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Proposed Accounting Standards Update: Accounting for Financial Instruments and Revisions to the Accounting for Derivatives and Hedging Activities

We appreciate the opportunity to comment on the proposed Accounting Standards Update ("ASU") entitled *Accounting for Financial Instruments and Revisions to the Accounting for Derivatives and Hedging Activities* ("the exposure draft"). BB&T Corporation and its subsidiaries offer full-service commercial and retail banking and additional financial services such as insurance, investments, retail brokerage, corporate finance, treasury services, international banking, leasing and trust.

We support the Financial Accounting Standards Board ("FASB" or "the Board") in its efforts to provide investors with useful, transparent and relevant information related to a reporting entity's exposure to financial instruments. We believe that certain aspects of the exposure draft move in the direction of achieving those objectives, including the steps taken to reduce the complexity surrounding the accounting for hedging activities. However, we believe that certain other aspects of the proposed guidance are flawed from a conceptual perspective and therefore should be reconsidered by the Board during its re-deliberation process.

We have summarized certain conceptual and operational issues that we believe warrant consideration in connection with the issuance of the final ASU related to financial instruments and hedging activities as follows:

The FASB and IASB must continue to work together to issue converged accounting standards related to financial instruments:

The current proposals by the IASB and FASB reflect vastly different approaches related to the classification, measurement and valuation (i.e. impairment) of financial instruments. We believe that certain concepts reflected in the IASB's exposure draft,

including the amortized cost option for various financial assets and liabilities more appropriately considers the objectives of a reporting entity's business model in determining the balance sheet presentation of financial instruments and therefore should be considered by the Board during its re-deliberation process. In addition, we believe the IASB's approach with respect to the use of an expected loss model to measure the impairment of financial instruments should be discussed and analyzed further. While we do not believe that the IASB's approach is operational in its current form, we believe that many aspects of the IASB approach have merit from a conceptual perspective and represent a more transparent approach to reflecting the risk of loss related to financial instruments.

In outlining the factors contributing to the lack of convergence between the two proposals, the Board indicated that its main objective was to develop accounting standards that represent an improvement to U.S. financial reporting, and that "an improvement in jurisdictions with less developed financial reporting systems... may not be considered an improvement in the United States." Based on our reading of the IASB's exposure draft and related comment letters, it appears that many aspects of the IASB proposal have been well received by preparers, financial statement users, regulators and audit firms. In light of this response, we believe that it would be counter-productive for the Board to discount the direction taken by the IASB in connection with its financial instruments project.

The Board also indicated that the phased approach taken by the IASB, and the timetables related to such an approach, contributed to the differing conclusions reached by the respective Boards. While we understand the Board's desire to address the accounting for financial instruments in a timely manner, we believe that the benefits of issuing a converged standard outweigh the benefits of issuing a non-converged standard in an expedited manner. In other words, the Board's stated concern could be easily remedied by using a different timetable with the same requirements. The end result would be a converged standard.

In light of all of the factors noted above, as well as the Securities and Exchange Commission's continued consideration of incorporating IFRS into the financial reporting system for U.S. issuers, we believe it is imperative that the respective Boards issue a converged accounting standard related to financial instruments. It is also important to keep in mind that the ability to reconcile the different proposals is not the same as having a converged standard.

Classification and Measurement

We acknowledge that the FASB has attempted to incorporate the merits of both sides of the fair value accounting debate in the exposure draft, primarily evidenced by the provisions of the exposure draft that allow for certain changes in fair value to be reflected in other comprehensive income. While the approach taken by the FASB is preferable to an approach that would require all changes in fair value to be recognized in net income, we have significant concerns related to the decision to move away from a mixed-attribute

measurement model and require the presentation of fair value information on the statement of financial position for substantially all financial instruments.

Convergence

The FASB's approach with respect to classification and measurement of financial instruments represents one of the significant areas of divergence from the approach taken by the IASB. We believe that it is noteworthy to highlight that this decision also diverges from the view expressed by the Financial Crisis Advisory Group ("FCAG") in its July 28, 2009 report, which states the following:

> *We believe that, for conceptual and/or practical reasons, a simplified mixed attribute model, rather than a full fair value-through-earnings model, is preferable.*

We previously outlined our desire for the Board to achieve substantial convergence with the approach taken by the IASB. Given that this area of divergence would lead to significant inconsistencies in reporting on a world-wide basis, we believe this issue must be reconciled prior to the issuance of final updated accounting guidance by either governing body.

Recent studies indicate that the majority of financial statement users favor a mixed-attribute measurement model supplemented by improved fair value disclosures:

PricewaterhouseCoopers ("PwC") conducted interviews with a broad spectrum of investment professionals in order to gain a better understanding of how potential financial statement users view the proposals put forth by the FASB and IASB. The results of these interviews were reflected in a publication issued in June 2010 that was entitled *What Investment Professionals Say About Financial Instrument Reporting*. While the results of this survey are by no means "scientific," we believe that certain key themes identified by PwC should be considered in the context of the proposed changes outlined in the exposure draft. We have summarized certain key findings as follows:

> *A majority of respondents favour a mixed measurement model, with fair value reporting for shorter lived instruments and amortised cost reporting for longer lived instruments (particularly bank loans and deposits) when the company intends to hold those instruments for the purpose of collecting the contractual cash flows. This view is held consistently across all geographies and industry sectors included in the survey sample.*
>
> *Respondents that favour the mixed measurement model think the information better reflects an entity's underlying business and economic reasons for holding an instrument...*
>
> *Fair value information for financial instruments is considered relevant and valuable by most respondents but is not necessarily the key consideration in their analysis of an entity...*

> *Respondents voice a consistent desire for improved disclosure of fair value information...*

The key findings reflected above (1) are consistent with the feedback we have received from investors and analysts, and (2) appear consistent with the feedback received by the IASB in connection with its exposure draft related to financial instruments. We believe this feedback clearly indicates that most financial statement users have concluded that management's intent with respect to a given financial instrument represents the primary factor that should be considered in determining the appropriate measurement model to apply.

While the majority of financial statement users appear to support the use of a mixed-attribute measurement model, we understand that certain financial statement users believe that fair value information related to financial instruments represents useful and relevant financial information. Given the inherent difficulty in estimating the fair value of long-term financial instruments as described below, and the lack of comparability that likely would arise, we believe that footnote disclosure of such information continues to represent the most reasonable means by which such information may be communicated to the financial statement user. In light of the comments above related to the need for improved financial statement disclosure, we would support a comprehensive project designed to reevaluate the disclosure requirements related to fair value measurements as an alternative to FASB's fair value approach related to loans and certain other long-term financial instruments.

The absence of reliable market data related to loans and certain other financial instruments represents a significant obstacle to providing users with useful and comparable fair market value information:

The following quote from the Financial Crisis Advisory Group's report dated July 28, 2009 outlines an important concept that must be considered in the context of the proposed changes to the classification and measurement of financial instruments:

> *It is also important to recognize that the quality of financial reporting can only be as good as the quality of the underlying data used by the preparer of the financial reports. Information about the fair value of assets and liabilities is, in many instances, dependent on well-functioning markets with infrastructure (including clearing mechanisms) that provide timely, reliable and relevant data.*

We believe that an expectation gap exists between the concepts outlined in the exposure draft and the ability of most reporting entities to comply with those requirements. The summary section of the exposure draft reflects the following statement regarding the Board's expectations related to the benefits of a fair value measurement model:

> *Fair value would provide users with the best available information about the market's assessment of an entity's expectation of its future net cash*

> *flows, discounted to reflect both current interest rates and the market's assessment of the risk that the cash flows will not occur.*

While we believe that reliable market information is generally available to estimate the fair market value of highly liquid financial instruments, we have significant concerns related to the availability of such information to support the fair market value of less liquid financial instruments such as loans. We reflected this concern in our 2009 Form 10-K as follows:

> *No readily available market exists for a significant portion of BB&T's financial instruments. Fair value estimates for these instruments are based on current economic conditions, currency and interest rate risk characteristics, loss experience and other factors. Many of these estimates involve uncertainties and matters of significant judgment and cannot be determined with precision. Therefore, the calculated fair value estimates in many instances cannot be substantiated by comparison to independent markets and, in many cases, may not be realizable in a current sale of the instrument.*

We believe that the disclosure reflected above provides an accurate summary of the challenges faced by BB&T (and likely most other financial institutions) in estimating the fair market value of loans. While we understand the Board's desire to provide "the best available information about the market's assessment of an entity's expectation of its future net cash flows," we do not believe that it is reasonable to assume that such information exists related to financial instruments such as loans.

In the absence of readily available market information, reporting entities would be required to make significant estimates regarding the market's assessment of an entity's expectation of its future net cash flows. The significance of the estimation required would likely result in wide variations in assumptions, thereby severely limiting the comparability, usefulness and relevance of the information being reflected in a reporting entity's balance sheet.

The requirement to present financial liabilities at fair value and core deposits at current value fails to provide useful and relevant information to financial statement users:

Paragraph BC98 of the exposure draft states the following with respect to the classification and measurement guidance related to financial liabilities:

> *The Board also believes that asset-liability management is core to the business strategy and analysis of financial institutions. The effects of changes in market variables affect valuations of both financial assets and financial obligations. Accordingly, like financial assets in the proposed model, many financial liabilities of financial institutions would be measured at fair value (with amortized cost also being presented for all financial liabilities). In addition, core deposit liabilities would be*

remeasured each period using a current value method that reflects the economic benefit that an entity receives from this lower cost, stable funding source. Thus, under the proposed model for a financial institution, the effects would be transparent on both core deposits and other financial liabilities and the financial assets they fund as market interest rates change.

We agree with the FASB in its conclusion that asset-liability management is core to the business strategy and analysis of financial institutions. From a theoretical perspective, we concur with the Board in its conclusion that financial liabilities should be presented at fair value to the extent that financial assets are required to be presented at fair value. However, consistent with our conclusions related to the relevance and usefulness of fair value information related to financial assets, we have significant concerns related to the requirement to present financial liabilities at fair value. These concerns are consistent with the views expressed by the FCAG in its July 28, 2009 report:

... as part of the financial instruments project, we have suggested that the Boards reexamine the reporting of gains from declines in the fair value of a reporting entity's own indebtedness within profit or loss, as entities are now permitted to do when they have elected the fair value option under either IFRS or US GAAP. While there may be some conceptual justifications, reporting gains in profit or loss seems counterintuitive and may not provide relevant, decision-useful information when the gain results from a change in the credit risk of the borrower rather than from the general price of credit, especially when the borrower lacks the ability to buy its own debt and actually realize the gain.

The Board's proposal provides reporting entities with the ability to reflect changes in fair value related to most financial liabilities in accumulated other comprehensive income, thereby addressing a portion of the concern expressed above. However, we believe the significance of other comprehensive income has effectively been increased through the Board's decision to require a continuous statement of comprehensive income. As a result, we believe that the FASB's proposal is not fully responsive to the concerns of the FCAG as outlined above.

Aside from the concerns related to reporting gains that arise from a decline in credit quality, we believe the presentation of financial liabilities at fair value is flawed from a conceptual perspective when the underlying business strategy related to these liabilities is to pay the related contractual cash flows. We have been unable to identify the benefit associated with presenting financial liabilities at fair value, aside from the symmetry that would be achieved (i.e. to the extent that long-term financial assets are presented at fair value, it would follow that long-term financial liabilities should be presented on the same basis). In the absence of a more compelling reason for presenting financial liabilities at fair value, we do not believe that such presentation provides the financial statement user with additional useful or relevant information. To the contrary, we believe that this requirement would decrease the transparency of a reporting entity's financial statements and potentially mislead certain financial statement users.

If a company cannot buy its debt at the fair value amount or it does not intend to buy its debt, then reflecting debt at fair value is irrelevant and potentially misleading. While we understand that certain financial statement users may find fair value related to financial liabilities useful, consistent with our conclusions related to loans and other long-term financial assets, we believe that footnote disclosure of such information remains appropriate.

Consistent with our conclusions related to the fair value requirement related to financial liabilities, we have not identified a significant benefit associated with the current value measurement approach. This measurement model requires the use of a substantial number of estimates and assumptions relating to (1) the quantification of "core deposits", (2) the implied maturity of core deposits, (3) the alternative funds rate for funding that would not be provided by a single source, and (4) the all-in-cost-to-service rate. To further complicate this process, substantially all of the estimates and assumptions noted above would need to be determined on a disaggregated basis in order to comply with the requirements outlined in the exposure draft. We struggle to understand how a measurement model with such a significant degree of estimation improves the comparability and consistency of the accounting for such financial instruments.

We also believe it is important to highlight that the concept of current value is neither understood, nor supported by the majority of financial statement users, preparers, auditors and others, as outlined in paragraph BC66 of the exposure draft:

> *The Board obtained feedback from users, preparers, auditors, and others about the potential operationality and usefulness of a current value measurement method. Although there was some support for current value, a majority of the input received was that current value was not sufficiently defined, resulting in wide-spread confusion about what it was meant to represent. Overall, there was little support for its use as an alternative to either fair value or amortized cost.*

Notwithstanding the conceptual concerns that we have related to the use of a current value measurement approach, we are troubled by the fact that the current value measurement approach would fail to achieve the symmetry that would be necessary if the Board continues down the path of requiring fair value presentation for significantly all financial instruments. The deposits held by a financial institution significantly contribute to the institution's overall enterprise value. We believe that the current value measurement approach, by its definition, fails to give appropriate consideration to all aspects of an institution's core deposits that drive enterprise value. While we are not supportive of FASB's proposed classification and measurement guidance, if the Board moves forward with its current proposal we believe that fair value measurement of core deposits should be considered.

The classification and measurement of financial instruments should give appropriate consideration to a reporting entity's business model:

We understand the FASB's desire to simplify the accounting related to the classification and measurement of financial instruments and believe that the "business strategy" criteria outlined in the exposure draft has merit from a conceptual perspective. We have discussed our concerns regarding loans above. We have also noted an overwhelming response from others in comment letters as well as other research and inquiries that loans should not be carried at fair value.

In addition, we believe the FASB's approach does not appropriately consider the business model employed by most financial institutions related to their securities portfolio. Securities portfolios represent a significant source of liquidity for financial institutions. As a result, these portfolios must be managed in a manner that is responsive to both dynamic funding requirements and changing market conditions. The composition of a financial institution's securities portfolio may change in connection with the execution of hedging strategies (i.e. interest-rate risk management) and frequently are used as a pledging source to support other transactions undertaken in the normal course of business. We believe these factors illustrate the difficulty that financial institutions would encounter in classifying debt securities using the fair value through other comprehensive income classification as outlined in the exposure draft.

While we believe the business strategy criteria outlined by the Board has merit from a theoretical perspective, in practice we struggle to understand how the criteria could be reasonably applied to most financial institutions' securities portfolio. This application issue is exacerbated by the prohibition against reclassifying a financial instrument from fair value through net income to fair value through other comprehensive income, and vice versa, after its initial measurement.

We believe that the current classification approach for securities (i.e. trading, available for sale and held-to-maturity) remains appropriate. The available-for-sale classification provides financial statement users with the most appropriate depiction of management's intent with respect to securities classified in this manner (i.e. it does not require management to reflect such securities as trading simply because it cannot assert that such securities will be held to maturity). In addition, available-for-sale classification also provides users with fair value information without subjecting a reporting entity to income statement volatility that does not correlate with management's intent related to the underlying securities.

However, to the extent that the Board determines that the proposed business strategy criteria must be adopted, we believe the prohibition against the reclassification of financial instruments should be eliminated in the final rules issued by the Board. As a means of achieving a more reasonable approach related to the classification and measurement of debt securities, we believe that it would be appropriate to allow for reclassifications of financial instruments based on changes in business strategy that are documented and supported by sufficient objective evidence. Such reclassifications would also be subject to disclosure requirements that would provide the financial statement user

with insight into the factors considered in determining that a change in business strategy was appropriate.

The Board should consider other approaches to simplifying the accounting for financial instruments:

We understand the FASB's desire to simplify the accounting for financial instruments. However, based on the factors noted above we believe the approach outlined in the exposure draft is flawed from a conceptual perspective and fails to achieve many of the objectives outlined by the Board. We believe that the following mixed-attribute measurement approach represents one alternative that should be considered by the Board:

- Fair value through net income – any financial instrument either originated or acquired with the intent to sell should be recorded at fair value with changes in fair value reflected in net income.

- Amortized cost – any financial instrument either originated or acquired with the expectation that it would be held for its duration should be recorded at amortized cost, subject to impairment testing and recognition.

- Fair value through other comprehensive income ("OCI") – any financial instrument not meeting one of the other two criteria should be recorded at fair value with changes in fair value reflected in OCI.

Since management intent represents the primary factor driving the classification of financial instruments, we believe that management should have the ability to reclassify financial instruments based on changes in management's intent as follows:

- Reclassification into fair value through net income – would occur when management with the appropriate authority commits to a plan to sell a financial instrument. Upon reclassification, the difference between amortized cost and fair value would be recognized in net income.

- Reclassification out of fair value through net income – would occur when management with the appropriate authority determines that the financial instrument will be held for the collection of its contractual cash flows. The financial instrument's fair value at the date of transfer would be considered its amortized cost for future measurement purposes.

- Reclassifications from fair value through OCI to amortized cost – such reclassifications would be infrequent. The financial instrument's fair value at the date of transfer would be considered its amortized cost. The fair value mark in OCI at the date of transfer would be amortized into income using the interest yield method.

We believe that periodic sales of financial instruments should not taint other similar financial instruments' classification to the extent that the sale was the result of changes in

management strategy. Changes in management strategy would need to be evidenced by changes in the economic environment, overall business strategy or other objective evidence.

The FASB should reconsider whether limitations on the use of the equity method of accounting are appropriate:

The exposure draft has established significant limitations related to the use of the equity method of accounting. Paragraph BC25 of the exposure draft provides some insight into the Board's thought process related to this change:

> *The Board believes that reporting entities have historically elected the fair value option when the investee's operations were not considered related to those of the investor's consolidation operations. Accordingly, those entities would now be required to measure such investments at fair value rather than having the option to do so.*

While the fair value option may be applied to equity method investments by certain reporting entities, we do not believe that requiring such an approach provides any meaningful benefit to financial statement users. As more fully described below, we believe that certain operational challenges that would arise from implementing such a practice would likely result in less transparent financial reporting related to many investments currently measured using the equity method of accounting.

Most financial institutions currently report their investments in low-income housing tax credit partnerships ("LIHTC's") using the equity method of accounting, since such a method generally results in financial reporting that most accurately reflects the economic substance of such investments. We believe that significant operational issues exist related to determining the fair value of such investments at each reporting date. A substantial portion of the economic value attributable to such investments arises as a result of the tax credits that are available to limited partners in such structures. Establishing the fair value of such tax benefits is problematic as such an estimate would require entity-specific views related to the tax credits and their related fair value.

In addition to our concerns related to operationality, we have concerns regarding the cost associated with adopting such an approach. The FASB shared this concern in paragraph 75 of SFAS 107, which was not codified as it was in the Basis for Conclusions section, as follows:

> *The Board believes that the incremental benefits of estimating fair value for unquoted investments accounted for under the equity method of accounting do not outweigh the related costs.*

In light of the operational issues described above, as well as the lack of cost-benefit associated with requiring fair value measurement for equity method investments, we strongly urge the Board to reconsider adopting limitations on the application of the equity method of accounting.

Credit Impairment Model

We understand the Board's desire to reevaluate the incurred loss model in light of the perceived weaknesses in this approach that became evident during the global economic crisis. Regardless of the ultimate approach selected by the Board in connection with this review, it is important to highlight that a significant degree of judgment will be required in determining the appropriate impairment of certain financial instruments at each reporting date. In light of this significant degree of estimation, we believe that any changes to the model should provide sufficient implementation guidance to facilitate consistent application of the model and appropriately consider operational challenges associated with implementation.

We have summarized our primary concerns related to the credit impairment model outlined in the exposure draft below. In addition, we have provided some additional commentary related to the use of an expected loss model and have outlined why we believe the Board should more fully evaluate the recommendations of the Expert Advisory Panel ("EAP") during the re-deliberation process.

The proposed changes to the credit impairment model related to financial instruments lack sufficient clarity:

Paragraph BC 174 of the exposure draft states the following with respect to the removal of the probable threshold:

> *The Board decided that a credit loss need not be deemed probable of occurring to recognize a credit impairment. The Board believes that removing the probable threshold would result in an entity recognizing credit impairments in net income earlier on the basis of its expectations about the collectability of cash flows rather than on a potentially arbitrary recognition threshold.*

While we agree that the removal of the probable threshold would likely result in the earlier recognition of credit impairment, we believe that the exposure draft fails to provide sufficient guidance related to the application of this concept, particularly as it relates to impairment that is evaluated on a collective basis. We acknowledge that many of the challenges associated with applying this guidance exist under the current authoritative accounting guidance, including determining "look-back" periods for historical net charge-off rates and establishing the appropriate degree that qualitative and environmental factors impact the estimation of the allowance for credit losses. However, we believe that the FASB's current project represents an opportunity to bring clarity to these issues, thereby improving the comparability of the allowance for credit loss estimates among reporting entities. We do not believe that the exposure draft in its current form provides this much needed clarity.

The credit impairment model adopted by the Board must provide for the use of objective, supportable assumptions related to future economic conditions:

We also have significant concerns related to the following provision reflected in paragraph 42 of the exposure draft:

> *In estimating cash flows expected to be collected for its financial assets at each reporting date, an entity shall assume that the economic conditions existing at that point in time would remain unchanged for the remaining life of the financial assets. An entity shall not forecast future events or economic conditions that did not exist at the reporting date in determining whether a credit impairment exists.*

We understand the Board's hesitancy related to providing a reporting entity with the ability to forecast future changes in the economy and the related impact that such changes would have on the carrying value of financial instruments. However, we believe that the provision noted above effectively requires a reporting entity to make the only assumption related to future events that is most assuredly wrong – that economic conditions will remain unchanged.

In addition, we believe that such a provision would have strong pro-cyclical tendencies, grossly exaggerating income during periods of economic expansion, and losses during recessionary periods. While we understand that the Board does not believe that pro-cyclicality should be considered a factor when evaluating the merits of proposals related to credit impairment, we respectfully disagree. We struggle to understand how the increased volatility that would arise from such a proposal would be considered an improvement for the vast majority of financial statement users.

We believe the FASB could effectively remediate this weakness by providing reporting entities with the ability to consider objective information related to expected changes in economic conditions (i.e. consensus views on future changes in the economic conditions). This modification would provide reporting entities with the ability to use the best information available in connection with the estimation of the allowance for credit losses, while at the same time ensuring that unsupportable projections related to future economic events are not considered. In order to ensure the comparability of such information, we believe that disclosure of the approach used to develop estimates related to future economic conditions should be required in the footnotes to the financial statements.

The obstacles outlined by the Board related to the use of an expected cash flow approach may be overcome:

The Board outlined its thought process related to determining that an expected loss approach was not desirable in paragraph BC 175 of the exposure draft as follows:

> *The Board decided not to pursue an expected loss model because the Board believes that oftentimes it would be difficult for an entity to accurately forecast expected cash flows through the life of a financial*

asset on the basis of forecasted future events. The Board also believes that it would be inappropriate to allocate an impairment loss over the life of a financial asset.

We understand the FASB's concern related to a reporting entity's ability to accurately forecast expected cash flows through the life of financial asset. While many reporting entities have a reasonable ability to forecast expected losses over periods of up to two years, forecasts of expected losses in later years would likely need to be derived from long-term historical loss rates. Notwithstanding these challenges, we believe that forecasting expected cash flows is much more logical than forecasting expected cash flows holding current economic conditions constant. In addition, we believe that it is important to highlight that certain existing authoritative accounting guidance, including the accounting for loans and debt securities acquired with deteriorated credit quality (ASC 310-30), already requires a reporting entity to estimate expected cash flows over the life of a financial instrument. As a result, we do not believe that the challenges associated with estimating future cash flows over the life of a financial instrument represent an insurmountable obstacle to the use of an expected cash flows approach.

In addition, we believe that the Board should reconsider its conclusion that it would be inappropriate for a reporting entity to allocate an impairment loss over the life of a financial asset. Financial institutions are compensated for the risk related to credit losses, as evidenced by the credit spread inherent in loan pricing. As a result, from a conceptual perspective, we believe that there is merit in establishing a provision for loan losses over the life of a financial asset.

We believe this concept was validated by the revenue recognition guidance reflected in paragraphs IN 15 through IN 17 of the Board's Proposed Accounting Standards Update related to Revenue Recognition (Topic 605) ("the proposed revenue recognition ASU"). The proposed revenue recognition ASU requires a reporting entity to adjust the transaction price associated with a given transaction in situations where the amount of consideration is variable. This guidance specifically mentions that customer credit risk is a factor that would result in transaction price variability. We believe that the guidance reflected in the proposed revenue recognition ASU could be directly applied to lending transactions.

The Board should give appropriate consideration to the recommendations of the EAP related to the potential use of an expected loss model:

Based on the conclusions noted above, we believe the Board should evaluate alternative impairment models, with a specific focus on expected loss models. We reviewed a sample of comment letters received by the IASB related to its exposure draft and concluded that most respondents support the use of an expected loss model, but have significant concerns related the operationality of the approach as outlined in the IASB exposure draft. On July 9, 2010, the EAP issued a summary of their discussions related to the IASB's exposure draft on impairment. We believe that many of the concepts outlined in this summary document have technical merit and should be more thoroughly evaluated by the boards of both the IASB and the FASB.

The EAP summary addressed a number of operational issues that warrant the FASB's attention. While most of these issues warrant additional consideration, we believe that two issues are particularly noteworthy. The EAP summary reflected commentary regarding the need for the "de-coupling" of contractual return and expected loss information. While the IASB and FASB proposals reflect certain significant differences, we believe that the conceptual issues outlined by the EAP related to this issue are representative of similar issues that would be encountered based on the FASB's proposed guidance related to interest income recognition. Please refer to the *Interest Income Recognition* section below for additional discussion related to this issue.

The second significant issue addressed by the EAP related to the importance of developing an expected cash flow approach that could be reasonably applied to open portfolios of loans (i.e. loans that are managed based on common risk characteristics.) The EAP summary report discussed the possibility of developing an approach to credit impairment that distinguishes between a performing ("good") book and a non-performing ("bad") book for purposes of estimating the allowance for credit losses. From a conceptual perspective providing for such differentiation appears appropriate based on the differences in the availability of detailed analysis (i.e. financial institutions manage their bad book much more actively and typically have more detailed analysis available to support impairment calculations).

While we have not fully analyzed the pros and cons associated with such an approach, we support the development of a credit impairment model that aligns with management's approach to managing the risks associated with its operations. We believe that leveraging processes currently used by management to operate the business results in better quality data and significantly reduces the cost of implementing a new model. While we understand that the Board is attempting to balance many competing priorities associated with the financial instruments project, we cannot over-emphasize the significance of the operationality. We encourage the Boards to continue working with the EAP to ensure that an appropriate balance is struck between the theoretical purity of the rules promulgated by the Boards and the practical application of those same rules.

We support the FASB in its efforts to improve the credit impairment model related to financial instruments, but have significant concerns related to the model outlined in the exposure draft. While the model being proposed by the FASB would result in the earlier recognition of losses, we believe the model fails to provide sufficient application guidance, thereby significantly increasing the risk of inconsistent application by reporting entities. We also have significant concerns related to the FASB's conclusion that allowance estimates must be made based on an assumption that existing economic conditions will remain unchanged.

We believe that the FASB's objections to the use of an expected loss model may be overcome, and therefore believe that further evaluation of an expected loss model should be undertaken. Based on the input provided by the EAP, it appears that the IASB expected loss approach carries significant operational issues that must be overcome prior to the final issuance of guidance related to credit impairment. We encourage the FASB and IASB to continue working towards reaching a converged approach related to credit

impairment that gives appropriate consideration to all of the feedback received during the exposure draft process.

Interest Income Recognition

From a theoretical perspective, the interest income recognition guidance reflected in the exposure draft has merit, and is consistent with the guidance reflected in the proposed revenue recognition ASU. However, we believe that the adoption of such an approach would (1) create significant operational challenges since most financial institutions manage interest income and the allowance for credit losses in separate systems and processes and (2) be viewed negatively by most financial statement users as both net interest margin and the allowance for credit losses are considered valuable performance indicators. As a result, we recommend the FASB re-evaluate the benefits associated with adopting such an approach and consider eliminating this provision from the final ASU adopted by the Board.

The operational challenges associated with the interest income recognition proposal reflected in the exposure draft are significant. As noted above, most financial institutions maintain separate systems related to interest income recognition and the allowance for credit losses. As a result, the implementation of these rules would either require significant investments in information-technology systems to integrate these separate systems, or manual intervention related to the interest income recognition process, likely driven by spreadsheets or other analyses that significantly increase the risk of error.

We also believe that the proposed guidance would result in the loss of significant financial metrics used by most analysts and other financial statement users. Net interest margin provides financial statement users with valuable information related to a reporting entity's investment decisions and effective use of leverage. Similarly, the provision for credit losses provides valuable insight into trends related to credit quality. The exposure draft would require a reporting entity to reflect excess provision that arises from the difference between contractual interest and the amount of interest income accrued to be reflected as a reduction to credit impairment expense (i.e. provision for credit losses). We believe that such a requirement would significantly decrease the usefulness of the provision for credit loss financial statement metric.

To the extent that the FASB continues down the path of linking interest income recognition and the allowance for credit losses, we strongly encourage the Board to consider the recommendations of the EAP related to the need for the separation of interest income recognition from the allowance estimation process (commonly referred to as "de-coupling"). We believe that developing a separate, high-level approach to determining the adjustment to contractual interest income, as opposed to requiring that such an adjustment be determined at the transaction level, represents a much more operational approach to implementing the concept being proposed by the Board.

Non-Accrual Guidance

From a conceptual perspective, we support the FASB in its efforts to promulgate accounting guidance related to determining when a reporting entity should cease accruing interest income on a financial asset. The approach outlined in the exposure draft has merit from a conceptual perspective when evaluated in conjunction with the interest income recognition guidance (since this guidance requires an entity to adjust its interest income recognition incrementally as the allowance for credit losses related to a given financial asset increases). Based on our opposition to the interest income recognition guidance described above, we have determined that it is appropriate to evaluate the non-accrual guidance on a standalone basis.

The non-accrual guidance reflected in the exposure draft would create a significant difference between regulatory reporting ("RAP") and GAAP. While we understand that the FASB has concluded that the consistency of RAP and GAAP should not be considered a significant factor in the context of the promulgation of GAAP, we believe that such differences would likely have a detrimental impact on certain financial statement users that rely on regulatory reporting to serve as a significant source of financial information. In addition, we believe that the operational challenges associated with tracking differences between RAP and GAAP should be considered a factor during the re-deliberation process. Significant differences between RAP and GAAP unnecessarily increase the complexity of a reporting entity's financial reporting, and result in the allocation of resources to track such differences that otherwise could be deployed to improve the overall quality of an entity's financial reporting. We encourage the FASB to work closely with the various regulatory bodies to minimize differences between RAP and GAAP that would arise in connection with the issuance of the final ASU related to financial instruments.

We also believe that it is important to highlight that the proposed non-accrual guidance reflected in the exposure draft would result in the loss of credit quality metrics that many financial statement users understand and highly value. We do not believe that the benefits associated with adopting the proposed approach outweigh the loss of these important credit quality metrics.

Derivative Instruments and Hedging Activities

We believe that many aspects of the guidance related to hedge accounting achieve the FASB's objective of improving the consistency and increasing the transparency of financial reporting related to hedging activities. We support the FASB in its conclusion that reasonably effective hedging relationships should qualify for hedge accounting. In addition, we believe that the use of qualitative assessments to evaluate the effectiveness of hedging relationships should streamline hedging documentation requirements, thereby allowing reporting entities to focus their attention on more important accounting and financial reporting matters.

While we support many aspects of the hedging guidance, we do not see a benefit associated with the provision significantly restricting the ability to de-designate/re-designate derivatives as reflected in the exposure draft. We do not believe that the ability to de-designate a hedge represents a significant financial reporting risk, and we are not aware of any significant issues that have arisen as a result of these provisions. We believe that the flexibility associated with de-designation must be maintained in order to provide reporting entities with the ability to adjust hedging relationships to reflect risk management strategies that are implemented at the enterprise level, without undue cost or other operational challenges. To the extent that the Board has concerns regarding de-designation strategies undertaken by reporting entities, we believe that additional disclosure requirements, designed to provide financial statement users with a more thorough understanding of the factors driving the decision to de-designate (or re-designate) could more appropriately address the Board's concerns.

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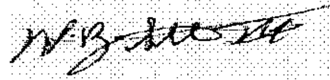
We would be pleased to discuss our comments with the Board members or the FASB staff at your convenience.

Very truly yours,



Henry R. Sturkie, III
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