April 1, 2011

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

Re: File Reference No. 2011-150; Supplementary Document — *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities — Impairment*

Dear Ms. Cosper:

Citigroup appreciates the opportunity to comment on the Supplementary Document — *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities — Impairment* (the Supplementary Document, SD, or the proposal).

We commend the Boards for their efforts to achieve convergence in this critical area. The FASB and IASB need to continue to work together on the impairment accounting model, which is critical, as well as the other parts of the financial instruments project, in order to eliminate the differences in their models and to issue a fully converged standard. However, if convergence for financial instruments in areas other than impairment, such as classification and measurement, is not achieved, we believe there would inevitably be very material differences in the application of the impairment model. For example, if asset classification and measurement models of the two boards do not consistently define which assets should be reported at amortized cost or fair value through OCI, and which ones at fair value through net income, the scope of the impairment model would differ significantly under the standards of each of the Boards.

Without convergence, financial statements of U.S. companies reporting under U.S. GAAP and foreign companies reporting under IFRS would not be comparable. Moreover, failure to achieve convergence in this area would have a very detrimental impact on financial institutions and global companies, such as Citigroup, with subsidiaries that apply IFRS for local reporting. We would be required to maintain accounting records under both U.S. GAAP and IFRS indefinitely, which is operationally burdensome. Additionally, as the SEC is finalizing the timetable for the

eventual adoption of IFRS for U.S. registrants, we are very concerned that U.S. GAAP registrants will be required to implement significant changes in U.S. accounting standards for financial instruments that are not convergent with IFRS and shortly thereafter be required to undertake a second significant implementation effort when adopting IFRS.

In principle, we support the proposed impairment model for open loan portfolios. However, the limited scope of the Supplementary Document makes it difficult to comment on this model. There are many significant issues related to impairment that need to be addressed (e.g. impairment recognition and measurement for revolving loan portfolios, closed loan portfolios, purchased impaired loans and loans modified in troubled debt restructurings (TDRs), measurement of credit losses, definition of write-offs, securities, measurement and recognition of interest income, etc.). While we understand that the Boards intend to consider the feedback received on this proposal in addressing these issues, we do not think it is feasible to fully evaluate an impairment model in isolation for loans in open portfolios without considering how that model would be applied to other types of loans. We recommend that the Boards consider the comments received for this impairment model, conduct field testing and incorporate those findings into a comprehensive proposal that addresses credit impairment as well as classification and measurement of financial instruments.

It is essential that the revised comprehensive accounting model for financial instruments be re-exposed for comment after full field testing by the Boards. Because of the critical nature of this accounting standard for financial institutions, there should be at least a 90-day comment period so that all issues can be fleshed out and unanticipated consequences can be avoided. We urge the Boards not to finalize a standard on impairment before another exposure draft is issued for comment that addresses financial instruments comprehensively, including classification and measurement, hedge accounting, and impairment. Within the impairment section, the comprehensive exposure draft should provide further guidance and clarity on the issues contained in the Supplementary Document, as well as on those issues that still need to be addressed.

In addition to developing a comprehensive model for all financial assets to be evaluated for impairment, we believe significant improvements are needed before the proposed model can be finalized even for open portfolios:

- Critical terms, such as “good book”, “bad book,” “foreseeable future,” “nonaccrual loans” and “write-offs” need to be well defined.
- Credit impairment requirements for loans modified in TDRs should be established; they should be subject to the same impairment accounting model as other loans and would be included in the “bad book” until such time as they demonstrate a sustained period of performance under the restructured terms, at which time a transfer to the good book is warranted.

- Credit impairment requirements for purchased impaired loans should be established; they should be subject to the same impairment accounting model as other loans.
- Discounting should not be applied to estimated credit losses, since it would add further complexity and, from the financial statement user perspective, confusion to this already complex model.
- Guidance on how the proposed model would be applied to portfolios of revolving loans is needed.
- Robust examples encompassing several periods of time in a portfolio's life should be provided.

The proposal would create a significantly increased operational burden as systems revisions would need to be implemented and/or new systems would have to be developed to comply with the SD's tracking requirements for weighted average total life and weighted average age of loan portfolios. Also, the proposed approach would result in the maintenance of two different financial reporting systems to support the calculation of expected losses over the foreseeable future period and time-proportional life-of-loan expected losses. Under the proposal, these two impairment models would be required to run concurrently. The development of all these new systems would require an enormous investment and significant amounts of time and resources to implement across the financial services industry.

We believe that more time is needed to provide adequate feedback on this proposal. Since the comment period coincides with the preparation of year-end and first-quarter financial statements, we have not had sufficient time to properly evaluate the proposed impairment model. We believe that the proposed impairment model requires additional field-testing in order for us to conclude whether it is operational. We are concerned that a lack of adequate consideration due to the short time-frame may result in the issuance of a poor impairment standard.

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Additional detail can be found in our responses on the specific questions outlined in the SD, included in the following Attachment.

We would be pleased to discuss our comments with you at your convenience. Please contact me at 212-559-7721.

Sincerely,

Robert Traficanti
Deputy Controller and Global Head of Accounting Policy

Cc: Sir David Tweedie, Chairman
International Accounting Standards Board
30 Cannon Street
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EC4M 6XH
United Kingdom

Attachment

General

Question 1: Do you believe the proposed approach for recognition of impairment described in this supplementary document deals with this weakness (ie delayed recognition of expected credit losses)? If not, how do you believe the proposed model should be revised and why?

While we acknowledge concerns with the current "incurred loss" model in ASC 450, we believe that the proposed approach lacks the clarity needed to calculate an impairment estimate. We believe that "foreseeable future" needs to be better defined and a distinction between that period and lifetime be clearly articulated. We are concerned that the proposed impairment model lacks an objective and clear principle. While the proposed model would deal with concerns about delayed recognition of credit losses by requiring losses to be recognized earlier, the recognition of higher credit losses is not a principle and would not serve as a good basis for a financial reporting model. We support the general principle existing in current GAAP in ASC 450 (formerly FASB Statement No. 5) where losses are recorded when incurred, rather than when it is estimated those losses would occur in the future. The proposal would be a significant departure from the current incurred loss model, which is widely applicable to areas beyond estimation of loan loss reserves (e.g., litigation loss contingencies, certain guarantees). If the proposed model were applied to these areas by analogy, it would have the effect of compromising a principle that is well understood. The Boards should clarify whether that is their intent.

In addition, the SD's proposed impairment model would still be pro-cyclical, as the proposal would require entities to book significant credit reserves for the foreseeable future (as currently defined in the SD) at the bottom of the economic cycle, which may result in immediate recognition of effectively the entire lifetime expected credit losses, since that amount would exceed the time-proportional credit loss amount. Conversely, at the top of the economic cycle, entities may have to record much smaller credit reserves, because their credit losses would be based on the time-proportional credit loss amount. Moreover, as discussed in the response to Question 4 below, in the case of revolving loan portfolios, neither the joint proposal in the SD nor the IASB proposal is operationally feasible.

Scope – Open portfolios

Question 2: Is the impairment model proposed in the supplementary document at least as operational for closed portfolios and other instruments as it is for open portfolios? Why or why not?

Although the supplementary document seeks views on whether the proposed approach is suitable for open portfolios, the boards welcome any comments on its suitability for single assets and closed portfolios and also comments on how important it is to have a single impairment approach for all relevant financial assets.

We support the reduction of complexity and minimizing the number of different impairment models applicable to financial assets. We believe that the application of a single impairment model approach for all loans included in the "good book" and expected lifetime losses for all loans included in the "bad book" would be operational with the possible exception of revolving loan products. Deriving the average age and life for these portfolios is quite complicated and additional guidance in this area, in order to ensure consistency among institutions would be useful.

However, a single model would not work for all other financial assets. More specifically, while the proposed model would work for open portfolios of loans, we do not believe that that the same proposed impairment model could be applied to debt securities. Debt securities are generally analyzed on an individual rather than a pooled basis because the credit exposure is with a particular issuer, rather than a type of borrower. Although entities may combine identical securities (e.g., those having the same issuer) for impairment evaluation, there is no concept of combining securities that have "similar characteristics" for purposes of an impairment evaluation. Therefore, we believe that securities should be treated differently than open portfolios of loans. Moreover, we believe it would be appropriate to have no allowance for credit losses for certain securities (e.g., U.S. government bonds and notes), but it is not clear that a zero loss reserve would be acceptable under the proposal.

Within financial assets evaluated for credit impairment individually, we do not think it is feasible to fully evaluate whether separate impairment models should apply for securities without knowing what the Boards are thinking in terms of the proposed model. However, since the current impairment guidance in ASC 320 (formerly FAS 115-1 and FAS 124-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*) works well for securities, we suggest that the current "other-than-temporary impairment" (OTTI) guidance be retained for securities. However, the current impairment model for securities would not work for individually evaluated loans, because the OTTI model is dependent on the securities' fair value as a trigger for impairment analysis. For most loans, the fair value is not as readily available as it is for most securities.

If the Boards intend to apply the open portfolio impairment model to securities, the Boards should, at the minimum, provide examples of the characteristics of debt securities that should be evaluated as being "similar."

Additionally, we want to emphasize our belief that there is no conceptual basis for having different impairment models for originated assets, assets purchased with a discount related to credit quality and loans modified in a troubled debt restructuring. With the changes to the overall impairment model, a separate credit impairment model for purchased assets and TDR loans is no longer justified.

Differentiation of credit loss recognition

Question 3: Do you agree that for financial assets in the 'good book' it is appropriate to recognize the impairment allowance using the proposed approach described above? Why or why not?

While we are concerned about the lack of sufficient time to consider the proposed impairment model adequately, based on the time available, our conclusion is that we could support the proposed impairment model for the good book in principle, if the Boards provide clarifying guidance regarding certain key terms. We agree with the basic principle that in any model that requires estimation of the life-of-loan losses, such credit losses should be recognized over the life of the loan, rather than be recognized immediately.

However, in order for the model to be operational, the concept of foreseeable future needs to be clearly defined. In current accounting literature, the term "foreseeable future" covers differing time horizons, depending on the industry and specific accounting standard. For example, ASC Topic 740-30-25-19 (formerly APB 23) guidance for income taxes requires a U.S. parent company to recognize an income tax liability on undistributed earnings of a foreign subsidiary "If circumstances change and it becomes apparent that some or all of the undistributed earnings of a subsidiary will be remitted in the foreseeable future…". Our understanding is that a one-year timeframe is used in practice to evaluate the foreseeable future under APB 23 and FAS 109 (paragraph 34). Similarly, we ask that for estimated credit losses the Boards define foreseeable future as a period of 12 months, except that loans with less than a 12-month expected life would use that shorter period, to ensure consistency and comparability across reporting entities.

While we recognize that there may not be a strong conceptual support for the threshold being 12 months (just as there is no conceptual reason for the foreseeable future period to be no less than 12 months as proposed in the SD), it is challenging to come up with a definition that would not be completely subjective. Because of that challenge, the Boards left the determination of the maximum foreseeable future period up to each individual entity. We are concerned about that and believe the foreseeable future horizon needs to be clearly defined to minimize subjectivity, improve comparability across entities, and limit the potential ability of an entity's management to manipulate the credit loss estimate. We observe that estimated credit losses during the foreseeable future become increasingly subjective the farther the period extends beyond 12

months. We also note that without a clear threshold, the information will be more difficult to audit.

Our understanding is that the banking regulators outside the U.S. have often allowed the loan loss reserve to cover less than 12 months, whereas the U.S. banking regulators have generally required at least a 12-month incurred loss period. Because of the difference in the way banking regulators in the U.S. and in other countries have applied the current incurred loss model, it becomes increasingly important to provide a clear definition of the floor for credit losses. Additionally, the foreseeable future period as stated in the current proposal may be much shorter for smaller less sophisticated companies than for larger financial institutions with more sophisticated models and better resources to estimate future credit losses (although even for these larger financial institutions, the loss estimates are still very subjective the farther out they go). Furthermore, the floor as currently defined in the SD can be a longer period in an economic environment with low volatility versus when the economy is very volatile. Since the SD does not define the upper limit of the foreseeable future period, the proposal will extend or even widen the lack of comparability that exists today among financial institutions of different sizes and across geographies.

Also, we are concerned about the applicability of the proposed time-proportional expected lifetime credit loss approach to certain revolving products, such as credit card receivables. The time-proportional remaining lifetime expected credit loss approach requires the computation of weighted averages, such as weighted average age and weighted average total life of the portfolio. These weighted averages require mathematical computations that involve specific loan balances with corresponding total lives and ages (since origination) of the specific loans. The proposal requires the updating of these weighted averages each reporting period. One revolving credit card account can be composed of hundreds of separate origination transaction amounts at hundreds of different origination dates, with each origination having a different life and different age. Credit card receivable balances are reduced through cardholder payments. Some cardholders pay their balances in full each month while others only pay a percentage of their balances. It is not operationally feasible to compute, track and update every period the weighted average age and weighted average total life of balances for millions of credit card accounts, the majority of which each have hundreds of underlying individual loan origination dates and multiple balance pay down scenarios. This process would require the balance of each account to be dissected and tracked by transaction origination date and remaining amount after application of payments and credits, requiring billions of individual records. We are asking the Boards to clarify how the time-proportional expected lifetime credit loss approach could be simplified and applied to credit card receivables and other revolving products. As discussed further in the response to Question 4 below, in the case of revolving loan portfolios, neither the joint proposal in the SD nor the IASB proposal is operationally feasible.

Finally, we would like to highlight that the time-proportional approach to measuring impairment places a greater burden on smaller financial institutions and entities outside of the

financial services industry which may lack operational capacity and sophistication to apply this complex model.

We agree that the bad book impairment allowance should always be equal to the remaining lifetime expected credit losses.

Question 4: Would the proposed approach to determining the impairment allowance on a time-proportional basis be operational? Why or why not?

While the proposal significantly increases the operational burden compared with the current accounting, we believe that it can be operational if our concerns in this letter are addressed by the Boards. However, we believe the illustrative example shows an unrealistic static case where loss estimates do not change over time. The Boards should provide an example that illustrates how the time-proportional allowance would be calculated when the life-of-loan expected loss estimates change over time.

Generally speaking, the portfolio statistics needed to determine the time-proportional balance, or "TPA," are common risk management analytics and as such should be available, albeit on a time lag that will vary by institution. However, we anticipate significant operational issues when applying this model to our revolving loan portfolios, particularly credit card portfolios. The joint proposal employs a "time-proportional amount of remaining lifetime expected credit losses." Both the age and total life components of the time-proportional methodology require the computation of weighted averages. Weighted average total expected life is a mathematical computation involving specific loan balance amounts with corresponding specific loan lives. Weighted average age is a mathematical computation involving specific loan balance amounts and their age, i.e., days since origination. The proposal requires the updating of these weighted averages each reporting period (paragraph B9).

One revolving credit card account balance can be composed of hundreds of separately originated loan amounts (each transaction charged to a credit card). Each charge is a separate loan origination and has a different amount. In order to determine a weighted average life, each cardholder's total balance would have to be dissected into the separate loan originations that form the ending balance. Each such separately identified balance would have to be assigned a life (based on the payment rate of the underlying account holder). Then the weighted average mathematics would be applied to these two factors to compute a weighted average life. This computation would require input of hundreds of millions of individual credit card loan transactions and would be complicated by changing payment rates and multiple payment rate patterns within individual cardholder accounts. For example, some cardholders have balances that bear varying interest rates. Bank regulations require that cardholder payments be allocated to higher interest rate balances first.

Even greater difficulties would be encountered in computing weighted average age. Each lending transaction would have to be tracked by origination amount, origination date and payments applied thereto to determine a weighted average age. Again, this would entail hundreds of millions of records with associated tracking requirements.

The paragraphs above describe the complex calculations for determining the weighted average life and age for individual cardholders. Once that process is completed, then a similar complex series of calculations would need to be performed for each portfolio. Accordingly, computation of such weighted averages is not operationally practical for revolving loan portfolios.

We understand that the expectation of the FASB and IASB may be that revolving loan portfolios would be approached in a manner similar to the Basel II methodology. We believe that such an approach was discussed at the FASB and IASB staffs' meetings with the advisory panel. Under the Basel II approach, each outstanding charge would not be considered a separate loan. Rather, one would focus on the entire account as the unit of analysis. The relevant age in the time-proportional approach would be the age of the account, not the age of the current outstanding charges, and the total age would be the age of the account plus its expected remaining life.

Use of the Basel II methodology, which is limited to internationally active banks, to derive an allowance for loan losses applicable to small balance revolving loan portfolios, such as credit cards, entails a system intensive process involving significant data collection and highly complex and sophisticated calculations. We are investigating the feasibility of employing such a methodology, but have not reached any conclusions. Furthermore, non-covered financial institutions or non-bank finance companies would not have had any reason to devote any attention to such an exercise. If the Boards believe that the Basel II methodology should be used for revolving loan portfolios, such methodology should be exposed for comment as part of the comprehensive exposure draft to allow companies to evaluate whether or not it is operationally feasible.

Question 5: Would the proposed approach provide information that is useful for decision-making? If not, how would you modify the proposal?

We believe that the definition for foreseeable future and the distinction between the "good book" and the "bad book" need to be clarified in order to provide useful, comparable information across reporters. We believe that the proposed approach could provide information that is useful for decision-making as long as there is accompanying disclosure of which approach was used to establish the impairment reserve and, if there was a change in approach compared with the prior period, an explanation of the factors that caused the change. In order to provide additional information that may be useful for the users of financial statements, we suggest that entities should disclose the basis for recognition of the current credit loss reserve (i.e., whether the recognized credit losses are based on the foreseeable future floor or time-

proportional amount). Otherwise, the changes in the allowance from period to period would be difficult for management to interpret and users to comprehend, particularly when the basis for recognition shifts from the time-proportional approach to the foreseeable future approach and vice versa.

Question 6: Is the proposed requirement to differentiate between the two groups (ie 'good book' and 'bad book') for the purpose of determining the impairment allowance clearly described? If not, how could it be described more clearly?

While we agree with the proposed requirement to differentiate between the good book and bad book, the proposed guidance that loans would be transferred into the bad book when "collectability becomes so uncertain the credit risk management's objective changes from receiving the regular payments from the debtor to recovery of all or a portion of the loan" is insufficient. The method proposed to differentiate between the good book and the bad book is based on management's strategy applied to the loans (i.e., a strategy to generate revenue vs. a strategy to forego revenue and focus on collection). Management's strategy is not always clear-cut and singularly focused. Strategies can have multiple objectives in differing degrees depending upon changing circumstances and future projections. Furthermore, different organizations may have different views and differing strategies when faced with similar circumstances.

Accordingly, we believe that the guidance should focus on the loan's characteristics rather than on internal credit risk management's objective and propose that separate criteria be used to differentiate loans that, due to their size and nature are individually evaluated for impairment from loans that, due to their size and volumes, are managed on a delinquency basis. We also propose that a corporate loan should be transferred to the bad book when it is impaired, using the current definition of impairment plus loans that are receiving special management attention for corporate loans, because they have been identified as high risk (e.g., classified II-substandard performing loans). We believe that 90+ days past due should be used as the "bad book" threshold for consumer loans managed on a delinquency basis. In addition, any consumer loans modified in a troubled debt restructuring should be included in the "bad book".

However, if this suggestion is not accepted, then the Boards need to clarify the triggers that indicate that a loan should be transferred from the good to bad book. The issue is that most of the examples in paragraph B3 seem to suggest too late a timeframe for recognizing that a loan belongs in the bad book. In one instance, the transfer seems to be required too early, as merely contacting delinquent borrowers by mail or phone is a routine first step and may not yet indicate that the loan collectability is so uncertain as to warrant the transfer to the bad book.

Additionally, we are asking that the mechanics of recording the transfer from the good book to the bad book as well as how to adjust the good book and bad book allowances for credit losses at the time of transfer to the bad book be clarified in an illustrative example.

Finally, we are asking for clarification as to when a loan may become eligible for transfer from the bad book back to the good book. The SD does not currently address when such transfers may occur. For example, assuming that a loan that is modified under a TDR is transferred to the bad book at the TDR date, we believe the TDR loan should remain in the bad book until such time as it demonstrates a sustained period of performance under the restructured terms. After such performance transfer to the good book should be permitted.

Question 7: Is the proposed requirement to differentiate between the two groups (ie 'good book' and 'bad book') for the purpose of determining the impairment allowance operational and/or auditable? If not, how could it be made more operational and/or auditable?

The proposed methodology based on management's strategy creates subjectivity that would blur definitions, resulting in inconsistent application and audit difficulties. We believe additional guidance is needed to differentiate between the good book and bad book in order for the impairment allowance to become operational and auditable. Please see our response to Question 6 above.

Question 8: Do you agree with the proposed requirement to differentiate between the two groups (ie 'good book' and 'bad book') for the purpose of determining the impairment allowance? If not, what requirement would you propose and why?

We agree with the proposed requirement to differentiate between the good book and bad book for the purpose of determining the impairment allowance for open portfolios of loans but not for debt securities. Please see our response to Question 3 regarding debt securities.

Minimum impairment allowance amount

Question 9: The boards are seeking comment with respect to the minimum allowance amount (floor) that would be required under this proposed model. Specifically, on the following issues:

(a) Do you agree with the proposal to require a floor for the impairment allowance related to the 'good book'? Why or why not?

Yes, although the minimum 12-month foreseeable future period should not be required when the life of a loan is less than twelve months. Please see our response to Questions 3 and 13.

(b) Alternatively, do you believe that an entity should be required to invoke a floor for the impairment allowance related to the 'good book' only in circumstances in which there is evidence of an early loss pattern?

We believe there should be a floor regardless of whether there is any evidence of an early loss pattern. This will promote comparability among peers.

(c) If you agree with a proposed minimum allowance amount, do you further agree that it should be determined on the basis of losses expected to occur within the foreseeable future (and no less than twelve months)? Why or why not? If you disagree, how would you prefer the minimum allowance to be determined and why?

Please see our response to Question 3.

(d) For the foreseeable future, would the period considered in developing the expected loss estimate change on the basis of changes in economic conditions?

We believe the foreseeable future period should be a fixed 12 months, except when the life of a loan is less than 12 months, in order to ensure reliability as well as comparability between reporters. There are a number of factors that will affect the period of time considered as "foreseeable future". Changes in economic conditions is clearly one such factor. However, if the Board does not accept this recommendation, we believe that foreseeable future periods would vary based on specific portfolios and could change based on changes in economic conditions. For example, we believe the floor can be a longer period in an economic environment with low volatility versus when the economy is very volatile. In addition, if the regulatory and legal environments are part of economic conditions, then changes in these environments can change the period of time in developing expected losses. Please also see our response to Question 3.

(e) Do you believe that the foreseeable future period (for purposes of a credit impairment model) is typically a period greater than twelve months? Why or why not? Please provide data to support your response, including details of particular portfolios for which you believe this will be the case.

The foreseeable future period (for purposes of a credit impairment model) is a function of the type of loan product, its contractual terms, management strategy, and economic, regulatory and legal environments. Please also see our response to Question 3.

(f) If you agree that the foreseeable future is typically a period greater than twelve months, in order to facilitate comparability, do you believe that a 'ceiling' should be established for determining the amount of credit impairment to be recognized under the 'floor' requirement (for example, no more than three years after an entity's reporting date)? If so, please provide data and/or reasons to support your response.

We support the higher of 12 months (foreseeable future) or time-proportional life-time losses as the ceiling. However, if our recommendation to set a 12-month fixed period is not accepted, the foreseeable future period could be considered to be greater than 12 months. In that case, we believe that such a ceiling is necessary. To accommodate transparency, period-to-period consistency and auditability, companies should be required to disclose the quantitative factors used in determining the foreseeable future period. Furthermore, different reporting entities may have more or less sophisticated systems and personnel that enable the determination of the foreseeable future period. Please also see our response to Question 3 for further detail.

Question 10: Do you believe that the floor will typically be equal to or higher than the amount calculated in accordance with paragraph 2(a)(i)? Please provide data and/or reasons to support your response, including details of particular portfolios for which you believe this will be the case.

The answer depends on the foreseeable future definition. However, based on preliminary modeling for some of our corporate loans, if the foreseeable future period is defined to extend beyond 18-24 months, the foreseeable future allowance would exceed the time-proportional allowance. If the foreseeable future period is defined to exceed 12 months for the consumer loan portfolios, the foreseeable future allowance is more likely to exceed the time-proportional allowance.

Flexibility related to using discounted amounts

Question 11: The boards are seeking comment with respect to the flexibility related to using discounted amounts. Specifically, on the following issues:

(a) Do you agree with the flexibility permitted to use either a discounted or undiscounted estimate when applying the proposed approach described in paragraph B8(a)? Why or why not?

(b) Do you agree with permitting flexibility in the selection of a discount rate when using a discounted expected loss amount? Why or why not?

We believe credit impairment should be based upon expected principal cash flow shortfalls and that discounting is not appropriate for the loss related to the foreseeable future floor. Because of the shorter timeframes, discounting would only add complexity without any substantial difference in the loss amount. Under the time-proportional full life-of-loan approach described in paragraph B8(a), while discounting may be appropriate conceptually, we do not believe it is necessary given the additional complexity that discounting would add to the already complex approach. Therefore, we do not support discounting. However, if the Boards decide to allow optional discounting, they need to define the appropriate discount rate in order to maximize comparability across companies.

Approaches developed by the IASB and FASB separately

Question 12: Would you prefer the IASB's approach for open portfolios of financial assets measured at amortized cost to the common proposal in this document? Why or why not? If you would not prefer this specific approach, do you prefer the general concept of the IASB's approach (ie to recognize expected credit losses over the life of the assets)? Why or why not?

See our response to Question 13 below.

Question 13: Would you prefer the FASB's approach for assets in the scope of this document to the common proposal in this document? Why or why not? If you would not prefer this specific approach, do you prefer the general concept of the FASB's approach (ie to recognize currently credit losses expected to occur in the foreseeable future)? Why or why not?

We generally support the combined approach, with certain improvements suggested in this letter, rather than the FASB's or IASB's individual approaches, except that, as noted above in Questions 3 and 4, we do not believe the time-proportional approach is operational for revolving loan portfolios.

Consistent with the IASB's separate approach, we believe that, for assets in the good book, the expected credit losses should be recognized over the remaining life of the asset using the time-proportional approach. We agree with the IASB that it would be inappropriate to recognize lifetime credit impairment immediately upon origination of a loan as much of those losses will be incurred over the life of the loan. Since the revenue associated with these financial assets is recognized over their lives, the related costs (i.e., credit impairment) should follow a similar

pattern. Immediate recognition of all expected losses, without upfront recognition of the future earnings that are intended to support/absorb these costs, is illogical.

However, the IASB's separate approach did not consider an impairment floor. We believe that in a good book such a floor is necessary to ensure that the recorded impairment reserve reflects at least those credit losses that are reasonably expected to occur within the foreseeable future (we believe the foreseeable future period should be defined as 12 months).

We also disagree with the FASB's interest recognition and credit impairment model as proposed in the FASB's original Exposure Draft, Accounting for Financial Instruments. That proposed credit impairment model is inappropriate and would be extremely difficult to implement, as it mixes together interest income and credit losses. Credit and interest rate risks are managed separately and different financial, risk and loan systems are used to monitor them and gather the requisite financial reporting information. Maintaining extensive records for each portfolio or asset in the portfolio to determine the effective interest rate, estimate changes in expected cash flows, reflect the resulting additions and reductions to the loss reserve, track the "excess interest" amounts that need to be recorded in the loss reserve, as well as any related loss reserve releases, and separately record subsequent recoveries will require an intensive expansion of multiple systems. Financial statement users are unlikely to find such a mixed presentation of credit losses and interest income useful in analyzing a reporting entity's results of operations. We support the IASB's tentative decision that the recognition of interest income and credit impairments should be separate analyses, not commingled. We encourage the FASB to reach the same conclusion.