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Via email: director@fasb.org

Technical Director
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856

Re: File Reference 1850-100, Leases (Topic 840)

Dear Technical Director:

TCF Financial Corporation ("TCF") is a Wayzata, Minnesota-based national bank holding company with \$18.3 billion in total assets. TCF, through its bank subsidiary TCF National Bank, has 440 banking offices in Minnesota, Illinois, Michigan, Colorado, Wisconsin, Indiana, Arizona and South Dakota, providing retail and commercial banking services. TCF also conducts commercial leasing and equipment finance business and commercial inventory finance business in the U.S. and Canada. TCF's leasing businesses, Winthrop Resources Corporation ("Winthrop") and TCF Equipment Finance, Inc, ("TCFEF"), finance equipment in all 50 states and, to a limited extent, in foreign countries. Combined, TCF's leasing companies represent the 13<sup>th</sup> largest bank-owned leasing operation in the United States and the 29<sup>th</sup> largest overall leasing operation in the United States.

We appreciate the opportunity to comment on the proposed Accounting Standards Update, *Leases (Topic 840)* (the "Proposed ASU"). We acknowledge the Financial Accounting Standards Board's ("Board") efforts to provide users of financial statements with a complete and understandable picture of an entity's leasing activities. However, as a lessor, lessee, and lender, TCF believes that, as currently written, the costs and time to implement the Proposed ASU will be significant without providing a benefit of additional meaningful information for users of financial statements like TCF as a lender. Our thoughts and specific concerns regarding the Proposed ASU follow.

#### **OUR VIEWS AS A LESSOR:**

The Proposed ASU suggests a very complicated approach to leasing for both lessors and lessees which, in TCF's opinion, will drive greater confusion and complexity to published financial reports. Historically, there has been a lack of substantive reporting or accounting issues with lessor accounting and it is our recommendation that the new lessor accounting rules closely approximate the direct financing lease rules that exist today.

Under current accounting, direct financing classification for lessors most clearly approximate other credit products and their respective accounting practices. Direct financing classification recognizes the "known" characteristics of the lease transaction as opposed to potential contractual contingency rentals and options. It is TCF's opinion that direct finance lease accounting matches the economic substance of the transaction. TCF prices lease transactions like an investment, that is, we determine the internal rate of return expected from the cash flows (rent, residual and tax benefits). Our service to the lessee materially ends upon their acceptance of the equipment and commencement of the lease, until the end phase or residual realization occurs. During the fixed term of the lease, the lessee controls the use of the equipment.

## **Derecognition and Performance Obligation Model Discussion:**

TCF is supportive of the derecognition method for lessors as it most closely resembles today's direct finance lease classification. The fundamental premise of using the derecognition method is that a lease transfers the value of the right to use equipment from the lessor to the lessee. The derecognition model also is symmetrical with the lessee Right of Use ("ROU") method reflecting the value transferred to the lessee.

The Proposed ASU, while on the right track with derecognition, misses the mark on residual accounting by not recognizing the economic effect of the residual. The Proposed ASU indicates that the residual should be classified as a fixed asset within property, plant and equipment, which TCF does not agree with. The asset cannot be used in our business and would significantly misrepresent the level of premises and equipment in use in TCF's business. The lease arrangement TCF typically enters into is a transfer of the right to use the equipment during the fixed contractual term, however we retain absolute title. We sell flexibility to our customers whereby they may, at the end of the fixed term, either 1) return the equipment to us, 2) renew/extend the lease, or 3) purchase the underlying equipment. In the majority of TCF's lease transactions the equipment is ultimately retained by the lessee at the end of the term. Therefore, it is TCF's view that the residual value of the equipment is a financial asset similar, but separate from the minimum lease payment receivable, and is considered to be collateral to the lease in addition to representing the un-leased portion of the equipment. The residual asset should be accreted to its fair value over the term of the lease. Residual realization is the cash flow that occurs upon expiration of the lease and is just another aspect of the lease lifecycle which is taken into consideration as an economic factor in entering into the transaction as a whole. Under the Proposed ASU, when the lease commences, a financial asset

associated with ROU is created, sold and recognized by the lessee. The residual is included in the determination of the pricing or determination of the financial asset associated with the ROU asset recorded by the lessee. In our view, the residual is considered to be collateral and should not be separated from the recorded asset by classifying the residual as premise and equipment.

TCF is not supportive of the performance obligation method for lessors. It misrepresents the lease transaction by unnecessarily grossing up the assets on the balance sheet by capitalizing the contract and leaving the leased asset on the books at its original cost. While the Proposed ASU suggests a combined presentation of the assets and liabilities created in the performance obligation method, the method also unnecessarily grosses up revenues and expenses. TCF does not believe the performance obligation reflects the economics of the lease. The performance obligation method is suggested to be appropriate when a lessor retains exposure to the significant risks and benefits associated with the underlying lease. The performance obligation method would also be required when the duration of the lease term is not significant in relation to the remaining useful life of the underlying asset or if a significant change in value of the underlying asset at the end of the lease term is expected. In TCF's opinion, if the value of the ROU has been transferred and the lessee has accepted the equipment, the lessee controls the use of the equipment and the ROU should be derecognized on the lessor's balance sheet.

In addition, the Proposed ASU does not provide sufficient clarifying guidance on the definition of risk retention, as used in the determination of which method, performance obligation or derecognition, to apply. In paragraph B26, the Proposed ASU states the existence of one or more indicators is not conclusive in determining whether the lessor retains significant risks or benefits, and that credit risk is not to be considered. The Proposed ASU states that the business model will indicate which method is appropriate. The vague wording in the Proposed ASU will create inconsistencies as differing entities may make classification decisions based on a business wide, portfolio by portfolio or transaction by transaction basis. Without clearer guidance on the risk retention concept, this aspect of the Proposed ASU will cause inconsistent interpretation by reporting entities and their accounting firms.

# **Contingent Rents and Options Discussion:**

TCF does not believe contingent rents and options meet the definition of assets for lessors or liabilities for lessees until the contingent event is probable. Within the Proposed ASU, a lessor must consider the probability of a lessee exercising contingent rents and options as part of recording the initial lease. Estimates are not reliable when unexercised contingencies or options remain open for an extended period of time, for example, three to five years, or longer. Inclusion of contingent rents and options will cause profit and loss volatility due to periodic adjustments of exercise probabilities, will add undesired complexity, will reduce comparability between companies, and may increase risks of financial statement manipulation through the significant increase in assumptions within the accounting framework.

TCF is also concerned about the burden of estimating thousands of transactional contingent rents and options across our portfolios, not only at inception of the lease, but for each subsequent reporting period. In our view, the benefit of providing users with a hypothetical impact based on a probability of exercise assessment is low. TCF provides contingent renewal rent options, not to disguise rentals, but to provide lessee flexibility in times of uncertainty. We believe the flexibility provided by contingent rentals and other options are what make leasing an attractive alternative to equipment purchase. These opportunities are controlled by the lessee. TCF recommends that contingent rent and options be included in the lease stream only if probable of occurance. The Proposed ASU's standard of more likely than not is too low of a threshold and creates significant up front and ongoing additional work to record a direct finance lease.

#### **OUR VIEWS AS A LESSEE:**

TCF appreciates that a key driving force behind the lease accounting project is to address the off-balance sheet nature of operating leases. Our leasing businesses' primary marketing tool is not off-balance sheet treatment; therefore we do not argue the merits of maintaining that treatment. We believe the proposed accounting change will affect us in three ways: 1) behavioral changes by lessees; 2) specific accounting requirement changes that will impact us as a lessee, primarily for facilities; and 3) changes to financial statements of our commercial lending customers.

Behavioral changes by lessees and the market impact that will result from requiring lessees to capitalize lease obligations are considered to be potentially detrimental to the leasing industry. This will likely occur where a lessor's main selling point is off-balance sheet financing and is of particular importance in the healthcare sector, where rental expense for lessees is a reimbursable expense under Medicare and depreciation and interest expenses are not. The Board should note that just the issuance of this Proposed ASU has directly impacted TCF's business as lessees have become hesitant to initiate new contracts due to the uncertainty of the accounting treatment and timing of any changes.

The Proposed ASU creates unnecessary complications in lessee accounting concerning contingent rental and option requirements and increased revaluation requirements at each reporting date. For example, under the Proposed ASU, leases that automatically renew until cancelled could essentially create assets with indefinite lives. Another example is the lease of traditionally non-depreciable assets such as land. Assuming the exercise of indefinite lease extensions, there is no clear guidance for determining the appropriate useful life of these types of assets, and as a result, we feel it would be inappropriate to amortize them. Instead, the estimated life of non-depreciable assets, such as land, should be related to a corresponding asset, such as a building, which has a determinable life. If no such asset exists, the requirement to determine an estimated life of such non-depreciable assets should be scoped out of the Proposed ASU. Determination of the amount of interest expense on such a lease would be equally challenging. This

complexity alone may persuade potential lessees to move away from leasing, opting towards other financing alternatives. Although many real estate investors do not want to sell land, but to lease it to maintain indefinite cash flows, some for future generations of families. Therefore, the ability to find reasonable retail locations may be constricted due to this new accounting.

From a lessee perspective, the true cost of a leased asset is the cash required under the lease terms. TCF supports the capitalization of lessees' operating leases, but we believe expenses should remain straight-line, which matches the economic nature of the right of use lease. Maintaining straight-line rent expenses also matches the tax and legal view of rent expense and would alleviate the need for complicating deferred tax accounting related to timing difference generated by the Proposed ASU.

To accomplish the capitalization of the ROU asset and liability, TCF recommends the best approximation of the value at inception is the present value of the contractual rental stream using the lessee's incremental borrowing rate over the term of the lease. The asset and liability are linked in the same contract. Both should be amortized using the same method, effectively offsetting each other ("linked accounting") since the asset and liability cannot be settled independently. Straight-line rental expense classified as an operating expense should be recorded. Any future material change should be recorded as an adjustment for both asset and liability and reflected in the income statement.

Without the use of "linked accounting", the lessee faces the prospect of increased lease costs resulting from the front-end loading effect of leased asset expense. Should a company's expansion rate and use of leasing increase, the front-end loading effect can be ongoing, resulting in the company appearing less profitable compared with competitors that don't use lease financing.

TCF agrees with a carve-out for short-term leases with a maximum possible lease term, including options to renew or extend, of 12 months or less to ease the cost of tracking and recording such leases. We recommend an additional scope carve-out for smaller leases, such as copiers, postage machine rent contracts, or other small dollar leases, when they are not core assets even when, in aggregate, they exceed a materiality threshold.

## **OUR VIEWS AS A LENDER:**

TCF, as a lender that reviews customer financial statements in order to make credit and pricing decisions, wishes to reiterate some of the points above. Contingent rents, including optional renewal periods, only meet the definition of a liability when the contingency is probable of occurring and can be estimated. Continuous adjustment to estimates will clearly be burdensome and will not provide additional clarity to TCF's lenders as they attempt to understand subsequent changes to the statements. Capitalization of non-bargain end-of-term options, such as renewals, does not meet the definition of a liability when exercise is not probable.

As a lender, our primary focus for commercial customers' financial statements are net operating income, debt service coverage and sources and uses of cash flows. The Proposed ASU will take significant effort to determine the effects on thousands of customer contracts and to modify covenants to new metrics that would need to be determined post implementation. TCF does not believe the cost and effort to modify all commercial contracts is worth making the change to put leases on the balance sheet. In addition, the modifications of covenants would likely create additional issues due to the proposed changes to accounting for trouble debt restructurings which TCF opposes.

## TRANSITION:

TCF disagrees with the simplified retrospective approach towards transition. These changes are complex and will be significant for both lessees and lessors. TCF recommends that capital leases for lessees and direct finance leases for lessors be grandfathered in as the financial impact should not be significant. For lessees with off balance sheet leases at transition there will be significant impact to financial statements, particularly with the impact from the resultant front-loading of expense that is proposed. If the front-loading aspect could be solved it would significantly reduce the impact for lessees including deferred tax accounting. The time required to complete the transition will be significant due to complexity of changes, underlying system changes and other accounting changes. TCF recommends the implementation effective date to be set as the first annual reporting subsequent to 2-3 years after the final issuance of the accounting standards update.

As is so often the case when abuse occurs as in the use of other forms of off balance sheet vehicles, there is a tendency for the pendulum to swing too far. Unfortunately lease accounting is an innocent bystander in this change. Certain aspects of the Proposed ASU are overly complex and create significant operational challenges that are incremental to today's business environment. Change in accounting approach is appropriate when it achieves its goal of allowing users of financial statements to make more informed investment and credit decisions. TCF respectively suggests this goal be used in formulating the final changes to this standard.

We appreciate the Board's consideration of our views.

Sincerely,

David M. Stæutz

Senior Vice President, Controller and Assistant Treasurer