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May 15, 2013

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

RE: Proposed Accounting Standards Update, "Financial Instruments – Overall (Subtopic 825-10), Recognition and Measurement of Financial Assets and Financial Liabilities" (File Reference No. 2013-220) and Proposed Accounting Standards Update, "Financial Instruments – Overall (Subtopic 825-10), Recognition and Measurement of Financial Assets and Liabilities, Proposed Amendments to the FASB Accounting Standards Codification" (File Reference No. 2013-221)

# Dear Technical Director:

We appreciate the opportunity to comment on the proposed Accounting Standards Update, "Financial Instruments – Overall (Subtopic 825-10), Recognition and Measurement of Financial Assets and Financial Liabilities" (the "proposed ASU" or "the proposal") and the proposed Accounting Standards Update, "Financial Instruments – Overall (Subtopic 825-10), Recognition and Measurement of Financial Assets and Liabilities, Proposed Amendments to the FASB Accounting Standards Codification" (the "proposed amendments to the Codification").

We acknowledge and support the FASB's efforts to reduce complexity and respond to calls to provide investors with more useful, transparent, and relevant information regarding an entity's recognition and measurement of financial assets and financial liabilities. We generally support the guidance in the proposed ASU and agree that it will help improve financial reporting for financial instruments by developing a consistent, comprehensive framework for classifying and measuring those instruments. Additionally, we support the progress made on agreeing the three classification and measurement categories and the principles of the contractual cash flow characteristics and business model assessments with the IASB as an important step towards reducing differences between the two Boards' respective models. We believe that the FASB should continue to work with the IASB to seek harmonization of application guidance and to avoid the confusion that would result from having two models that are similar in principle but applied differently in practice.

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We summarize our views on key aspects of the proposed ASU below. Our views are described in more detail in Appendix A – KPMG's responses to specific questions posed by the FASB regarding the proposed ASU.

The proposal would require an entity to classify and measure financial assets into one of three categories (amortized cost, fair value with qualifying changes in fair value recognized in other comprehensive income, or fair value with all changes in fair value recognized in net income) based on the asset's contractual cash flow characteristics and the entity's business model for managing the assets. We support the development of a mixed-attribute classification and measurement model and the criteria used for classification and measurement of financial assets. However, we believe that the principles underlying the cash flow characteristics and business model assessments are not sufficiently explained so as to allow their meaning to be generally understood and consistently applied. We believe that the FASB should clarify the principles governing the application of these assessments and avoid relying primarily on specific examples to convey these principles. We believe that principle-based guidance should drive the assessments. This would allow entities to apply judgment within the acceptable framework instead of relying on specific examples for guidance. This would also mitigate the difficulty in interpreting fact patterns not included in the examples.

We support the FASB's proposal not to change the accounting for most financial liabilities so these instruments would continue to be measured at amortized cost. However, we believe the FASB should provide greater clarity on how to apply the guidance on nonrecourse financial liabilities.

We support the elimination of the current unconditional fair value option. We consider a limited fair value option to be a better alternative to today's unconditional fair value option. The proposal would reduce alternative accounting methods, thereby improving comparability and decision-usefulness of financial statement information.

We agree that an entity should be permitted to early adopt the proposed presentation provisions related to changes in instrument-specific credit risk for hybrid financial liabilities that would qualify for the fair value option under the proposed ASU. However, we believe that the option to early adopt the proposed presentation provision should be extended to all financial liabilities that would qualify for the fair value option. These provisions would eliminate a source of volatility in earnings that financial statement users do not find helpful. Further, limiting early

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adoption to only these provisions would foster comparability among financial statement preparers.

We expect that financial statement preparers would need sufficient time to analyze and implement appropriate policies, processes and internal controls to address the requirements within the proposed ASU. In our view, the FASB should provide no less than two full calendar years from finalization of the ASU to implement the proposed guidance. We also believe the implementation effective date of this proposed ASU should coincide with the effective date of the FASB's Proposed Accounting Standards Update, Financial Instruments – Credit Losses. Also, we urge the FASB, as part of the insurance contracts project, to allow insurers adequate flexibility to be able to reclassify financial assets on adoption of the new insurance standard based on facts and circumstances at that time to align where appropriate their accounting for financial assets with their accounting for insurance contracts. Furthermore, while we believe that the transition provisions in the proposed ASU are operable given an appropriate effective date, we encourage the FASB to clarify its guidance on how to assess a financial instrument's cash flow characteristics and the entity's business model at the transition date.

In addition, our responses to the Board's specific questions on the proposed amendments to the Codification are set forth in Appendix B – KPMG's responses to specific questions posed by the FASB regarding the proposed amendments to the Codification.

If you have any questions about our comments or wish to discuss any of the matters addressed herein, please contact Enrique Tejerina at (212) 909-5530.

Sincerely,

KPMG LLP

KPMG LLP

# Appendix A – KPMG's responses to specific questions posed by the FASB regarding the proposed ASU

## Question 1

Do you agree with the scope of the proposed model? If not, which other financial instruments should be included or excluded from the guidance in this proposed Update and why?

Yes, we agree with the scope of the proposed ASU.

# Question 2

Do you agree with the industry-specific specialized guidance scope exceptions in paragraph 825-10-15-9? If not, why? What would you propose instead?

We agree with retaining the selected existing industry-specific specialized guidance for brokers and dealers, investment companies, agricultural entities and depository and lending institutions. We are not aware of a compelling reason to supersede the selected existing guidance for these industries.

# Question 3

The proposed amendments would require an entity to classify financial assets into the appropriate subsequent measurement category (that is, at amortized cost, at fair value with qualifying changes in fair value recognized in other comprehensive income, or at fair value with all changes in fair value recognized in net income) on the basis of the contractual cash flow characteristics of the instrument and the business model within which financial assets are managed. Does the classification of financial assets based on the cash flow characteristics and the business model assessment provide decision-useful information? If yes, how will this classification influence your analysis of the entity? If not, why?

We believe that classification of financial assets based on their contractual cash flow characteristics and an entity's business model assessment would provide decision-useful information to financial statement users about an entity's involvement in financial assets. The contractual cash flow characteristics of a financial asset are important in determining how to classify and measure it because they determine the variability of the related cash flows, and an entity's business model assessment determines its likely future cash flows from the financial asset. We note the proposed approach would improve financial reporting for financial assets by developing a consistent framework for classifying those instruments that links their measurement to the way in which an entity expects to benefit from the cash flows of those assets.

In addition, we recognize that the terms "contractual cash flow characteristics" and "business model" are similar in meaning to the terms used in the proposed limited amendments to IFRS 9 (the IFRS 9 ED), which in turn achieves greater convergence in classifying and measuring financial instruments. This is one of the key objectives of the financial instruments project. However, as described in our responses to Questions 4 and 10, we believe that the principles underlying the cash flow characteristics and business

model assessments are not sufficiently explained so as to allow their meaning to be generally understood and consistently applied.

## **Question 4**

Do the proposed amendments appropriately convey the principle associated with the contractual cash flow characteristics assessment? If not, why? What would you propose instead?

We believe that the proposed amendments do not appropriately convey the principle associated with the contractual cash flow characteristics assessment (the solely payments of principal and interest or SPPI test). We believe that the principle underlying the SPPI test is not sufficiently explained so as to allow its meaning to be generally understood and consistently applied. The proposed guidance provides definitions of principal and interest and specific examples on how to apply the principle associated with the SPPI test. We believe that the FASB should clarify the principle governing the application of the SPPI test and avoid relying primarily on specific examples to convey this principle. There is a risk that features that are not contemplated in the specific examples would inappropriately be interpreted as disqualifying an instrument from meeting the SPPI test.

We believe that principle-based guidance should drive the assessment. This would allow entities to apply judgment within the acceptable framework instead of relying on specific examples for guidance. Additionally, we believe that there are related application issues in implementing the contractual cash flow characteristics assessment which we have included in our response to Question 6.

#### **Question 5**

The proposed amendments define principal as the amount transferred by the holder at initial recognition. Should the definition of principal be expanded to include repayment of the principal amount at maturity or other settlement? If so, what instruments would fail (or pass) the contractual cash flow characteristics criterion as a result of this change?

We generally agree with the definition of principal within the proposed ASU and do not believe that the definition should be expanded to include repayment of the principal amount at maturity or other settlement. However, as described in our in response to Question 6, we believe that the FASB should provide greater clarity as to how the SPPI test should be applied to financial assets to foster consistency in application of the principle. In addition, please see our comment on prepayment options in our response to Question 8.

# Question 6

Do the proposed amendments contain sufficient application guidance and illustrations on implementing the cash flow characteristics assessment? If not, why?

We believe the overall guidance in the proposed ASU on implementing the SPPI test could be further improved. As noted in our response to Question 4, we believe that the principle underlying the SPPI test lacks clarity as it is not sufficiently explained so as to allow its meaning to be generally understood and consistently applied. Constituents would need to look to the specific examples provided to understand the principle and fact patterns not included in the examples would be difficult to interpret. As a result, there

are a number of application issues that we expect would arise in practice that are not addressed in the proposed ASU. We describe these application issues below.

# **Other Interest Considerations**

There are other elements of interest that are not currently contemplated by the proposed ASU, but are considered customary in today's financial markets. For example:

- Loan agreements may provide a reasonable return to the lender to cover its costs of servicing a loan and, in some cases, for explicit payments of fees to cover reasonable administrative and other expenses incurred by the lender, which may all be considered as part of the effective interest rate of the loan.
- Debt instruments may have a negative yield because their initial transaction cost exceeds their total expected cash flows. In some of these instances, the negative yield may reflect the highcredit quality of the debt instrument during a time of financial strain and some may believe it is an investor's payment to a custodian for safekeeping of its funds.

We believe that these elements are consistent with a financial instrument having cash flows that are solely payments of principal and interest. However, the proposed ASU is silent on how these elements would be evaluated and whether these contractual terms would be consistent with the SPPI test.

# <u>Adequacy of Consideration for Time Value of Money and Credit Risk – Below Market Interest Rate Loans</u>

We believe it is unclear whether the SPPI test requires that the consideration to be received by the financial instrument holder for time value of money and credit risk should be considered adequate and, if so, how the assessment of adequacy should be performed.

We are aware of two possible views.

- The consideration must be adequate in order to satisfy the SPPI test. Proponents of this view point to the analysis in 825-10-55-61 Instrument G: Perpetual Instrument. This states that the instrument fails the SPPI test because interest does not accrue on deferred interest amounts. As a result, interest payments are not consideration for the time value of money on the principal amount outstanding (i.e., there is a failure to receive adequate compensation for the time value of money).
- The SPPI test requires only that any payments that arise under the instrument do in fact represent solely compensation for time value of money and credit risk (or repayment of principal) and that there are no cash flows that do not represent compensation for time value of money and credit risk (or repayment of principal).

These two competing views may give rise to significant diversity in practice with respect to loans that bear a rate of interest that is intentionally below market rates or which are interest free. Such loans may commonly arise in transactions with related parties, employees, customers or suppliers. It is unclear how these loans would be assessed under the proposed ASU.

Should a financial asset with a contractual term that modifies the economic relationship (see paragraphs 825-10-55-17 through 55-20) between principal and interest be considered to contain cash flows that are solely payments of principal and interest? Should this be the case if, and only if, the contractual cash flows could or could not be more than insignificantly different from the benchmark cash flows as discussed in paragraph 825-10-55-19? If not, why? What would you propose instead?

We agree that a financial asset with a contractual term that modifies the economic relationship between principal and interest should be considered to contain cash flows that are solely payments of principal and interest in certain circumstances. This requirement aligns with the principle of how a financial asset would be evaluated under the SPPI test (i.e., the financial asset would satisfy the SPPI test if its contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding). We also agree that this should be the case if, and only if, the contractual cash flows could not be more than insignificantly different from the benchmark cash flows as discussed in paragraph 825-10-55-19; except as described in our response to Question 8, we recommend replacing the phrase "more than insignificantly different" with the phrase "significantly different".

Also, as described in our response to Question 8, we believe that the FASB should consider broadening the scope of modified economic relationships to address customary terms that exist within debt instruments today and provide greater clarity as to how to apply the guidance on assessing whether a modified economic relationship results in cash flows that are solely payments of principal and interest on the amount of principal outstanding.

#### **Question 8**

Do the proposed amendments contain sufficient application guidance in paragraphs 825-10-55-17 through 55-20 on assessing a modified economic relationship? If not, why?

We believe that the proposed guidance on assessing a modified economic relationship should be clarified as there are a number of application issues that we expect would arise in practice which are not addressed in the proposed ASU. We describe these application issues and recommendations for actions below.

#### Definition of Modified Economic Relationship

The term "modified economic relationship" is narrowly defined within the proposed ASU to include only interest rate reset and leverage features. Other terms of a debt instrument may change the timing or amount of payments of principal and interest on the principal amount outstanding. The narrow definition of a modified economic relationship may present a risk that other customary terms or features that are reasonably included to protect the commercial interest of a borrower or lender and that may change the timing or amount of payments of principal or interest would be interpreted as disqualifying a debt instrument from being classified at amortized cost or FV-OCI. For example, such features may include

market disruption clauses relating to changes in money market conditions or the macroeconomic environment that may affect the lender's financing costs or access to funding. The clauses might include interest rate amendments on account of:

- Changes in country rating, country risk premium (e.g. credit default swap prices), central bank interest rates, interbank money market interest rates, external credit rating of the lender, and interest on fixed customer deposits of the lender;
- Movements in the yield curves of bonds issued by the country or the lender relative to swap yield curves; or
- The lender's cost of funding exceeding the LIBOR/EURIBOR rate otherwise applied to the loan to the customer.

These features may allow the lender to reset the interest rate applied to loans to customers based on its cost of funding plus a margin. We believe these features have become more common in bank loans over the last few years following the onset of the financial crisis and with continuing concerns over market instability and bank liquidity. The proposed guidance is silent at to how these elements would be consistent with the SPPI test's modified economic relationship assessment.

We recommend that the FASB deliberate these issues and consider widening the scope of the modified economic relationship analysis to include such features.

# Criterion to Evaluate Terms that Modify the Economic Relationship

In assessing the economic relationship that is modified by a contractual term of the instrument, the proposed ASU requires an entity to consider the cash flows of a comparable financial asset (that is, a benchmark instrument) that does not contain the modification and evaluate whether the contractual cash flows of the financial instrument under evaluation could be "more than insignificantly different" from the benchmark cash flows. We recommend that the criterion in making the assessment be enhanced to require an entity to consider whether the cash flows from the financial asset being assessed could be "significantly different" from the corresponding benchmark cash flows instead of "more than insignificantly different". We believe that it is inherently more complex for entities to have to consider and calibrate whether an item is "more than insignificant" rather than just whether it is "significant." The former may suggest a need to focus attention on a supposed grey area between "insignificant" and "significant" and an unduly narrow view as to what level of difference is acceptable.

# **Identification of Benchmark Instrument**

The proposed ASU requires an entity to consider the cash flows of a comparable financial asset or benchmark instrument, but does not contemplate scenarios in which interest rates are reset by a regulatory regime, which may impact an entity's ability to identify or construct a comparable benchmark instrument. For example, an entity in China acquires a five-year, floating-rate retail loan with a remaining maturity of one year. Interest rates are reset by the Chinese central bank based on the original maturity of a loan. The loan would be repriced based on the new official rate set for five-year loans. The proposed guidance does not address how the modified economic relationship assessment would work in this type of market.

We believe that the FASB should seek additional feedback on this issue. We note that US GAAP is intended to be applied not only in the United States but globally, both in relatively free markets and in more regulated markets, and we do not consider the fair value through net income (FV-NI) classification and measurement determination for what are vanilla lending activities in the relevant jurisdictions, to necessarily be the most useful conclusion. In particular, in the Chinese example described above, it does not seem practical to assert that the interest received over the life of such an instrument does not represent consideration for the time value of money and credit risk associated with that instrument. Rather, we believe that the concepts of interest and the time value of money, as well as the nature of a benchmark instrument, should be evaluated in the context of the particular market and regulatory framework in which an instrument exists. In some cases, it is possible that this might differ from the principle currently implied by the proposed ASU. The modified economic relationship assessment should be focused on identifying features that significantly modify the cash flows away from how consideration for the time value of money and credit risk is generally established in the context of the relevant market framework. We recommend that the guidance in the proposed ASU on modified economic relationships be clarified to reflect these objectives.

# Sufficiency of Application Guidance

We acknowledge that performing the assessment of a modified economic relationship would require significant judgment in identifying a benchmark instrument, evaluating what scenarios are reasonably possible, and when cash flows in a modified economic relationship could be more than insignificantly different from a benchmark instrument. We believe that allowing entities to exercise reasonable judgment in applying the underlying principle of modified economic relationship is preferable as opposed to the creation of quantitative bright lines which might produce unintended consequences. Similarly, we do not believe it would be necessary or desirable to introduce more prescriptive detail as to how to quantify or measure differences since this would add complexity and may not result in the most efficient or appropriate solution in all situations.

We do, however, believe the examples on applying the modified economic relationship assessment (in 825-10-55-19 and 825-10-55-20) should be improved by being more comprehensive and directional as to the stated outcome. In particular, it would be helpful to indicate the FASB's thought process as to how a one-month versus three-month mismatch may be *less* likely to give rise to a more than insignificant difference whereas a six-month versus five-year mismatch may be *more* likely to give rise to a more than insignificant difference when evaluating the cash flows associated with terms that modify an economic relationship.

#### **Prepayment Options**

The proposed ASU includes guidance for assessing contractual terms that may change the timing or amount of payments of principal or interest such as prepayment options and specifies conditions that would need to be met for the prepayment option to meet the SPPI test. One of the criteria requires the prepayment amount to "substantially represent unpaid amounts of principal and interest on the principal amount outstanding, which may include reasonable additional compensation for the early termination of the contract". We believe it is unclear how to assess this criterion. For example, it is unclear how to assess whether the prepayment option feature meets the criterion for a financial asset acquired in a secondary market transaction at a premium or discount. An example of such scenario may be when an

entity acquires a debt instrument with a par of \$100 in a secondary market transaction at a discount to par for \$90, and the instrument contains a contractual term that permits the issuer to prepay the debt instrument before its maturity. If the issuer prepays the instrument at \$100 plus accrued interest, which is above the principal amount of \$90 (as defined in the proposed ASU), it is unclear whether the prepayment amount substantially represents unpaid amounts of principal and interest on the principal amount outstanding. In this example and consistent with the requirements within the proposed ASU, the entity also would need to assess whether the prepayment amount includes reasonable, additional compensation for the early termination of the contract.

In a contrasting example, an entity acquires a debt instrument with a par of \$100 in a secondary market transaction at a premium to par for \$110, and the instrument contains a contractual term that permits the issuer to prepay in the event of certain tax law changes. If the prepayment amount is \$100 plus accrued interest, which is below the principal amount of \$110 (as defined in the proposed ASU), it is unclear whether the prepayment amount substantially represents unpaid amounts of principal and interest on the principal amount outstanding. One view may be that the SPPI test is not met because the contractual terms may result in a negative return to the holder of the debt instrument.

In our view, if a non-prepayable financial asset is acquired in a secondary market transaction at a premium or discount, the SPPI test would be met if the contractual terms of the asset give rise on specified dates to cash flows that are solely payments of principal and interest. In other words, discounts or premiums would not affect the SPPI test. However, the meaning of "substantially represents" or "reasonable, additional compensation" in situations with a prepayable debt instrument acquired at premium or discount is unclear. We recommend that the FASB clarify the guidance in the proposed ASU.

# Question 9

For beneficial interests in securitized financial assets, the proposed amendments would require an entity to look through to the underlying pool of instruments in determining whether the tranche contains payments of solely principal and interest. Do you agree with this look-through approach? If not, why? What would you propose instead?

We agree with the look-through approach in determining whether the tranche contains payments of solely principal and interest in the case of beneficial interests in securitized financial assets. However, we believe that the scope of instruments that would be required to apply this guidance is unclear. In many cases, beneficial interests in securitized financial assets have economic characteristics that are similar in nature to other types of debt instruments that would pass the SPPI test. A possible example is an instrument that economically represents an investment in particular assets or cash flows (i.e., a non-recourse financial asset with an underlying asset such as a rental building). We believe that the fact that an instrument is nonrecourse does not necessarily prevent it from meeting the SPPI test if all other terms of the instrument meet the SPPI test. In our view, the holder would need to assess the underlying assets or cash flows to conclude that they are consistent with the SPPI test evaluation. However, the proposed ASU is not clear whether the holder would be required to apply this look-through approach, which is applicable to beneficial interests in securitized financial assets, to a non-recourse financial asset described above, and if so, when to apply it. We recommend that the FASB provide clarification as to which financial assets fall in scope of the guidance for beneficial interests in securitized financial assets.

## Credit Risk Exposure Evaluation

In addition to the look-through requirement, an entity would need to assess the credit risk exposure inherent in the tranche of a beneficial interest. The proposed ASU does not provide guidance about how to evaluate whether the credit risk exposure inherent in a beneficial interest in securitized financial assets is equal to or lower than the credit exposure in the underlying pool of financial instruments. We believe that this evaluation should be applied to only reasonably possible scenarios. This approach would make this evaluation consistent with the application guidance for the modified economic relationship test. We recommend that the guidance in the proposed ASU for beneficial interests in securitized financial assets be clarified to indicate the need to consider only reasonably possible scenarios when evaluating the credit risk exposure.

In addition, we note that under the proposal an entity would not consider the probability of an event occurring and triggering contingent cash flows in the determination of whether the contractual cash flows are solely payments of principal and interest in applying the SPPI test. However, the entity would disregard the contingent term if it would affect the instrument's contractual cash flows only upon the occurrence of an event that is extremely rare, highly abnormal, and very unlikely to occur. It is unclear why these contingent cash flows are evaluated differently from those related to the modified economic relationship test. We believe that this evaluation should be applied to only reasonably possible scenarios. This approach would make this evaluation consistent with the application guidance for the modified economic relationship test. We recommend that the guidance in the proposed ASU for contingent cash flows be clarified to indicate the need to consider only reasonably possible scenarios.

### Question 10

Do the proposed amendments appropriately convey the principle associated with the business model assessment? If not, why? What would you propose instead?

We believe that the proposed amendments do not appropriately convey the principle associated with the business model assessment. As noted in our response to Question 3, we believe that the principle underlying the business model assessment is not sufficiently explained so as to allow its meaning to be generally understood and consistently applied.

We believe that the principle-based guidance should drive the assessment. This would allow entities to apply judgment within the acceptable framework instead of relying on specific examples for guidance. Additionally, we believe that there are related application issues in distinguishing among the three business models which we have included in our response to Question 11.

# Question 11

Do the proposed amendments provide sufficient application guidance and illustrations on how to distinguish among the three business models, including determining whether the business model is to manage assets both to collect contractual cash flows and to sell? Do you agree with the proposed guidance provided to describe those business models? If not, why?

We believe that the overall guidance in the proposed ASU on distinguishing between business models could be further improved. In particular, we believe that the guidance should have a more consistent

focus on the need to identify the objective of a business model and that it is this objective which should drive the assessment. As noted in our response to Question 10, we believe that the principle underlying the business model assessment lacks clarity as it is not sufficiently explained so as to allow its meaning to be generally understood and consistently applied. Constituents would need to look to the specific examples provided to understand the principle and fact patterns not included in the examples would be difficult to interpret. As a result, there are a number of application issues that we expect would arise in practice that are not addressed in the proposed ASU. We describe these application issues below.

We believe that the FASB should work with the IASB to seek harmonization of application guidance and to avoid the confusion that would result from having two models that are similar in principle but applied differently in practice. For example, there are differences in the terms used in the guidance on the frequency of sales out of the "hold to collect" model. Specifically, the proposed ASU notes that sales that result from reasons other than managing credit exposure should be "very infrequent". However, the IFRS 9 ED uses the term "infrequent" when describing the same point.

# Assessing Collection and Sales Activity

We believe that distinguishing between the three types of business models should involve an assessment as to whether collecting the contractual cash flows of financial assets and selling financial assets is either integral or incidental to achieving the objective of the business model. A consistent focus on identifying the objective of a business model in this way would assist in assuaging concerns about consistency in application as it would make clearer that the purpose of considering the frequency of sales activity is in confirming or disconfirming the objective (i.e. in determining whether sales activity is integral to or incidental to the model's objective) rather than apparently being an end in itself. Without this focus, we believe there is a greater risk that the assessment of the business model will be perceived to be driven primarily by subjective and divergent interpretations as to whether sales are "very infrequent" or establish a "pattern" and there will be an increasing demand for bright-line quantification of these terms.

The proposed ASU currently uses differing and potentially inconsistent terminology when referring to how sales and collection activity impacts the assessment. As stated above, we believe that the proposed ASU should state a consistent general framework, such as whether the collection of contractual cash flows or realization of assets through sale are either integral or incidental to the objective of the business model. However, the question then arises as to how to distinguish between sales that do not contradict the "hold to collect" objective and sales that would indicate that the business model of the entity with regard to that particular portfolio is other than hold to collect. The frequency, timing and significance of sales are indicators of whether such sales are integral or incidental to the objective of the business model.

Thus, in the "hold to collect" business model, any sales of assets before maturity are incidental to the objective of collecting the principal and interest cash flows. Sales of assets may be incidental to the objective because they were for reasons that were not reasonably expected at the acquisition date, because they are near maturity (and thus the proceeds approximate the collection of the remaining contractual cash flows) or because they are so immaterial that they do not contradict the objective.

In the "both hold to collect and to sell" model, assets are managed to generate an overall return both by collecting cash flows and by disposal, depending on market conditions and liquidity needs, and so both

collecting contractual cash flows and realization through sale are integral to the objective and neither is incidental.

In a "held for sale" model, selling the assets is integral to the objective while collecting the contractual cash flows is incidental to the objective. If assets are managed on a fair value basis, then the collection of cash flows also is incidental since the objective is solely to manage on a fair value basis.

Additionally, the proposed ASU provides specific examples of sales that would not be inconsistent with the objective of the "hold to collect" model because it is expected that those events would occur very infrequently. The identification of these specific examples may lead an entity to consider that sales that result from these events are more acceptable within the "hold to collect" business model than any other sales irrespective of their frequency of occurrence.

# Objective of the "Both Hold to Collect and to Sell" Business Model

Related to and reinforcing the points noted in the previous comment is the absence of any specified boundary between the "both hold to collect and to sell" business model and the residual measurement category in which financial assets are measured at FV-NI. We believe this boundary also could be clarified by clearer specification of the nature and objective of a "both hold to collect and to sell" business model. However, ultimately we expect that there may remain significant judgment around this boundary, and we would not see that in itself as a fundamental problem.

The business model associated with the FV-OCI measurement is defined as one that has the objective of both to collect contractual cash flows and for sale. This basic definition is impractical since apart from a few very pure "hold to maturity" approaches, all business models involve both holding financial assets and selling financial assets. In order to more clearly distinguish this model from other types of business models, we believe that the FASB should enhance the business objective or objectives associated with this category. This has been challenging to do because there is a less obvious link between the objective and how assets are managed than in the case of a "hold to collect" business model and the objectives may be more diverse. In our view, distinguishing features of the "both hold to collect and to sell" business model would include:

- The entity acquires financial assets with the objective of receiving investment returns and obtaining a realizable value or liquidity, but its objective is not primarily to realize gains through the sale of assets;
- Attaining the entity's objective will involve the entity holding those assets for the long term or
  until maturity or selling them and both outcomes are reasonably anticipated (i.e. both activities
  are integral to achieving the objective);
- Whether the entity will hold or sell an asset will depend on future changes in circumstances (e.g., at initial recognition, an entity has not made a decision whether to sell or hold that particular asset and does not intend to sell the asset in the near-term); and
- The assets are not managed solely on a fair value basis.

We understand that some believe that the difficulty in articulating an objective for this category arises because there are no business models with an identifiable "hold and sell" objective. As explained above, we are not convinced by this argument. However, if this view is widespread among stakeholders and the FASB is persuaded by the argument that it is not possible to delineate clearly the scope of "both hold to collect and to sell" business model, then we would encourage the FASB to consider alternative approaches based on:

- Establishing defined comprehensive objectives for the business models associated with the FV-NI business model, while retaining the FV-OCI measurement category as a residual category for financial assets that meet the SPPI criterion and which are held within neither a "hold to collect" (i.e. amortized cost) nor a FV-NI business model; or
- Other criteria for FV-OCI measurement of financial assets based on reducing accounting mismatches that would otherwise arise as a result of developments in the insurance contracts project between an insurer's recognition and presentation of gains and losses arising on insurance contracts and related financial assets.

# Business Model Assessment for Pools of Receivables

The proposed ASU contains guidance for assessing the business model for pools of receivables. The guidance applies to those situations where upon recognition of a pool of similar financial assets, an entity might expect to sell a portion of the pool and continue to hold and manage the other portion to collect the contractual cash flows. If the entity, at recognition, has not yet identified specific assets that it will subsequently sell, and the assets meet the SPPI test, the entity would need to use judgment in allocating the percentage of the financial assets in the pool into the measurement categories. A possible example would be when an entity intends to sell 20 percent of these financial assets shortly after origination and to hold the remainder to collect the contractual cash flows. At initial recognition, the entity has not identified which specific assets it will sell and which specific assets it will continue to hold.

Based on the proposed ASU, the entity would need to use judgment in allocating a percentage of the financial assets to various business models. In this example, the entity would allocate 20 percent to the FV-NI category and 80 percent to the amortized cost category. If the entity sells only 15 percent of its financial assets instead of 20 percent as it originally anticipated, this may affect subsequent measurement of the financial assets. The proposed ASU does not provide guidance about the subsequent accounting for pools of financial assets allocated by percentage to various business models. One view may be that classification can only be performed at origination, and thus, for example, if the entity sells 15 percent of its financial assets instead of 20 percent as it originally anticipated, the five percent excess would remain where it was originally classified (i.e., in the FV-NI category). We recommend that the FASB clarify the subsequent accounting for pools of financial assets allocated by percentage to various business models.

## Question 12

Should the classification and measurement model for financial instruments contain an explicit tainting notion or should it rely on the principle and exercise of professional judgment? Why?

We do not support an explicit "tainting" notion to be included within the classification and measurement model. We believe that the classification and measurement model for financial instruments should rely

on the principle and exercise of professional judgment. We recognize that questions may arise in practice as to what level of sales of amortized cost financial assets can occur without calling into question future classifications of a hold-to-collect contractual cash flows business model. As noted in our response to Question 11, we believe that the proposed ASU should state a consistent general framework, such as whether the collection of contractual cash flows or realization of assets through sale are either integral or incidental to the objective of the business model. This approach would allow entities to exercise reasonable judgment in applying the underlying principle, which is preferable to the practice of a tainting notion which may produce unintended consequences. For example, an entity may try to avoid the potential negative effects of the tainting rule on its financial statements by not classifying any financial assets as held-to-collect contractual cash flows even though some of the entity's assets should be classified in that category.

### **Question 13**

The proposed amendments would require loan commitments, a revolving line of credit, or a commercial letter of credit (the potential creditor) to be measured on the basis of the likelihood of exercise of the commitment and the classification of the underlying loan that would be made upon exercise of the commitment. Do you agree with the proposed classification of loan commitments? If not, why? What would you propose instead?

We agree with the proposed classification of loan commitments, revolving lines of credit, or commercial letters of credit to be measured on the basis of the likelihood of exercise of the commitment and the classification of the underlying loan that would be made upon exercise of the commitment. Classifying and measuring a loan commitment, a revolving line of credit, or a commercial letter of credit on the basis of the likelihood of its exercise and in accordance with the classification of the related drawn loan is consistent with the premise that a loan commitment is an integral part of the loan origination process.

#### **Ouestion 14**

Do you agree with the initial measurement principles for financial instruments? If not, why?

We agree with the initial measurement principles for financial instruments. However, the proposed ASU does not address how the transaction price would be allocated upon initial measurement between two components (e.g., pro rata based on fair values or fair value of the financial instrument and remainder to the other component) when part of the consideration given or received for a financial instrument is for something that also is required to be measured at fair value. We recommend that the guidance in the proposed ASU be clarified.

#### **Ouestion 15**

The proposed amendments would eliminate the unconditional fair value option (for financial instruments within the scope of this proposed guidance) in existing U.S. GAAP and, instead, permit an entity to irrevocably elect at initial recognition the fair value option in limited circumstances or "options". Do these options provide decision-useful information? If not, why?

We support the proposed elimination of the unconditional fair value option and, instead, permitting an entity to irrevocably elect at initial recognition the fair value option in limited circumstances. The

proposal would reduce alternative accounting methods, thereby improving comparability and decision-usefulness of financial statement information.

While the FASB has generally aligned its proposed model to be consistent with IFRS 9 as it relates to the fair value option, there remains a difference in eligibility criteria that will continue to adversely affect comparability. In contrast to the proposed ASU, IFRS 9 allows an entity to elect a fair value option for financial liabilities or financial assets otherwise measured at amortized cost to eliminate or significantly reduce an accounting mismatch between assets and liabilities. We suggest that the proposed ASU include an accounting mismatch between assets and liabilities as one of the eligible criteria for the fair value option to improve the comparability between an entity applying the proposed ASU with one applying IFRS 9. Incorporating the additional criterion for an entity to elect the fair value option for financial liabilities measured at amortized cost, specifically where an accounting mismatch exists, would eliminate or significantly reduce earnings volatility for certain entities that have a strategy of funding the purchase of financial assets measured at FV-NI by issuing "plain-vanilla" debt.

#### **Question 16**

Should financial liabilities subsequently be measured at amortized cost, unless certain exceptions are met? If not, why?

Except as described in our response to Question 15, we agree that financial liabilities should be subsequently measured at amortized cost, unless certain exceptions are met. We believe that the most relevant measurement attribute for the majority of financial liabilities is amortized cost due to the fact that financial statement users generally place less importance on the fair value of financial liabilities than financial assets since most entities do not settle financial liabilities at fair value.

### Question 17

The proposed amendments would require a nonrecourse financial liability that is settled with only the cash flows from the related financial assets (see paragraph 825-10-35-11) to be measured on the same basis as those assets. Do you agree with the proposed amendments? If not, why? What would you propose instead?

We agree with the proposed amendments that would require a nonrecourse financial liability that is settled with only the cash flows from the related financial assets to be measured on the same basis as those assets. However, we note that the proposed ASU does not provide any implementation guidance in this area, and therefore it is unclear how the FASB intends this principle to be applied. It is unclear what the FASB means by requiring nonrecourse financial liabilities to be measured on the same basis as the related financial assets. For example, it is unclear how to account for the difference between the fair values of nonrecourse financial liabilities and the related financial assets or if there is a cap limit to the nonrecourse financial liability balance depending on the related financial asset balance. We suggest that the proposed ASU provide greater clarity on how to apply the nonrecourse financial liability principle.

Additionally, we note that the proposed guidance would not apply to nonrecourse financial liabilities that require settlement of the obligation from cash flows associated with both financial and nonfinancial assets. It is unclear whether the proposed guidance would apply in situations when some of the financial assets become nonfinancial assets as a result of a foreclosure (e.g., loans may be foreclosed and real estate

obtained). We suggest that the proposed guidance consider this fact pattern and clarify whether it would apply in such situations.

#### **Question 18**

The proposed amendments would require financial assets measured at amortized cost that are subsequently identified for sale to continue to be classified and measured at amortized cost less impairment and would prohibit recognition of the gain, until the sale is complete. Do you agree with the proposed classification and measurement requirements? If not, why?

We agree with the proposed requirement. The proposed requirement to continue to classify and measure financial assets subsequently identified for sale at amortized cost is consistent with the principle of reclassifying financial assets only when there is a change in an entity's business model. Prohibiting recognition of any gain until the related sale is complete is consistent with the amortized cost model as well.

# Question 19

The proposed amendments would provide a practicability exception for measuring equity investments without readily determinable fair values that do not qualify for the practical expedient in paragraph 820-10-35-59 (that is, the net asset value per share expedient) and a one-step impairment model for all equity investments subject to the practicability exception. Do you agree with the proposed amendments? If not, why?

We believe that fair value is decision-useful information for investments in equity instruments. However, the practicability exception for measuring equity investments without readily determinable fair values coupled with a one-step impairment model strikes a reasonable cost/benefit balance for measuring these investments. Please refer to our response to Question 35 relating to the application of the one-step impairment model to equity method investments.

# Question 20

Should an entity evaluate the need for a valuation allowance on a deferred tax asset related to a debt instrument measured at fair value with qualifying changes in fair value recognized in other comprehensive income separately from the other deferred tax assets of the entity (rather than combined and analyzed together)? If not, why?

A requirement that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to a debt instrument measured at FV-OCI separately from its other deferred tax assets represents a change from the current practice for a large number of entities. The basis for conclusions indicates these deferred tax assets are unique. However, this proposal does not address whether other deferred tax assets related to items recognized in other comprehensive income or transactions outside of continuing operations are also unique. If the FASB believes adding another exception to accounting for income taxes is necessary, the rationale for the exception and the limitations on analogizing to this exception should be clearly stated.

Under the amendments in this proposed Update, hybrid financial assets would not be required to be analyzed for bifurcation under Subtopic 815-15 and would be assessed in their entirety on the basis of the proposed classification requirements. In contrast, hybrid financial liabilities would be assessed for bifurcation and separate accounting under Subtopic 815-15, and the financial liability host contract would be subject to the proposed amendments. Do you agree with this proposal? If not, why? What would you propose instead?

We agree that the current requirement to analyze hybrid financial assets for bifurcation and separate accounting should be eliminated; and we acknowledge that current U.S. GAAP guidance in this area is complex and difficult to apply. The proposed approach would reduce complexity in the accounting for hybrid financial assets, which is one of the FASB's intended objectives in developing the revised framework for the classification and measurement of financial instruments.

We agree with the proposal to require hybrid financial liabilities to continue to be analyzed for bifurcation and separate accounting. We believe that if the approach proposed for hybrid financial assets were to be applied to hybrid financial liabilities, significantly more hybrid financial liabilities would be recorded at fair value in their entirety. Financial statement users generally appear to place less importance on fair value information for financial liabilities than they do for financial assets. In addition, while we acknowledge that current U.S. GAAP guidance on embedded derivatives is complex and difficult to apply, we believe that important information about an embedded derivative feature may be obscured if an entity evaluated the classification of the hybrid financial liability in its entirety. Therefore, in contrast to our views on hybrid financial assets, we believe that the benefit to financial statement users of providing information about embedded derivative features at fair value and host financial liability contracts at amortized cost outweighs the cost of evaluating and potentially separating an embedded derivative from the hybrid financial liability as well as the inconsistent treatment of hybrid financial assets versus hybrid financial liabilities.

# **Question 22**

The proposed amendments would require reclassification of financial assets when a change in business model occurs and prescribes how those changes should be subsequently accounted for. Do you agree with the proposed amendment on reclassifications? If not, why?

We agree with the proposal to require reclassification of financial assets between categories, if and only if, the business model related to these financial assets changes. Although reclassifications may be considered to reduce comparability and add complexity, we believe financial assets should be measured based on an entity's current business model (as well as based on their contractual cash flow characteristics). This would provide appropriate and relevant information to financial statement users (i.e., amortized cost or fair value). We also agree with the subsequent accounting related to the change in classification as set forth in the proposed ASU.

The proposed amendments would require public entities to parenthetically present fair value for items measured at amortized cost on the face of the statement of financial position. Does that presentation requirement provide decision-useful information? If not, why? What would you propose instead?

Generally, financial statement users regard fair value and amortized cost information related to financial instruments as being decision useful-information. However, different financial statement users place different levels of emphasis on fair value and amortized cost information. The proposed approach strikes a reasonable balance for the users of the financial statements of public companies.

#### **Ouestion 24**

The proposed amendments would exempt nonpublic entities from parenthetical and footnote disclosures of fair value. Should nonpublic entities be required to parenthetically present fair value information on the face of the statement of financial position for financial instruments measured at amortized cost? If not, should fair value disclosures in notes to the financial statements be required for some or all nonpublic entities for financial instruments measured at amortized cost?

We believe that the issue is whether or not certain entities should be required to expend the effort and resources to create or obtain and provide fair value information to financial statements users in light of the resulting benefit that financial statements users may receive from that incremental information. The degree of importance that financial statement users place on such fair value information for public companies may differ (in general) from that which they place on such information for nonpublic entities. That said, we appreciate that the users of nonpublic entity financial statements have differing needs and levels of interest in fair value information. Even though the distinction between public and nonpublic entities may not be optimal, it is operational and considerate of efforts to simplify reporting for nonpublic entities.

#### **Ouestion 25**

The proposed amendments would require an entity to separately present changes in fair value attributable to changes in instrument-specific credit risk in other comprehensive income for financial liabilities for which that entity has elected the fair value option. Would the proposed presentation requirement provide decision-useful information? If not, why? What would you propose instead?

We believe that the proposed requirement adequately addresses the concerns raised about potential gain recognition related to deterioration in instrument-specific credit risk for an entity's financial liabilities. We agree with the proposed amendments to require an entity to separately present changes in fair value attributable to changes in instrument-specific credit risk in other comprehensive income for financial liabilities for which that entity has elected the fair value option. See our response to Question 30 regarding early adoption of these presentation requirements.

The proposed amendments would require an entity to separately recognize in net income changes in fair value attributable to foreign currency gain or loss on foreign-currency-denominated debt securities measured at fair value through other comprehensive income (see paragraphs 825-10-45-14 through 45-15). Is the proposed fair-value-based method provided for computing the foreign currency gain or loss component operable? If not, why? What would you propose instead?

We believe that the method of separately recognizing in net income changes in foreign currency transaction gains or losses from other components of the change in fair value of a debt instrument denominated in a foreign currency should be based on an amortized-cost-based method as opposed to a fair-value-based method. As noted in the basis for conclusions, stakeholders supported including in net income transaction gains and losses on foreign-currency-denominated debt instruments classified as FV-OCI. They noted that their underlying rationale for this accounting treatment is that changes in foreign currency exchange rates would result in realized gains and losses if the entity would hold the related debt instrument to collect its contractual cash flows. As an extension of this rationale, it seems logical that the basis for measuring such foreign currency transaction gains or losses would be based on a hold to collect notion.

#### **Ouestion 27**

The proposed amendments would require a public entity to provide disclosure of the core deposit liability balance, implied weighted-average maturity period, and the estimated all-in-cost-to-service rate by significant type of core deposit liability. Do you agree with the proposed disclosure requirement and, if so, how would you use that information? If not, what information should be provided and why? Is it appropriate not to require this information for nonpublic entities?

We believe the proposed disclosures would provide decision useful information to financial statement users. The information that would be disclosed essentially represents remaining information that a financial statement user would need to assess the fair value of the related intangible. Additionally, we are supportive of limiting these new disclosure requirements to public entities.

#### **Questions 28 and 29**

Are there any other disclosures that would provide decision-useful information and why?

Do you agree with the proposed disclosure requirements? If not, which disclosure requirement would you change and why?

We agree that the proposed disclosure requirements provide decision useful information for financial statement users based on our understanding of what users find helpful. We believe that it is important for the FASB, as they intend, to consider the views of financial statement users, preparers, the Securities and Exchange Commission, other regulators, etc. regarding the usefulness and adequacy of the proposed disclosure requirements, and the need for additional disclosures.

Should an entity be permitted to early adopt only the proposed presentation requirements related to changes in instrument-specific credit risk for hybrid financial liabilities that would qualify for the fair value option under the proposed requirements? If not, why?

We believe that an entity should be permitted to early apply the proposed presentation provisions related to changes in instrument-specific credit risk for hybrid financial liabilities that would qualify for the fair value option under the proposed ASU. In addition, we believe that the option to early adopt the proposed presentation provisions should be extended to all financial liabilities that would qualify for the fair value option under the proposal. These provisions would eliminate a source of volatility in earnings that financial statement users do not find helpful. Early adoption of these provisions would also allow entities to immediately address financial statement users' concerns about the usefulness of reporting gains in earnings related to a deterioration of an entity's own creditworthiness. Further, limiting early adoption to only the aforementioned provisions would foster comparability among financial statement preparers.

#### **Question 31**

Should the effective date be the same for both public entities and nonpublic entities?

We believe that the effort and cost to nonpublic entities must be considered in light of their available resources. Although, these factors may vary greatly among nonpublic entities, it is reasonable to defer the mandatory effective date of the proposed ASU for one year for nonpublic entities compared to public entities.

## **Question 32**

How much time is needed to implement the proposed guidance?

Preparers will need sufficient time to analyze and implement appropriate policies, processes and internal controls to address the requirements within the proposed ASU. In our view, the FASB should provide no less than two full calendar years from finalization of the ASU to implement the proposed guidance. Furthermore, we believe the implementation effective date of this proposed ASU should coincide with the effective date of the FASB's Proposed Accounting Standards Update, *Financial Instruments — Credit Losses*. Also, we urge the FASB, as part of the insurance contracts project, to allow insurers adequate flexibility to be able to reclassify financial assets on adoption of the new insurance standard based on facts and circumstances at that time to align where appropriate their accounting for financial assets with their accounting for insurance contracts.

# Question 33

Are the transition provisions in this proposed Update operable? If not, why?

We believe that the transition provisions in the proposed ASU are operable given an appropriate effective date, except as noted below.

We interpret the guidance included in the basis for conclusions to require an entity to apply the proposed guidance to the financial instruments, held or outstanding as of the effective date, as of the beginning of

the first reporting period in which the guidance is effective. We further interpret that an entity would be required to assess a financial instrument's cash flow characteristics and the entity's business model at the effective date evaluating the facts as they exist on that date. We recommend that the guidance be clarified and included in the proposed ASU and not as part of the basis for conclusions.

In addition, please see our responses to Questions 30 and 32.

#### **Question 34**

The proposed amendments would require investments that qualify for the equity method of accounting in Subtopic 323-10, Investments—Equity Method and Joint Ventures—Overall, to be subsequently measured at fair value with changes in fair value recognized in net income if the investment is held for sale at initial recognition. Are the proposed indicators/conditions operable? If not, why? What would you propose instead?

The proposed ASU would require that investments that qualify for the equity method of accounting be considered held for sale if the investor has identified potential exit strategies even though it may not yet have determined the specific exit strategy and the investor has defined a date or range of dates at which time it expects to exit the investment. Given that a specific exit strategy need not be determined and that only a date or range needs to be defined, we believe that these conditions would often be met. For example, an investment in a limited life entity that would qualify for the equity method of accounting could be viewed as meeting these conditions. We suggest that the FASB clarify its intention as to the types of investments it means to capture. Further, it seems that the second condition encompasses the first. That is, it seems that if the investor identified a potential exit strategy in a manner that satisfies the first indicator, then the second indicator (i.e., the investor has defined a date or range of dates at which time it expects to exit the investment) would always be met. Lastly, the FASB should indicate whether contemporaneous documentation of the existence of the held-for-sale indicators is required at initial recognition for this accounting treatment.

# Question 35

The proposed amendments would change the current two-step impairment model for equity method investments to a one-step impairment model for all equity investments. Do you agree with the proposed one-step equity impairment model? If not, why? What would you propose instead?

We do not believe that the one-step impairment model for investments in equity securities without readily determinable fair values that are not accounted for using the equity method would necessarily be appropriate for equity method investments. Also, although we support the use of qualitative factors in impairment assessments as addressed in our comment letters on the FASB's exposure drafts on qualitative assessments of impairments of goodwill and indefinite-lived intangible assets, we do not agree with the use of a more-likely-than-not threshold for fair value impairment tests related to equity method investments.

#### Question 36

Do you agree that the current portfolio-wide option for not-for-profit entities, other than health care entities, to account for their equity method investments at fair value should be retained? If not, why?

Should that option also be made available to not-for-profit health care entities that are within the scope of Topic 954, Health Care Entities?

We agree that the current portfolio-wide option for not-for-profit entities to account for their equity method investments at fair value should be retained. We are not aware of a compelling reason to supersede the existing guidance for not-for-profit entities. Further we believe that this option should be expanded to not-for-profit health care entities as we do not believe that it is conceptually justified to distinguish between not-for-profit entities that are health care entities and those that are not.

### Question 37

The proposed amendments would eliminate the fair value option for hybrid nonfinancial instruments in current U.S. GAAP and would provide a new fair value option for hybrid nonfinancial liabilities. For a hybrid nonfinancial liability, an entity would apply the bifurcation and separate accounting requirements in Subtopic 815-15 and account for the embedded derivative in accordance with Topic 815. The financial liability host that results from separation of the nonfinancial embedded derivative would be subject to the proposed amendments. However, an entity would be permitted to initially and subsequently measure the entire hybrid nonfinancial liability at fair value (with changes in fair value recognized in net income) if after applying Subtopic 815-15 the entity determines that an embedded derivative that requires bifurcation and separate accounting exists. In contrast, for a hybrid nonfinancial asset the proposed amendments would require the hybrid contract to be measured at fair value (with changes in fair value recognized in net income) if the hybrid nonfinancial asset contains an embedded derivative that would have required bifurcation and separate accounting under Subtopic 815-15. Do you agree with the proposed amendments? If not, why? What would you propose instead?

We agree that the financial liability host that results from separation of a nonfinancial embedded derivative should be subject to the proposed ASU. We also agree that an entity should be permitted to irrevocably elect to measure the entire hybrid nonfinancial liability at fair value; however, we suggest the issue below be clarified.

Under the proposal, an entity would be able to elect to apply the fair value option to a hybrid nonfinancial liability only if a derivative embedded in that liability would require bifurcation. However, an entity would be able to elect to apply the fair value option to a hybrid financial liability unless the embedded derivative(s) do not significantly modify the cash flows of the hybrid instrument and it is clear with little or no analysis that bifurcation would be prohibited. It is unclear why there should be such a distinction between a hybrid nonfinancial liability and a hybrid financial liability.

# Appendix B – KPMG's responses to specific questions posed by the FASB regarding the proposed amendments to the Codification

# Question 1

Do you believe that the proposed consequential amendments that would result from the proposals in the Proposed Update on financial instruments have been appropriately reflected? If not, what alternative amendment(s) do you recommend and why?

We believe that the proposed consequential amendments that would result from the proposals in the Proposed Update on financial instruments have been appropriately reflected.

# Question 2

Do you believe that all guidance related to financial instruments in various Topics in the FASB Accounting Standards Codification (for example, Topics 310 and 470) should be consolidated into a single Topic?

We believe that the FASB should retain the current structure of various Topics covering various financial instruments and avoid creating a single Topic that consolidates guidance related to financial instruments. In our view, the current structure of the FASB Accounting Standards Codification adequately separates guidance by the type of financial instrument, and the proposed alternative would create a very broad Topic and would increase complexity in the organization of the guidance on financial instruments.

# Question 3

The proposed amendments also would eliminate the fair value option (for financial instruments not within the scope of the proposed Update on financial instruments) in current U.S. GAAP (see paragraph 825-10-15-4), related to guarantees, contingencies, rights and obligations of insurance contracts and warranties, written loan commitments, and firm commitments. Do you agree with the proposed elimination and the effective date and transition guidance? If not, why? What would you propose instead?

As described in our response to Question 15 in Appendix A, we support the proposed elimination of the unconditional fair value option, including elimination of the fair value option for financial instruments not within the scope of the proposed ASU. We consider a limited fair value option to be a better alternative to today's unconditional fair value option. The proposal would reduce alternative accounting methods, thereby improving comparability and decision-usefulness of financial statement information. As described in our response to Question 15, we suggest that the FASB include an accounting mismatch between assets and liabilities as one of the eligible criteria for the fair value option to improve the comparability between an entity applying the proposed ASU with one applying IFRS 9. We agree with the FASB's decision to link the transition and effective date for eliminating the fair value option for financial instruments that are not in the scope of the proposed ASU to their respective projects to be consistent with the guidance in the respective projects.