembles the calculations done today.

If FASB moves forward with this or a variation of this proposal, it is crucial that there be an adequate phase-in/transition period of at least three years.

We appreciate the opportunity to share my thoughts on the proposal. Again, I would urge FASB to reconsider the proposed changes as addressed above. If you have questions or need further information, please feel free to contact me by telephone 920-439-2595 or by email at svandermeuse@kohlercu.com or jehmann@kohlercu.com.

Sincerely,

Sue Vandermeuse

Sue Vandermeuse, CUCE, CUERME
VP Internal Audit & Risk Management