

May 15, 2013

Ms. Leslie Seidman Chairman Financial Accounting Standards Board 401 Merritt 7 P.O. Box 5116 Norwalk, CT 06856-5116

Dear Ms. Seidman:

The Global Financial Institutions Accounting Committee of the Securities Industry and Financial Markets Association ("SIFMA")¹ appreciates the opportunity to provide comments on the Financial Accounting Standards Board's ("FASB's" or the "Board's") proposed Accounting Standards Update "Financial Instruments-Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Liabilities" (the "Proposed Update"), file reference number 2013-220.

We support the Boards efforts in working toward a converged classification and measurement model and acknowledge and support the following provisions in the Proposed Update:

- Consideration of business model and contractual cash flow characteristics to determine initial classification and subsequent measurement of financial assets (i.e., "the three bucket approach");
- Retention of amortized cost as the default measurement for financial liabilities, including deposits;
- Recognition of changes in instrument specific credit risk (own credit) on fair value option elected debt in other comprehensive income (including early adoption of this provision) and recycling of such changes to earnings upon settlement;
- Providing symmetry in the measurement of non-recourse liabilities and related financial assets; and
- Recognition of foreign currency transaction gains/losses in net income for foreign currency denominated debt instruments measured at fair value in other comprehensive income ("FV-OCI").

However, our members have an overall concern the Proposed Update does not provide a classification and measurement framework for financial institutions that is reflective of their lending, investing and trading business models and associated risk management practices. The proposed framework should assist users of financial statements in understanding the impacts of

-

¹ SIFMA brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association. For more information, visit www.sifma.org.

management's decisions, rather than drive such decisions or undermine risk management strategies. While we support the previously highlighted provisions of the classification and measurement framework, we have concerns with the proposed assessment of whether contractual cash flows of financial assets are solely payments of principal and interest ("SPPI test"), with the majority of firms supporting the retention of the existing "clearly and closely related" (C&CR) embedded derivative guidance; believe that Business Model Assessment is too narrowly defined, and that firms should have an option to use a Fair Value Option. Our specific comments and recommendations to address this overall concern are described below.

Key Concerns with the Proposed Update

<u>Contractual Cash Flow Characteristics Assessment:</u> We believe the Board should revise its assessment of whether contractual cash flows of financial assets are solely payments of principal and interest ("SPPI test"). While we agree that the classification and measurement framework should consider the contractual cash flow characteristics of a financial asset, the SPPI test raises the following concerns:

- The SPPI test places too much emphasis on inconsequential financial terms that are not expected to significantly affect the fair value of a financial instrument and, coupled with the inability to bifurcate the embedded terms causing failure of the SPPI test, may result in fair value net income ("FV-NI") measurement for many plain-vanilla lending products and debt securities which may not be consistent with the business model for such assets;
- The SPPI test in the Proposed Update lacks sufficient guidance and will need considerable clarification to implement due to the ambiguous nature of the test and complexity of its application to a continually evolving multiplicity of financial instruments and embedded features; and
- Unnecessary complexity is created from separate frameworks (and extensive implementation guidance for each) to assess the cash flow characteristics for the same hybrid financial instrument, as the holder of such instruments is required to apply the SPPI test and the issuer the C&CR model.

For these reasons and others identified in the appendix the majority our members recommend the Board replace the SPPI test with the existing "clearly and closely related" embedded derivative guidance in Topic 815 ("C&CR model"), including an option to bifurcate the embedded feature. The C&CR model already provides an appropriate basis for an assessment of the cash flow characteristics of a financial asset and is sufficiently developed, well understood and appropriately applied in practice. These members also believe the Board should allow bifurcation of the embedded feature that prevents financial assets from meeting the contractual cash flow characteristics criterion (regardless of which model – C&CR or SPPI – the Board decides upon). These members believe allowing bifurcation of embedded derivatives facilitates financial reporting more reflective of risk management activities for certain economic or accounting hedging strategies. However, a minority of members support removal of bifurcation for financial assets as they believe it promotes convergence to IFRS and reduces complexity.

Alternatively, if the Board decides not to accept the recommendation of the majority of our members and decides to retain the SPPI model with no bifurcation, we have recommended changes to that model as expressed in the appendix of our letter.

Business Model Assessment: We are concerned the definition of the 'hold-to-collect' business model is too narrow and may result in classification and measurement of many investments in debt instruments (that satisfy the contractual cash flow characteristics criterion), including a financial institution's "held for investment" loan portfolio, at FV-OCI. We observe the 'hold-to-collect' business model in the Proposed Update is largely modeled after the eligibility criteria for "held-to-maturity" debt securities in Topic 320, which is rarely used by financial institutions in practice due to its stringent nature. Financial instruments that are held for the collection of contractual cash flows are not always held to maturity and effective risk management may require sales of financial instruments in anticipation of an observation of credit deterioration or to reduce concentrations of risk. Financial reporting based on an accounting oriented business model framework will not accurately portray how the business of banking is conducted, thus providing users with a limited or inaccurate understanding of the business activities of a financial institution. It is critically important that the business model concept be more reflective of actual lending, investing and trading activities and the concept be articulated consistently in the classification and measurement model for financial instruments.

<u>Fair Value Option</u>: We strongly disagree with the Board's decision to limit the existing unconditional fair value option. Our members strongly support an unconditional fair value option to measure financial assets and financial liabilities. We believe such an option reduces complexity and accounting asymmetry, and provides more meaningful financial reporting. We also believe such benefits exceed any perceived costs. Alternatively, if the Board decides to pursue a limited fair value option, we recommend convergence with the IASB on this issue as their proposal permits financial reporting more reflective of business activities managed on a fair value basis than the Proposed Update.

Our specific comments on the Proposed Update, which include additional concerns not addressed above, are expressed more fully in the appendix.

We thank you for the opportunity to provide our industry view. The Global Financial Institutions Accounting Committee would be pleased to discuss our response with the FASB staff. Please contact me at 212-357-8437 if you have questions or comments concerning our letter.

Regards,

Matthew L. Schroeder

Matt Schoeler

Chairman, SIFMA Global Financial Institutions Accounting Committee

Copy to:

Paul Beswick, Chief Accountant, Office of the Chief Accountant, SEC Susan Cosper, Technical Director, FASB Shahid Shah, Practice Fellow, FASB Mary Kay Scucci, PhD, CPA, Managing Director, SIFMA

Appendix

CONTRACTUAL CASH FLOW CHARACTERISTICS ASSESSMENT (including bifurcation of embedded derivatives)

Replace the SPPI test with the existing clearly and closely related ("C&CR") framework:

The majority of our members believe the C&CR framework is well established, well understood, has been vetted by practitioners and preparers, and is conceptually sound across various types of financial instruments. Under the current framework, fair value measurement is required for embedded terms that would otherwise require fair value measurement on a stand-alone basis; in other words, the embedded terms meet the definition of a derivative. These members believe there will be significant implementation issues and limitations associated with the proposed SPPI model, and as such, believe the current framework remains a better alternative for the assessment of contractual cash flow characteristics. Accordingly, we ask the Board to consider the following additional limitations of the SPPI test if the Board continues to pursue the SPPI test as proposed:

- Although the SPPI test may appear to be simple, the ambiguous nature of the test and
 complexity of its application to a continually evolving multiplicity of financial instruments
 with embedded features will inevitably necessitate the development of implementation
 guidance, whether by standard setters or auditors, similar to and possibly more extensive
 than existing implementation guidance for the C&CR framework; and
- Because bifurcation will no longer be permitted, fair value measurement of the entire hybrid instrument may be required even when embedded terms are not expected to significantly affect the fair value or cash flows of the instrument. For example, the SPPI test may require FV-NI for many plain-vanilla debt instruments. Such instruments include certain loans with variable rates tied to prime or other rates without a specific tenor, even if the business model is to 'hold-to-collect' contractual cash flows. Additional examples are listed within the section entitled: Insignificant embedded features in plain-vanilla debt instruments may cause FV-NI.
- Moreover, the SPPI test adds additional complexity to the accounting model as the SPPI criteria are applied to assets whereas the C&CR are applied to liabilities when determining whether embedded features exist. This seems counter to the Board's simplification objective and may result in inconsistent outcomes for similar instruments.

The bifurcation model (option) should be retained

The majority of our members believe the Board should retain bifurcation of embedded features that prevent financial assets from meeting the contractual cash flow characteristics criterion. This is applicable whether the Board accepts the recommendation above or retains the SPPI test within the Proposed Update. These members are concerned about the potential restatement risk in a model that requires FV-NI measurement for the entire financial asset. We believe the operational burden of implementing an internal control system to effectively capture all insignificant cash flows will not be cost beneficial. We are also concerned about the potential practice issues to could arise, for example, a standard embedded feature determined to not cause FV-NI treatment later determined to be problematic due to evolving interpretations of SPPI. We find this outcome troubling for embedded features that have minimal impact on the fair value or cash flows of the entire financial asset.

Additionally, the bifurcation model facilitates effective economic hedging strategies and promotes consistent treatment with other non-hybrid financial instruments. Bifurcation of a qualifying embedded feature permits an organization to isolate and hedge the risk inherent within each component of a financial instrument more easily as derivative instruments generally are structured to mitigate a particular risk. Bifurcation of the embedded feature also facilitates more reliable tracking of effectiveness of the hedge relationship. The inability to bifurcate qualifying embedded derivatives will undermine risk management strategies and exacerbate accounting measurement mismatches. We believe it would be more appropriate to account for the host contract in accordance with the business model underlying the hybrid instrument rather than defaulting to fair value measurement through net income. Such a model would promote consistency with other non-hybrid instruments in similar risk management strategies or business models and we encourage the Board to retain the option to bifurcate qualifying embedded derivatives.

Our other members support the removal of bifurcation for financial assets as they believe it promotes convergence to IFRS and reduces complexity.

If the Board decides to retain the SPPI model, clarification and improvement is needed:

We recommend various changes and clarification guidance be provided in order to achieve a more conceptually sound classification and measurement result across a vast array of debt instruments. Overall, we believe the consideration of the cash flow characteristics should follow a cohesive principle rather than detailed and potentially inconsistent application guidance. As currently proposed, an entity would be required to consider any embedded feature of an instrument based on a narrow and rules-based interpretation of the SPPI test, in some cases irrespective of the significance of the embedded feature. Therefore, we believe the Proposed Update should be clarified or modified to address the following conceptual issues.

Clarify application of the benchmark instrument

We are concerned with the ambiguity in determining the benchmark instrument and assessing whether the cash flows of the modified instrument are "more than insignificantly" different than the benchmark instrument. While the proposal does not define the threshold at which the cash flow difference would be considered significant, we are concerned that auditors would develop bright lines in practice. In addition, even if the cash flows of the modified instrument could be more than insignificantly different than those of the benchmark instrument, these modified cash flows may be highly unlikely to occur given the nature of the trigger associated with the embedded feature. Rather, we propose that a qualitative consideration of the cash flow characteristics of an instrument precede the quantitative requirement to compare the cash flows of the modified instrument to those of a benchmark instrument. The qualitative assessment would consider the significance of the embedded feature to the hybrid instrument and also the likelihood of the feature to impact the cash flows. A quantitative assessment on an instrument-by-instrument basis should only be required if a qualitative assessment cannot be made.

Insignificant embedded features in plain-vanilla debt instruments may cause FV-NI

We are highly concerned that the SPPI test as proposed would result in financial assets with embedded features that do not significantly impact the fair value or cash flows being required to be classified as FV-NI in their entirety even when that does not reflect the business model with respect to recognition of the cash flows. If an instrument that otherwise has the basic principal and interest characteristics of debt includes involuntary conversion or suspension provisions, which are highly unlikely to be triggered at the time of recognition, then the inclusion of such conditions in the terms of the instrument should not require FV-NI due to the SPPI test. Additionally, certain plain-vanilla debt instruments may require FV-NI for features that are inconsequential to the valuation of the instrument. We are concerned that these types of common loan products would fail the rigid criteria under the SPPI test and as such, irrespective of a firm's

business model, would be classified as FV-NI resulting in volatility reported in earnings that is not expected to be realized.

For illustrative purposes, we have listed a few common "plain-vanilla" financial instruments for the consideration of the Board that we believe, without further clarification, have a high risk of failing to satisfy the requirements of the SPPI test.

- Adjustable rate mortgages, which are debt instruments that typically encompass a low introductory rate that is fixed for a specified period (usually two, three or five years) and then adjusts periodically to a floating rate. The floating rate may reset based on a reference index that does not have a tenor (e.g., Prime). These adjustable rate mortgages may fail the SPPI assessment because a) there is an introductory rate for a period of time and then a rate reset or b) the instrument is based on Prime, which doesn't have a specified tenor.
- Contingent convertible bonds (CoCos) are debt instruments that are mandatorily transformed into shares of equity or written off upon a triggering event. CoCos are not intended to be converted under normal circumstances; however, conversion would occur if the issuing firm failed to meet pre-set solvency conditions that would indicate that it is in danger of becoming seriously undercapitalized. Therefore, the expectation is that CoCos would not be converted except in extremely unlikely circumstances. Under the proposed model, although the conversion criteria are highly unlikely to be triggered, these instruments would not pass the SPPI test and would be classified as FV-NI, which would not reflect the normal business model or expected future cash flows of such instruments.
- Perpetual preferred securities ("PPS") are typically structured as equity instruments but possess significant debt-like characteristics. Financial institutions hold these instruments primarily for the dividend payments that are akin to coupon payments of a debt instrument, which are typically based on floating rates such as LIBOR. We recognize the example provided by the Board illustrates a cumulative PPS in which interest accrues on deferred amounts that would possibly qualify as a financial instrument whose cash flow characteristics are solely payments of principal and interest. However, we consider this feature inconsequential to the valuation of the instrument and do not believe it should be a key determinant in classification and measurement of the instrument.

Clarify the definitions of principal and interest to eliminate unintended consequences

The proposed definitions of principal and interest for the purposes of the SPPI test may have unintended consequences. For the purposes of the SPPI test, consideration of principal based on the amount exchanged at inception may cause prepayable debt instruments that are purchased at a premium or discount to fail the SPPI test. Also, for zero-coupon bonds, the amount transferred at inception does not represent principal as it includes interest-related compensation. The definition of principle should include the unpaid contractual balance due, which is important for amortizing financial instruments. In addition, the definition of interest in the proposal is too narrow. We suggest that other factors, such as funding and servicing costs and profit margin, should also be considered in determining whether the interest component of the cash flows is reasonable.

Eliminate the look-through requirement for securitized financial assets

For beneficial interests in securitized financial assets, the majority or our members do not support looking through to the underlying pool of instruments in determining whether the tranche contains payments of solely principal and interest. These members are concerned securitized assets may require FV-NI classification under the Proposed Update due to the following conceptual and operational concerns with the look-through approach:

- It may not be operational to apply the SPPI test to the underlying pool of assets to determine the amount transferred by the trust at initial recognition of the assets. Instrument-level information is not always accessible to the investors due to legal constraints imposed by the trustees or it may be cost-prohibitive to obtain the information, especially for multi-layer structures like CDOs and CLOs. We do not think looking through all the way to detailed underlying collateral to identify the principal amount would result in a better accounting outcome than the current analysis required under existing U.S. GAAP.
- If the Board retains the SPPI test for securitized assets, the look-through approach requires a determination of whether the underlying pool can be changed after recognition in a way that the beneficial interest may not meet the SPPI test. We think this requirement is not operational and suggest the FASB require the SPPI analysis be performed only at initial recognition. Also, clarification would be needed when performing the SPPI test for underlying assets in a securitization vehicle that holds nonfinancial assets, such as foreclosed real estate assets. It is not clear how to analyze a beneficial interest where there already may be real estate in the underlying pool of assets.
- The inclusion of a credit risk criterion for beneficial interests in securitized assets is unnecessary and results in inconsistent classification and measurement for financial assets with similar credit risks. For example, loans and plain vanilla debt securities are not subject to this criterion, but may have similar subordination or a lower credit rating than a beneficial interest and qualify for amortized cost. We do not understand the conceptual basis for applying the credit risk criterion only to beneficial interests and recommend the criterion be removed. If the Board retains this criterion in the final standard, we would ask for clarification of the meaning of credit exposure to ensure consistent application of this assessment. If not removed or clarified, we are concerned the credit risk criterion may be interpreted to require FV-NI classification for all but the most senior securitized assets, which may be inconsistent with the business model under which the assets are managed.

The current U.S. GAAP embedded derivative model for beneficial interests requires the holder to analyze both the contractual terms of the beneficial interest and the activities within the securitization structure. This analysis requires an understanding of the nature and amount of the assets, liabilities and other financial instruments, such as derivatives and guarantees that compose the securitization, as well as the payoff structure and priorities. The current bifurcation model would identify many of the features that would cause a beneficial interest to fail the proposed SPPI test and recommend a similar approach be retained within the Proposed Update.

BUSINESS MODEL ASSESSMENT

'Hold-to-collect' business model is too narrowly defined

The Proposed Update provides that the classification of financial assets should be based on both the cash flow characteristics and the business model in which the asset is managed. We understand the objectives of this requirement and agree amortized cost is the appropriate classification for financial assets that meet the contractual cash flow criterion (subject to comments previously discussed in this letter) and are managed under a 'hold-to-collect' business model. We also agree that amortized cost is not the appropriate classification for assets managed to realize fair value changes, which typically necessitate significant sales activity. However, we believe the 'hold-to-collect' business model interprets how financial institutions manage risks too narrowly, and may result in FV-OCI classification for many traditional 'held-for-investment' loan portfolios.

The Proposed Update permits sales out of the amortized cost category only if (i) the sales are a result of a significant deterioration in the issuer's creditworthiness and the purpose of those sales is to maximize the collection of contractual cash flows, (ii) the sales that result from reasons other than managing credit exposure are very infrequent and (iii) sales of assets occur close to the maturity date of such assets and the proceeds from those sales approximate the collection of the remaining contractual cash flows. Additionally, the Proposed Update indicates that sales to manage credit concentration and interest rate, prepayment or foreign currency risk are inconsistent with the amortized cost classification. Such a narrow model is consistent with the existing 'heldto-maturity' guidance for debt securities in Topic 320. The 'held-to-maturity' debt security classification is rarely used in the financial services industry due to the stringent nature of the criteria and inconsistency with the entity's risk management strategies. However, financial assets managed in a 'hold-to-collect' business model are not necessarily 'held-to-maturity'. Sales of such assets, not specifically contemplated at initial recognition, do occur subsequently during the normal course of managing the business and associated risks for reasons other than those defined by the Proposed Update. We do not agree that such sales are inconsistent with a business model of holding to collect contractual cash flows.

Prudent risk management strategies require entities to set exposure limits on their portfolios and, as a result, may cause entities to sell assets to reduce concentration risks. Financial institutions can be exposed to various types of concentration risk – including by borrower, industry, geography, collateral and product – and managing such risks is inherent in credit risk management. Prudent credit risk management in a 'hold-to-collect' business model has the objective of preserving the collection of contractual cash flows, which often requires anticipatory actions before the contractual cash flows become jeopardized and there is an observed significant decline in the borrower's credit worthiness. This activity is standard in the lending business and is consistent with the overall objective of the business model to collect for contractual cash flows. We believe the Proposed Update should be revised to indicate such sales, executed as part of an entity's credit risk management strategy, are not inconsistent amortized cost.

Similarly, fundamental in the banking industry are meeting regulatory capital requirements. Circumstances may arise that require sales of 'hold-to-collect' financial assets to meet regulatory capital requirements that may not result from broad regulatory capital rule changes or regulator action impacting the entire industry. These entity-specific scenarios may result from changes in facts and circumstances or forecasts not reasonably foreseen since initial recognition of the 'hold-to-collect' financial assets. We believe the Proposed Update should be revised to indicate voluntary sales executed to manage regulatory capital requirements or those sales required by regulator actions specific to an entity are not inconsistent with amortized cost.

Additionally, there are other examples of sales that are isolated or nonrecurring that also occur for valid business reasons other than those previously mentioned (e.g., sale of a specific business unit or portfolio, strategic product shift, etc.), which are not contemplated at inception but may occur over time. We believe the amortized cost classification would be appropriate for such financial assets as long as the business objective of holding the assets for contractual cash flows is met at inception and until the time such an event becomes likely.

In summary, while we agree that the classification and measurement of financial assets should be based upon an entity's business model, the proposed 'hold-to-collect' business model approach is overly narrow. The Proposed Update indicating which sales out of the amortized cost category are permitted is too restrictive. Such restrictions would cause many assets that are truly managed for the purpose of collecting contractual cash flows to be classified as FV-OCI solely due to events that are either outside of the entity's control, are part of prudent business practices, or are unforeseen at origination/acquisition of the financial asset.

Clarify business model test application level (portfolio or instrument)

ASC 825-10-55-28 states that an entity may have more than one business model for managing its financial assets. For example an entity may hold a portfolio of investments that it manages to collect contractual cash flows and another portfolio of investments that it manages to realize fair value changes. In our view, the guidance implies that the business model test should not be applied on an instrument-by-instrument level. However, an entity's key management personnel could conclude that it manages different portfolios of financial assets under different business models. We believe that this interpretation is also consistent with how IFRS 9 is currently applied. We ask the Board to further clarify the wording in ASC 825-10-55-28 to acknowledge explicitly that the business model test should be applied at a portfolio level rather than at a higher level.

Permit hedging strategies for financial assets measured at amortized cost

Financial institutions manage exposure to interest rate risk of banking book assets and liabilities in aggregate as part of the asset-liability risk management process. The Proposed Update permits loans in the amortized cost category to be the hedged instrument in a fair value or cash flow hedge; however, the current prohibition on hedging debt securities in the 'held-to-maturity' category for changes in fair value or cash flows attributable to interest rate risk has been retained in the Proposed Update. We believe both loans and debt securities should be treated the same in this regard and that hedging of interest rate risk should be permitted for both. We are concerned that certain instruments, such as debt securities held at amortized cost, are prohibited as eligible hedged items in this type of accounting hedge as such instruments must be held to maturity. Regardless of whether selling activity is anticipated, a financial institution is still subject to interest rate risk, which manifests itself in net interest margin in future periods. For example, a financial institution is subject to interest rate risk when fixed-rate financial assets, regardless of business model, are financed with floating-rate debt. The interest rate of the financial asset does not provide compensation for potential future changes in interest rates associated with the floatingrate debt. A financial institution commonly uses a fair value hedging strategy in order to maintain net interest margin within a specified range. This type of hedge strategy is common today for loan portfolios that are held for the collection of contractual cash flows and likely classified within the amortized cost category under the proposed guidance. Given that Under the Proposed Update, loans and debt securities would be treated the same regarding classification, we strongly encourage the Board to allow fair value and cash flow hedges, including hedges of interest rate risk, for all financial assets classified as amortized cost.

Clarification is required for portions of pools with similar financial assets

Clarification is required for the application of the business model assessment to pools of similar financial assets when an entity expects to sell a portion and to hold a portion to collect contractual cash flows. While allocation of a pool of similar financial assets among classification categories is

consistent with common business strategies, we are concerned with the implications of the subsequent accounting for these assets following this allocation based on percentage allocation. Because an entity would not know specifically which assets it will ultimately sell and which will be held for collection of cash flows, this will inevitably result in sales of assets out of the portion of the pool initially allocated to the 'hold-to-collect' category. However, an entity would not be permitted to reclassify the assets when the decision to sell had been reached. We believe that clarification is required on this point to ensure that subsequent or day two accounting can be applied consistently and subsequent sales activity would not result in perceived violation of the business model assessment at initial recognition.

We also suggest the Board consider similar guidance for individual assets, such as loan participations and syndications. Consistent with current accounting guidance, we believe that it is reasonable and in line with common business models that an entity should be able to classify a single loan based on a percentage allocation in accordance with its strategy to syndicate a portion of the loan with other lenders and to hold a portion of the loan to collect cash flows.

Converge with IFRS 9 reclassifications for "infrequent" business model changes

We support reclassification where the business model has changed, but are concerned that the use of "very infrequent" would lead to an interpretation of "never."

Given basic loan feature characteristics, if an entity's business model determines the classification of an instrument, then reclassifications are necessary when a business model changes. To be consistent with the business model principle, reclassification should be required both into and out of FV-NI when the business model changes. We would expect changes in business model to be infrequent, determined by an entity's key management personnel and as a result of fundamental significant external or internal changes.

We would support convergence with the IFRS 9 reclassification requirements, and would prefer that reclassifications be characterized as "infrequent" rather than "very infrequent." Other than removing "very", we urge the FASB to use the same language included in IFRS 9, paragraphs 4.4.1 – 4.4.3, 5.6.1 – 5.6.3, and B4.4.1 – B4.4.3, to avoid any potential interpretational differences between US GAAP and IFRS.

FAIR VALUE OPTION

Eliminate limitations on existing unconditional fair value option

We strongly disagree with the Board's decision to limit the existing unconditional fair value option. We are unaware of any abuse of this option. Elections are generally made by SIFMA committee members for the same reasons, typically to reduce complexity or accounting asymmetry. We acknowledge the practice issue that arose relating to own credit for unsecured debt elected under the fair value option and we are supportive of the Board's proposed solution. In our view the unconditional fair value option is a necessary "tool" given the complexity of accounting for financial instruments. Existing disclosures provide transparency over the use of the fair value option tool. It is unclear to us why the Board believes limiting the use of a preparer's professional judgment as to when the fair value option should be applied will produce better financial reporting.

The limited fair value option provided in the Proposed Update cannot capture all potential examples of where a fair value option would best represent future cash flows for the reasons described above. For example, the limited fair value option is not provided for financial assets that meet the criteria for amortized cost classification, irrespective of whether they are managed on

a fair value basis or hedged using derivatives that cannot qualify for hedge accounting under existing U.S. GAAP. Additionally, the fair value option is commonly used to avoid an accounting mismatch for financial liabilities with non-bifurcatable risks that are hedged using derivatives and hedge accounting is not otherwise available. We are concerned that the proposed conditional fair value option in paragraph 825-30-15-2 of the Proposed Update will not always be available as a remedy for the examples described above because of the limiting nature of the Proposed Update.

The Board believes the benefits of an unconditional fair value option are less than the costs of providing such option. We do not agree. The perceived benefits of eliminating the unconditional fair value option will be diminished, given the different business models, hedging programs and potential use of the limited fair value option.

If the Board disagrees and continues to support a limited fair value option, we ask the Board to converge with the IASB on this issue as their proposal is more reflective of business practices than that currently within the Proposed Update.

Permit fair value option for instruments managed for credit risk

Under the revised IFRS 9, entities will be permitted to elect the fair value option for a financial instrument after initial recognition, if the credit risk of the financial instrument (for example, a loan or loan commitment) is subsequently risk managed with a credit derivative when certain criteria are met. SIFMA's members strongly recommend that the FASB incorporate the same guidance into its final standard on recognition and measurement, for the reasons discussed below.

- Under current U.S. GAAP (ASC Topic 825), entities may elect the fair value option only at initial recognition of a financial instrument, or in certain specified other circumstances. For financial institutions with significant portfolios of loans and loan commitments, it is not possible to identify at initial recognition the specific loans (or portions of loans) that will be risk managed with credit derivatives because creditworthiness, established risk limits of particular borrowers, total exposure, and the pricing and availability of credit derivatives all change over time. To manage these changes, a financial institution may subsequently decide to (or not to) risk manage with a credit derivative.
- SIFMA's members believe that a fair value election after initial recognition, when the entity is managing the risk exposure of a financial instrument with credit derivatives, results in better information for financial statement users. While the entity holds both the financial instrument and the related credit derivative, fair value accounting for both instruments that reflects the extent of offsetting changes in fair value is appropriate. Any changes in fair value of the underlying financial instrument since initial recognition would be immediately recognized in earnings, and SIFMA's members would support highlighting such amounts in either a separate caption on the income statement or in the footnotes to the financial statements.

EQUITY INVESTMENTS

Retain existing equity method accounting with unconditional fair value option

We do not support the proposed model for accounting for equity method investments. We believe retaining equity method accounting under the current framework together with the unconditional fair value option allows preparers the flexibility to choose the best model that aligns with their business strategy. The proposed model will require equity method accounting for equity method investments that are managed on a fair value basis but do not meet the criteria for held for sale, for example, an investment in an entity that may not meet the criteria for Investment

Company accounting ("close call") but is managed like a fund. Conversely, investments that may structurally meet the requirements for 'held-for-sale', such as certain tax credit vehicles may not be managed on a fair value basis and therefore FV-NI may not be appropriate.

We are also concerned that the application of the rules is unclear. The assessment of 'held-for-sale' must be performed at initial recognition; however, the Proposed Update doesn't provide guidance on the accounting for a subsequent change in strategy for an investment that doesn't initially meet the 'held-for-sale criteria'. Additionally, it is unclear whether there would be a tainting concept for new investments if initial exit strategies are not met.

Provide a FV-OCI category for equity instruments not held for trading

To increase convergence with the proposed accounting requirements under IFRS, we believe that a FV-OCI category should also be introduced for certain types of equity instruments, such as exists under IFRS, thus facilitating greater transparency and comparability in financial reporting between U.S. GAAP and IFRS.

Equity instruments that are held for trading are required to be measured at FV-NI. For all other equities where no significant influence exists, we propose that management have an ability to make an irrevocable option on initial recognition, on an instrument by instrument basis, to present changes in FV-OCI rather than FV-NI.

We believe permitting a FV-OCI classification for equity investments not held for trading purposes is more reflective of business model under which these investments are managed. For example, an equity investment may be held as part of a long-term dividend investment strategy as an enhanced yield alternative to debt investments. Requiring FV-NI classification for long-term, strategic equity investments may not be indicative of the performance of the reporting entity and therefore may add volatility to earnings where it isn't warranted. This is specifically relevant when the entity holds equity instruments for strategic benefits rather than for increases in the value of the investment.

Therefore, allowing for the measurement of perpetual, strategic type of equity investments that are not held for trading at FV-OCI not only seems rational, but also supports consistency with IFRS 9.

OTHER CLASSIFICATION AND MEASUREMENT ISSUES

Provide consistency and clarification for loan commitments remote of funding

We support the notion that the measurement of a loan commitment should follow the accounting for the funded loan. We believe this requirement would result in classification of a loan commitment according to the way the loan commitment is managed and will generally reduce complexity. Additionally, we agree that the fees on loan commitments that are remote of funding should continue to follow the guidance in subtopic 310-20 as proposed in Paragraph 825-10-35-21 of the Proposed Update for loan commitments held for the collection of cash flows.

However, we remain concerned about the implications of the Proposed Update for loan commitments that are remote of funding held in a business model that is other than a 'hold-to-collect' strategy. Because such loan commitments are excluded from the scope of paragraph 825-10-25-28 of the proposed Update, there is no guidance on the classification and measurement of such loan commitments if the business model is other than 'hold-to-collect'. We believe whether a loan commitment is expected to be funded or is remote of funding should have no bearing on the business model classification. For example, a loan commitment that is remote of funding can

be held for market making purposes and risk managed on a fair value basis. Consequently, we believe all loan commitments even if they are remote of funding should be recorded consistent with the related business model. We recommend the following changes to the proposed Update to clarify this point.

825-10-25-28 An entity that issues a **loan commitment**, a revolving line of credit, or a commercial letter of credit (the potential creditor) for which the likelihood of exercise is deemed to be not remote at inception of the instrument, shall classify that instrument in accordance with the classification of the underlying loan......

825-10-35-20 Paragraph 825-10-25-28 requires a creditor to classify a **loan commitment**, a revolving line of credit, or a commercial letter of credit for which the probability of exercise is not remote in accordance with the classification of the underlying loan to be made under the commitment....

825-10-35-21 If the exercise of a loan commitment, a revolving line of credit, or a commercial letter of credit is deemed to be remote, and the loan commitment is held for the collection of cash flows a creditor shall recognize the commitment fee received, if any, over the commitment period in accordance with the guidance in Subtopic 310-20.

Align measurement of nonrecourse debt to eliminate accounting mismatches

We support the proposal to align the measurement of nonrecourse liabilities with the financial assets that will be used to settle the nonrecourse debt. However, we encourage the Board to also align the measurement of nonrecourse debt with any non-financial assets that will be used to settle the nonrecourse debt, as we do not believe the nature of the assets associated with the nonrecourse debt should create accounting mismatches. For example, current nonrecourse debt issued by consumer and commercial real estate securitization vehicles may contain non-financial instruments in the form of foreclosed real estate property. We are concerned that the existence of the foreclosed real estate would preclude the ability to align the measurement bases of the nonrecourse debt and the assets of the securitization vehicle that will be used to settle the nonrecourse debt. This view was recently supported by the EITF² and we encourage the Board to amend the proposed guidance to align the measurement of nonrecourse liabilities to include both the financial and non-financial assets that will be used to settle the nonrecourse debt. Additionally, many securitization vehicles that issue nonrecourse debt hold financial instruments that may become non-financial assets over time. As this occurs post initial recognition, further clarification is needed as it is unclear how nonrecourse debt that was initially measured in alignment with the related financial assets should be treated when all or a portion of those financial instruments become non-financial assets.

PRESENTATION AND DISCLOSURE

Simplify the face of the financial statements

Financial assets and financial liabilities should be measured based on the way an entity expects to utilize those assets and liabilities. Therefore, we do not believe that both amortized cost and fair value should be provided on the face of the financial statements. Amortized cost instruments by their nature are to be held for the collection of cash flows and, therefore, providing fair value information on the face of the balance sheet may confuse investors and users. We believe that this information is best kept in the notes to the financial statements. Similarly, providing amortized

² Accounting for the Difference Between the Fair Value of Asset and Fair Value of Liabilities of a Consolidated Collateralized Financing Entity (Issue 12-G).

cost information for fair value option measured structured notes, is difficult to determine as the embedded derivative component makes the effective interest rate complicated. This derived amount is not relevant to either the settlement amount or fair value, is operationally difficult to obtain and provides extraneous information that is not decision useful.

Eliminate Level 3 disclosures for amortized cost

We do not agree with the proposed Level 3 quantitative disclosures of significant unobservable inputs for financial instruments that are measured at amortized cost. Level 3 inputs, by their nature, require more subjectivity and management's assertions than quoted prices or valuation techniques. Providing highly unobservable management assumptions related to Level 3 data does not provide useful information and results in voluminous disclosures which are not relevant to investors in understanding an entity's financial statements when the instruments are not measured on a fair value basis. Providing this information is operationally burdensome to preparers for very little benefit. We note that entities are currently required to disclose the level in the fair value hierarchy for financial instruments that are not measured at fair value. This current level of information is sufficient for financial statement readers to assess the potential level of unobservability inherent in valuing financial instruments that are not currently carried at fair value.

Eliminate increased disclosures on core deposits

We strongly oppose the requirement to disclose our core deposit liability balance, the implied weighted-average maturity period and estimated all-in-cost-to-service rate on the basis that these amounts represent proprietary information that we believe is inappropriate for use in financial statements. Additionally, these terms are not adequately defined and therefore will not result in comparable or meaningful disclosures.

TRANSITION AND EFFECTIVE DATE

Provide clarification of limited early adoption for hybrid financial liabilities

We support changes in an entity's own credit for all recourse debt measured under the fair value option to be included in FV-OCI and subsequently recycled upon settlement. In current practice today, these instruments are typically settled with the creditor and not through an intermediate third party on a fair value basis. Therefore the fair value component related to own credit is not currently realized. We do not believe an entity should recognize gains due to a change in its own creditworthiness in earnings on fair value option liabilities unless and until that change is realized.

We believe this early adoption included in 825-10-65-2(d) contains inconsistent wording. The paragraph states early adoption is limited to "hybrid" financial liabilities but refers to paragraphs 825-30-15-2 and 825-30-15-3 which include both financial and hybrid liabilities. We believe this inconsistency should be clarified to include all instruments designated under the fair value option in accordance with paragraph 825-10-45-17 and expanded including non-financial hybrid liabilities under 825-30-15-5.

Provide coordinated timelines and adequate time for implementation

If the Board moves forward with the Proposed Update as written, the changes to current guidance would require an adequate amount of time to plan, design and implement. Further, in order to implement properly, we suggest aligning the implementation time period with the Proposed Accounting Standards Update—Financial Instruments—Credit Losses (Subtopic 825-15) as this proposal is interrelated to the Proposed Update. Since these proposals are expected to be implemented during the same time period as other significant new proposals such as Proposed Accounting Standards Update—Revenue Recognition (Topic 605): Revenue from Contracts with Customers—Proposed Amendments to the FASB Accounting Standards Codification and Proposed

Accounting Standards Update—Leases (Topic 840), we would support at a minimum three (3) full years from final issuance for implementation.

We strongly support early adoption of the proposed presentation requirements related to changes in instrument specific credit risk for all financial liabilities that would qualify for the fair value option under the Proposed Update.

Additionally, the reclassification guidance in 825-10-35-23(a)(2) provides for the fair value of the financial assets at reclassification date as the assets' new carrying value for amortized cost basis. We request expanding this within the transition guidance in 825-10-65-2 related to all financial instruments (including equity method investments) currently recognized under the fair value option which will be required to be classified under the equity method of accounting under the Proposed Update. Regardless of which implementation approach the Board moves forward with, we believe the Board should also work together with the IASB to coordinate implementation dates which should be at least three (3) years after issuance.