



Two Court Square, 15th Floor
Long Island Citi, NY 11101

May 15, 2013

Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Re: File Reference No. 2013-220: Proposed Accounting Standards Update, *Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*

Dear Ms. Cosper:

We appreciate the opportunity to provide feedback to the Financial Accounting Standards Board (FASB) on the proposed Accounting Standards Update (proposed ASU, or the proposal), *Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*. The FASB's focus on improving the accounting for financial instruments is critical for financial institutions and an effort that Citi supports.

Citi also supports the efforts of the FASB and International Accounting Standards Board (IASB) to more closely align U.S. generally accepted accounting principles (U.S. GAAP) with the International Financial Reporting Standards (IFRS). However, we believe that the goal of convergence is not more important than that of developing high quality accounting standards.

Citi concurs with the FASB that financial assets should be measured based upon their cash flow characteristics and the business model within which they are managed. Citi also supports the proposed three measurement categories, and the proposed requirement to measure financial liabilities primarily at amortized cost.

The following aspects of the proposal are changes to existing U.S. GAAP that Citi believes will improve the accounting for financial instruments:

- Requiring a single recognition and measurement principle for all financial assets, which would reduce the need to distinguish between loans and securities;
- Reporting changes in fair value due to instrument-specific credit risk (a company's own credit) in other comprehensive income (OCI) rather than net income for liabilities measured at fair value under the fair value option (FVO);
- Recognizing changes in the fair value of equity securities in net income;
- Elimination of the tainting provisions for sales of financial assets classified in the 'hold-to-collect' (amortized cost) category; and
- Recognition of foreign currency transaction gains and losses in net income for foreign-currency-denominated debt instruments measured at fair value with qualifying changes in fair value recognized in other comprehensive income (FV-OCI).

We believe that some aspects of the proposal will require additional implementation guidance and clarification by the Board. With respect to the cash flow characteristics assessment, we believe that the

necessary clarifying guidance would be voluminous and potentially very complex. As an alternative we suggest that the Board retain the embedded derivative guidance in effect today, which was designed to accomplish the same objective.

The following commentary describes areas of the proposal that Citi believes require amending in order for the proposal to be operable, understandable, and considered an improvement to existing U.S. GAAP:

- The 'solely payments of principal and interest' (SPPI) test, while simple in concept, can be very complex in application, is not materially different in objective than the existing 'clearly and closely related' (CCR) concept for embedded derivatives in U.S. GAAP, and will result in measurement outcomes that are inappropriate for certain financial instruments. We believe that the Board should retain the existing CCR guidance for hybrid financial assets, as the proposal does for hybrid financial liabilities.
- Under the proposal, there will be a need to identify and evaluate immaterial terms of every hybrid financial asset to complete the SPPI test at transition and for every subsequent origination or acquisition of a financial asset. This approach will require an unacceptably high cost of compliance to financial statement preparers that we believe outweighs the benefits for its financial statement users.
- As the SPPI test will now be determinative of a measurement category, we anticipate the potential for restatement risk may significantly increase for the industry as application views may evolve on current or future standard terms of hybrid financial assets. We do not believe immaterial terms should lead to such potentially punitive results.
- The application guidance about permissible sales activity out of the amortized cost category is defined in a very narrow manner. As proposed, various instruments that form part of a bank's core customer lending activity will be required to be measured at FV-OCI when amortized cost would provide the most useful information for such assets. To address this concern, we recommend that the Board develop a principle around unacceptable sales out of the amortized cost category and broaden the guidance about permissible sales out of the amortized cost category to include additional examples of permissible sales.
- The business model assessment in the proposal is applied only at initial recognition, and never again, regardless of changes in intent (with one exception that is expected to occur only rarely). The permanence of classification may result in situations where, subsequent to initial recognition, the measurement category of a financial instrument is at odds with the management's strategy for that instrument.
- Further, the business model assessment, as expressed in the proposal, seems to be required to be applied at a very high level where performance is evaluated by key management personnel, which would hinder the ability of financial statement preparers to provide a more granular evaluation by portfolio. We believe that an assessment of the business model within which a financial asset is held should be performed at the level at which asset management decisions are made, generally at a portfolio level.
- - The proposal would eliminate the unconditional FVO in existing U.S. GAAP. We do not support the proposal's limitations on the FVO. The FVO is operational today and retaining it will help reduce the complexity in implementing a new accounting model for financial instruments. Further, disclosures provide transparency in its use, and we are not aware of any actual or perceived abuses of the FVO. We recommend that the Board continue to permit preparers to unconditionally elect to measure both financial assets and financial liabilities at fair value with all changes in fair value recognized in net income (FV-NI) upon initial recognition.

In the absence of these improvements, the proposal could be inconsistently interpreted and very costly to apply. As described above, we believe that retaining the CCR model for the identification of embedded derivatives, the requirement to bifurcate embedded derivatives and an unrestricted FVO would be less complex and more cost-effective than the proposed SPPI test as a means to address the recognition and measurement of financial instruments. We support the proposed business model assessment, primarily because it would eliminate the need to distinguish between types of financial instruments based on legal form when classifying into measurement categories. However, we believe that in order to render the business model operable, the Board should incorporate the suggested amendments and clarifications, specifically with regard to sales from the amortized cost measurement category.

The subsequent sections of this letter contain our observations regarding the operability and understandability of the FASB's proposal for the recognition and measurement of financial assets, as well as our assessment of the proposal's ability to achieve the Board's stated objectives in this project.

We would be pleased to discuss any of our comments at your convenience. Please feel free to call me at (347) 648-7721.

Sincerely,



Robert Traficanti
Deputy Controller and
Global Head of Accounting Policy

Question 1: Do you agree with the scope of financial instruments included in this proposed Update? If not, which other financial instruments should be included or excluded from the guidance in this proposed Update and why?

Citi agrees with the scope of financial assets included in the proposed update.

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?

Citi agrees with the industry-specific specialized guidance scope exceptions in the proposal.

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?

Citi believes that the principle behind the contractual cash flow characteristics assessment is clear; however, we have significant concerns regarding the implementation guidance related to this concept in the proposal, as discussed in our responses to subsequent questions below.

We believe that a cost-effective, simple alternative to the proposed 'solely payments of principal and interest' (SPPI) test would be to retain the existing 'clearly and closely related' CCR guidance contained in Subtopic 815-15, *Derivatives and Hedging—Embedded Derivatives*. Similar to the SPPI test, the CCR guidance is intended to identify the features of a financial instrument that are not 'plain-vanilla' arrangements and preclude them from measurement at amortized cost. When it was first implemented, the CCR guidance addressed the same implementation issues identified in our responses to subsequent questions below. The CCR guidance is well understood, consistently applied, and is symmetrical with the Board's proposal for hybrid financial liabilities.

If the Board decides to retain the existing CCR guidance, we also recommend that the Board consider revising the guidance in paragraph 815-15-25-26(b) (the "double-double test") to require consideration of reasonably possible interest rate scenarios as opposed to all possible scenarios, similar to the proposed guidance in paragraph 825-10-55-20 of the proposal.

Further, we support the FASB's initial conclusion in BC195 and request that the Board retain the existing bifurcation requirements in Topic 815 for embedded derivatives. Citi believes that, as under current U.S. GAAP, an embedded derivative that is not clearly and closely related to the host instrument should be required to be bifurcated and accounted for separately as a derivative, rather than requiring the whole arrangement (host and embedded derivative contract) to be measured FV-NI. However, if an embedded feature requires bifurcation, we believe an entity should have the unconditional option to measure the entire hybrid instrument at FV-NI, consistent with existing U.S. GAAP and in order to align the accounting with an entity's business or risk management strategy.

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?

Citi believes that the definition of principal should be expanded to include repayment of the principal amount at maturity or other contractual settlement dates. In the absence of such an expansion any instrument purchased at a premium or discount subsequent to the original issuance, but prepayable at par, may fail the SPPI test.

Further, we suggest that the definition of interest also be expanded to include consideration for factors such as servicing and funding costs and profit margin, not just for the time value of money, credit risk, and liquidity.

Question 6: Do the proposed amendments contain sufficient application guidance and illustrations on implementing the cash flow characteristics assessment? If not, why?

Citi does not believe that the application guidance and illustrations provided in the proposal are sufficient to equip financial statement preparers to implement the SPPI concept. After considering the guidance and illustrations, we have persistent unanswered questions, suggesting that further clarification is required. Further, in certain cases we believe that the guidance provided results in classification outcomes that are not appropriate for the type of arrangement being considered. Areas in which we believe the proposed guidance could be improved are discussed in our responses to subsequent questions below.

Question 7: 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?

Citi agrees that a contractual term that significantly modifies the economic relationship between principal and interest should generally invalidate an entity's ability to classify a financial asset at amortized cost or FV-OCI. However, as described in Question 4 above, we believe the determination of whether a contractual term modifies the economic relationship between principal and interest should be based on the existing CCR guidance in Topic 815, which is well understood and operational.

The proposed SPPI guidance prohibits bifurcation of embedded derivatives from financial assets and requires the entire financial asset that contains a contractual term that modifies the economic relationship between principal and interest be classified as FV-NI. The detailed nature of the SPPI test increases the risk that an entity could overlook a non-substantive feature when evaluating a financial asset and improperly classify a financial asset upon initial recognition. If this 'non-SPPI' feature is subsequently detected, the holder of that financial asset may be required to reclassify the entire financial asset to the FV-NI measurement category, resulting in potentially material adjustments to previously reported information and the need to restate previously issued financial statements.

Shortly after the adoption of Topic 815, restatements increased significantly due to the complexity of the new hedge accounting rules. We see an analogous situation as implementation issues related to the SPPI test arise and preparers later determine that current (or future) standard provisions (which by themselves may not be significant features of the financial instrument) require fair value accounting for instruments previously reported at amortized cost or FV-OCI. We believe the current bifurcation guidance is more easily understood and is consistent for hybrid financial assets and hybrid financial liabilities and with the Board's initial decision to require fair value accounting for embedded derivatives separate from their host instruments.

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?

Citi believes that the proposed SPPI test will cause many common features of financial assets to trigger the classification of the entire financial asset into FV-NI, irrespective of the probability that the feature will have an economic impact on the cash flows of the asset (other than features that are extremely rare or being triggered) or the materiality of the feature.

We do not believe that the implementation guidance provides sufficient guidance regarding the classification of financial assets into measurement categories on the basis of the instruments' cash flow characteristics.

Below are select examples of common financial instruments that demonstrate how the proposed SPPI guidance leads to counter-intuitive measurement category classification results:

Adjustable rate mortgages and credit card receivables indexed to a Prime rate: The majority of these variable rate retail lending arrangements are indexed to a Prime rate, as published daily in the national media. The Prime rate is applied in setting an interest rate for between one and 12 months, but the Prime rate has no tenor and, as a result it would be considered to be "an interest rate reset feature in which the frequency of the reset does not match the period of time covered by the interest rate" [paragraph 825-10-55-18]. Without additional application guidance, these assets will fail the proposed SPPI test as this feature "more than insignificantly" modifies the economic relationship between principal and interest. In our view, this interest rate reset feature does not introduce an unacceptable level of leverage, and therefore should not result in the instrument's failing the SPPI test. These are plain-vanilla assets, and the contracting parties have no intent to include leverage in the instrument.

Credit card introductory rates: Credit card issuers commonly offer an initial zero-percent introductory rate for a limited period of time, which is subsequently reset based on a benchmark rate when the introductory period expires. It is unclear whether this 'interest-free' period will be considered to have "more than insignificantly" modified the relationship between principal and interest. The same conclusion could result when analyzing post-introductory period credit card receivables, which have a standard interest-free period of up to 55 days for purchases made on the card.

We believe that the strict interpretation of the SPPI test in paragraphs 825-10-55-17 through 55-24 violates the principle of the proposal that relatively simple instruments with cash flows that represent interest and principal that are held to collect contractual cash flows should qualify for measurement at amortized cost. Precluding these instruments from measurement in the amortized cost or FV-OCI categories would detract from the decision usefulness of reported financial information.

We do not believe the application guidance in paragraph 825-10-55-18 provides sufficient examples and detail on how to determine whether a feature introduces "more than insignificant" leverage or variability that could be "more than insignificantly different from the cash flows of the benchmark instrument" and we fear inconsistent application will result in practice.

We note that many of these issues have already been addressed via the embedded derivative bifurcation requirements in Subtopic 815-15, *Derivatives and Hedging—Embedded Derivatives*. Those requirements arose from the attempt to interpret a similar concept, namely, whether a feature is "clearly and closely related" to the host instrument.

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?

Citi disagrees with the look-through approach proposed by the Board. In many cases, it is not operational or feasible to look through to the individual assets collateralizing a secured beneficial interest. Only original transferors involved in forming the securitization entity could conceivably have enough information about the collateral pool to be able to conduct the required assessment. Citi is also concerned that the application of the criteria in paragraph 825-10-55-26 to a securitization vehicle that holds nonfinancial assets, such as foreclosed real estate assets, would result in beneficial interests in that vehicle failing the SPPI test. Without amending the look-through requirement in the proposal, most asset-backed securities, including mortgage-backed securities issued by government-sponsored entities, could be required to be classified as FV-NI.

We do not believe that looking through to the underlying collateral to identify the cash flow characteristics of securitized financial assets would result in more appropriate classification and measurement outcomes than under existing U.S. GAAP. Current U.S. GAAP requires the holder of beneficial interests 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 comprise the securitization, as well as the payoff structure and priorities. We believe that retaining existing U.S. GAAP would identify many of the features that could be considered to result in cash flows that are not principal and interest.

Citi disagrees with the criterion in subparagraph 825-10-55-26(c), as it would introduce a credit risk criterion to the classification and measurement decision for securitized financial assets. It is not clear why there is an analysis of credit risk for beneficial interests, while other types of debt securities, including high-yield instruments, are not subject to a similar analysis.

Question 10: Do the proposed amendments appropriately convey the principle associated with the business model assessment? If not, why? What would you propose instead?

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?

With the exception of the issues discussed below, Citi believes that the proposed amendments contain sufficient application guidance and illustrations to distinguish among the three business models. We ask the Board to clarify in the body of any issued accounting guidance that the business model is intended to be applied at a portfolio level (as stated in BC165), and not at a more aggregated segment or business level. Within a segment or business, an entity may have many portfolios with varying business model objectives. It would be inappropriate to require that all portfolios within a segment or business to be assigned to a single business model when that level of aggregation does not reflect how management evaluates those portfolios. A portfolio-level approach would be consistent with the application guidance in paragraph 825-10-55-28, including how information is reported to key management personnel and how management is compensated.

Application guidance on amortized cost category

Citi supports the FV-OCI business model for assets managed both to collect contractual cash flows as well as for sale and, in our view, it is well defined and described in the proposed amendments. However, a key area of concern is the very narrow scope of assets which may qualify for amortized cost based on the current wording and application guidance on permitted sales.

The business model for instruments managed solely to collect contractual cash flows is currently defined in a very narrow manner, mostly due to the guidance around permissible sales activity. The proposed amendments represent a significant change from the held-for-investment loan model in current U.S. GAAP, which offers more flexibility with respect to sales than the held-to-maturity security model in Topic 320, *Investments—Debt and Equity Securities*. Citi strongly recommends that the guidance around permissible sales out of the amortized cost category be broadened. While the application guidance for the FV-OCI business model results in a balanced composition of assets managed to collect contractual cash flows and those managed for sale, the proposed application guidance for the amortized cost business model would allow sales in only very limited scenarios. The risk is that various instruments that form part of a bank's core customer lending activity will be required to be measured at FV-OCI when amortized cost provides the most useful information for such assets. We do not believe this was the Board's intent. To address this concern, we recommend that the guidance around permissible sales out of the amortized cost category be broadened to include additional examples of permissible sales and a principle around unacceptable sales.

The proposed amendments would permit sales out of the amortized cost category when the credit quality of a financial asset has suffered significant credit deterioration or in very infrequent other circumstances consistent with the held-to-maturity guidance in Topic 320. However, consistent with an entity's documented investment and risk policy, sales may occur for reasons other than significant credit deterioration. Such sales may be due to entity limits set on exposure to a particular country/jurisdiction, industry or obligor, and may be summarized as sales due to concentration risk. Entity limits are necessarily fluid as economic conditions change – for example, limits to Eurozone exposure changed throughout the financial crisis, even though particular obligors did not suffer significant credit deterioration. It is also worth noting that these risks and limits are assessed on a combined basis across various financial instruments, including for example derivative exposures, not just loan assets. And although these sales occur in response to concentration limits, they are also in line with a documented hold-to-collect investment strategy, which is different from sales made under a business model where assets are managed to be held or sold.

As an illustration, in most periods Citi sells a very small percentage of its corporate loan portfolio classified as held for investment under current U.S. GAAP. The sales are due to a combination of factors, including (a) significant credit deterioration of specific obligors; (b) to manage concentration risk to specific countries/jurisdictions, industries, or across the client relationship as a whole (taking into account debt securities, derivatives, clearing relationships, and other activities); and/or (c) where Citi has decided to exit certain client relationships for cost/benefit reasons. While the total amount of sales would represent, for example, less than 5% of the total loan portfolio, the proposed amendments could be interpreted to require all or a significant majority of the loan portfolio to be classified as FV-OCI because sales have occurred in the past and could occur for reasons other than solely significant credit deterioration in the future. It is not possible to assert, at inception of a loan, that the loan will never be sold for the reasons discussed above. To make such an assertion, a bank would have to severely restrict its ability to manage credit and concentration risk. Citi does not believe it is the Board's intention to limit the amortized cost category in this manner and, in our view, requiring all or a significant majority of the corporate loan portfolio to be measured at FV-OCI (when in practice substantially all of the portfolio is ultimately held until maturity of the loan) is not the most appropriate accounting classification. To

address these concerns, Citi recommends that the explicit prohibition on sales due to concentration risk in paragraph 825-10-55-31 be removed and the application guidance be revised to clarify that sales due to concentration risk can be consistent with a business model whose objective is to hold assets in order to collect contractual cash flows.

The application guidance on the amortized cost business model predominantly focuses on “acceptable” reasons for sales. We do not believe sales due to concentration risk are the only examples of an acceptable sale, nor do we believe it is possible or helpful to develop an exhaustive list of acceptable reasons for sales. In our view, the guidance would be more useful and practicable if the Board developed a principle around *unacceptable* sales out of the amortized cost category. The principle should focus on sales that are inconsistent with a business model to hold to collect contractual cash flows. Examples would include gains trading, duration management (that is, managing on a fair value basis) and similar activities that are inconsistent with the hold-to-collect model.

Citi agrees with the Board that a combination of factors rather than a single factor should determine an asset’s classification. Although that is explicitly stated in ASC 820-10-55-28, the guidance on sales seems to override those principles with the result that sales is the strongest (practically the sole) factor to consider.

Pools of similar financial assets

We support the guidance in paragraph 825-10-25-30 on the application of the business model assessment to pools of similar financial assets when an entity expects to hold a portion of the pool to collect contractual cash flows and manage another portion to hold or sell. However, we request that the Board clarify how this guidance would be applied to pools of similar financial assets that are recognized over a period of time. For example, financial institutions often warehouse pools of financial assets and build them over time. Paragraph 825-10-25-30 reads, “Upon initial recognition of a pool of similar financial assets...” [Emphasis added] seems imply that the entire pool must be acquired or originated, and thus classified, at the same time. We do not believe that this was the Board’s intention, and request that the Board clarify that paragraph.

We also suggest that the Board provide guidance on the subsequent accounting for the financial assets accounted for under this allocation guidance. Inevitably, some individual assets initially classified in the amortized cost category will be sold and other individual assets initially classified in the FV-OCI category will be identified as held-to-collect. For assets initially classified in the FV-OCI category later identified as held-to-collect, we suggest that an entity be required to reclassify the asset to amortized cost by reversing the balance in accumulated other comprehensive income to bring the asset to par. Alternatively, the Board could require subsequent accounting similar to the guidance in 825-10-35-10(d) on reclassifications from the available-for-sale category to the held-to-maturity category in current U.S. GAAP.

We also suggest that the Board consider expanding the allocation guidance in paragraph 825-10-25-30 to individual financial assets, for example, loan participations or syndications. Current U.S. GAAP permits an entity to classify a percentage of a single loan as held-for-sale and another portion as held-for-investment. We believe this guidance is reasonable and is consistent with industry practice.

Hedging interest rate risk

Citi believes that the amendments in subparagraphs 815-20-25-43(c)(2) and 25-43(d)(2) of the FASB’s proposed ASU *Financial Instruments—Overall (Subtopic 820-10): Recognition and Measurement of*

Financial Assets and Financial Liabilities: Proposed Amendments to the FASB Accounting Standards Codification may unnecessarily limit eligible hedge items. Under current U.S. GAAP, held-for-investment loans are eligible for fair value or cash flow benchmark interest rate hedges, whereas held-to-maturity debt securities are not. Citi believes that an institution can be subject to interest rate risk in its net interest margin, irrespective of the legal form of the financial assets, the business model for managing those assets, or the anticipated selling activity. For example, many financial institutions finance fixed-rate financial assets with floating-rate debt. Those institutions often manage their exposure to interest rate risk associated with the floating-rate debt or with their future net interest margin through fair value hedges, either in the aggregate or at a portfolio level. A similar issue may arise if fixed-rate debt is used to fund a purchase of variable-rate assets classified at amortized cost and a cash flow hedge is needed to manage the interest rate mismatch between the assets held and the funding therefor. Thus, we strongly encourage the Board to clarify that fair value and cash flow hedging strategies are permitted for all financial assets measured at amortized cost, including debt securities.

Classification of financial assets within a business

Citi believes that the business model assessment in the proposal, should be performed at the level at which the assets are managed, i.e., the portfolio or business line level. When a business is managed with the objective of collecting contractual cash flows, we believe that all of the assets within that business (assuming they pass the cash flow characteristics criterion) are to be classified as amortized cost.

We do not believe that the business model will be considered to have been changed until such point that the business within which those financial assets are managed would qualify to be accounted for as held for sale – i.e., when all of the following criteria in paragraph 360-10-45-9 are met:

- Management commits to a plan to sell the business;
- The business is available for immediate sale in its present condition;
- An active program to locate a buyer and other actions required to complete the plan to sell have been initiated;
- The sale is probable and the transfer is expected to qualify for recognition as a completed sale within one year;
- The business is being actively marketed for sale at a price that is reasonable in relation to its current fair value; and
- Actions required to complete the plan indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn.

We do not believe that selling financial assets as part of a disposal group that meets the held-for-sale criteria above is inconsistent with management's initial hold-to-collect assertion with respect to those assets. Instead, when these criteria are met, we believe all of the financial assets within the business will be considered to be held for sale and accounted for as described in paragraph 825-10-35-14 of the proposal for financial assets subsequently identified for sale. Accordingly, prior to the time that the held-for-sale criteria are met for an identified business divestiture or portfolio sale, management's initial classification of the asset at origination or purchase as amortized cost or FV-OCI should continue to be appropriate.

The illustrative guidance in paragraph 825-10-55-86(b) seems to suggest that where such a change in business model occurs the assets within that business should be reclassified. We request that the Board provide additional guidance regarding whether paragraph 825-10-35-22 (reclassification) or paragraph 825-1035-14 (financial assets subsequently identified for sale) should be applied in this case.

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?

Citi agrees the classification and measurement model for financial instruments should not contain an explicit tainting notion and that it should rely on the principle and exercise of professional judgment.

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?

Citi agrees with the notion in the proposal that the measurement of a loan commitment should follow the accounting for the underlying loan (were it to be funded). As discussed our response to Questions 10 and 11, we also suggest that the Board clarify that portions of these instruments can be measured at amortized cost, FV-OCI or FV-NI.

Citi believes that standby letters of credit should be classified in the same way. We are unsure of why a distinction is being drawn between standby letters of credit and commercial letters of credit.

Question 14: Do you agree with the initial measurement principles for financial instruments? If not, why?

Citi agrees with the general initial measurement principles in paragraphs 825-10-30-1 to 6 of the proposal.

Unconditional Fair Value Option

The proposal would eliminate the unconditional FVO in existing U.S. GAAP (for financial instruments within the scope of this proposed guidance) and, instead, permit an entity to elect to measure at FV-NI only certain financial instruments.

Citi does not support the proposal's limitations on the FVO. We believe that today's unconditional FVO allows reporting entities to better align their external financial reporting with their internal risk management, reduces earnings volatility that arises from a mixed measurement model, and reduces complexity in U.S. GAAP. The Board acknowledges in paragraph BC322 that the classification and measurement model in the proposed ASU will not result in FV-NI classification for many items currently eligible for fair value election. The proposed ASU's election requirements appear intended to alleviate only the most common sources of volatility that stem from a mixed measurement model. The sources of volatility from a mixed measurement model cannot always be anticipated. We believe the FASB's approach introduces unnecessary complexity by trying to anticipate these situations and either precludes the fair value election for common sources of mixed measurement volatility (e.g., financial liabilities with non-bifurcable risks, hedged using derivatives and where hedge accounting is not otherwise available) or is otherwise unclear on whether common fact patterns would be eligible for fair value election under the proposed ASU (see further discussion below). Consequently, the proposed ASU will result in reporting entities' experiencing the sort of 'fictional' earnings volatility the unconditional fair value election was originally intended to alleviate and which the FASB still seeks to mitigate based on paragraph BC322.

Consistent with comments made in our March 20, 2006 letter to the FASB on fair value election, we believe one of the most challenging aspects of the accounting for financial instruments under a mixed measurement model relates to the question of scope—determining which recognition and measurement principles apply to a specific financial instrument. This issue is particularly relevant for entities such as Citigroup with subsidiaries that apply industry-specific accounting guidelines in the AICPA Audit and Accounting Guides, *Depository and Lending Institutions, Brokers and Dealers in Securities, and Audits of Investment Companies* as codified. The appeal and power of the unconditional fair value election is that it eliminates unnecessary complexity in applying U.S. GAAP by eliminating the need for scope assessment and thus potential differences in application across reporting entities.

We also do not agree with the FASB's perception that the benefits of today's unconditional fair value election are less than the costs of reduced comparability among reporting companies. Because of differences in business models, hedging programs, and the potential use of a limited fair value election (and commensurate anticipated differences in application of the election requirements, as discussed further below), we believe any incremental reduction in comparability due specifically to an unconditional fair value election is far outweighed by the benefits of reducing complexity in U.S. GAAP and alleviating the accounting distortions associated with a mixed measurement model.

On the basis of these points, we believe the FASB should retain an unconditional FVO.

IFRS 9 Approach

If the FASB moves forward with limiting the unconditional FVO, we propose that the option be limited in a manner equivalent to IFRS 9, permitting fair value election when doing so eliminates or significantly reduces a measurement or recognition inconsistency, i.e., an accounting mismatch. The IFRS 9 approach accomplishes the FASB's objective as stated in paragraph BC322, converges with IFRS, and does so without introducing unnecessarily complex application requirements.

Managed on a net basis

As currently drafted, the proposed ASU permits fair value election for a group of financial assets and financial liabilities when an entity manages the exposure relating to the financial assets and financial liabilities (which may be derivative instruments subject to Topic 815) on a net basis. Paragraph BC322 indicates that the FASB intends this fair value election to alleviate accounting mismatches without having to apply complex hedge accounting provisions. It is unclear why the FASB would require recognized assets and liabilities to be present in order for the collective exposure to be considered managed on a net basis. Rather, per the discussion in the Basis for Conclusions, it appears the FASB's intent is to allow election for positions which are economically offsetting and managed collectively on a fair value basis (whether or not they result in recognized assets and/or liabilities.)

The below list of examples highlights our questions on what is considered a "group of financial assets and financial liabilities" managed on a net basis. On the basis of these examples, we recommend that if the FASB retains the "net basis" requirement (as opposed to our suggestions above), the final standard should permit election for *economically offsetting exposures which are managed on a fair value basis*.

- Many financial institutions manage the credit risk associated with a loan by executing a single-name credit default swap (CDS) indexed to the borrower. It is not clear whether this common fact pattern, which appears to meet the spirit of the requirement per paragraph BC322, would be considered a "group of financial assets and financial liabilities" whose exposure is managed on a net basis. While the loan is an asset for the reporting company, the CDS is purchased protection which

most typically would not be presented as a liability on the balance sheet. Thus, it is not clear whether this would be considered a “group of financial assets and financial liabilities” under the election requirement. It would also be counterintuitive that fair value election would be possible were the purchased credit protection to be in a liability position, but not in an asset position.

- We understand the proposed ASU precludes election for hybrid liabilities with embedded features that do not require bifurcation and separate accounting (see related discussion below requesting confirmation whether our understanding is accurate). A common example of a hybrid liability which does not require bifurcation is a debt instrument with a range-accrual feature. This type of feature typically does not fail the “double-double” test and, thus, fair value could not be elected under the hybrid liability provisions of the proposed ASU. These instruments are, however, managed by the issuer on a fair value basis, often economically hedged with interest rate swaps or other cash instruments held for trading purposes. These economic hedges provide offsetting exposure to the issued liability but may or may not result in a recognized asset, depending on market conditions. Thus, it is not clear whether this would be considered a “group of financial assets and financial liabilities” under the election requirement.
- Many financial institutions hold prepayable fixed-rate, AAA-rated, agency-issued mortgage-backed securities (or a pool of prepayable residential mortgages) which are economically hedged by interest rate swaps. These securities often do not qualify for hedge accounting, because the prepayment risk associated with the underlying pool of loans is not fully offset by a cancellable interest rate swap and the resulting levels of ineffectiveness preclude hedge accounting. Because the relationship does not qualify for hedge accounting, reporting companies often make a fair value election on the securities to align their measurement with the interest rate swaps that economically hedge them. The proposed ASU indicates that this sort of security would not be classified as FV-NI on the basis of its cash flow characteristics. Thus correcting accounting mismatches for this type of transaction and related risk management is possible only through a fair value election and it is not clear whether the securities and their economic hedges would be considered a “group of financial assets and financial liabilities” under the election requirement.
- Broker-dealer entities typically run a “matched book”, where collateral received under reverse repurchase transactions is funded through repurchase transactions. To the extent the tenors and interest rate features (that is, fixed vs. floating interest rates) of the reverse repurchase and repurchase transactions differ, broker-dealer entities manage the interest rate exposure on a fair value basis with interest rate futures and other derivatives. While Citi believes this fact pattern would qualify under the proposed guidance in the proposed ASU, even this common fact pattern raises questions that we believe could be easily resolved through our recommendations above.

Hybrid Liabilities

We request that the FASB further clarify the fair value election provision for hybrid liabilities. As drafted, it is not clear whether the election may be applied only to those liabilities containing a feature which requires bifurcation or whether it may be applied to a broader set of liabilities that contain embedded features that do not require bifurcation but may “significantly” alter the cash flows of the instrument. Paragraph BC324 appears to indicate that the election applies only to instruments containing a bifurcatable feature: “The Board decided that providing a fair value option in that situation would achieve an appropriate balance between avoiding the cost of bifurcating a hybrid financial liability and limiting the fair value option to situations in which an option is necessary to reduce implementation costs.” However, the election requirements in paragraph 825-30-15-3 imply a broader set of liabilities could be eligible.

Further, we believe the second election condition of “little or no analysis” is not operational. We highlight the example included above—a liability with a range accrual feature. These instruments typically do not fail the double-double test and thus do not require bifurcation. However, to conclude on the double-double test, the issuer and investor must make a series of complicated judgments (for example, whether the debt host contract is fixed or floating rate, and what the initial rate on a plain-vanilla instrument would be). Every fact pattern requires an analysis to be performed. For entities like Citi that issue many instruments, sometimes on a daily basis, it is not operational to assess the instruments for bifurcation. Furthermore, the assessment adds no value to our financial statements, and, as we manage the exposures on a fair value basis with derivatives, fair value accounting through net income is the most appropriate and representationally faithful accounting. It is unclear what is meant by “little or no analysis” in the proposed ASU, and we believe the guidance will lead to differences in application and incremental costs for no perceived benefits.

Equity Method Investments

We believe that equity-method investments should be eligible for fair value election. Citi believes accounting for certain equity-method investments at fair value is most representative of our investment objective and management outlook. For example, investments in limited partnerships will presumably be accounted for under the equity-method when such investments are more than 3-5% of the partnership. However, the limited partner is not involved in the management of the investee and would not be able to exercise significant influence, nor is the investment held for sale. Citi believes accounting for these investments at fair value is most representative of our passive investor status and our management outlook. Citi struggles with accounting for a 3-5% limited partnership interest as an equity method investment when such accounting would not be applied to another investment that was substantially the same except for its legal form. In addition, there is a significant cost to applying equity method accounting to these investments, particularly when they are held by businesses that manage their investments on a fair value basis and have built books and records infrastructure with fair value measurement and reporting in mind. We believe the fair value election for equity-method investments accommodates differences in management outlook and allows reporting companies to balance the costs associated with application of equity-method accounting with their related business strategy.

Fair Value Option When Economically Hedging Credit Risk (IFRS 9)

Under the revised IFRS 9, entities will be permitted to elect fair value accounting 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. To qualify for fair value accounting for the financial instrument, appropriate criteria are included in IFRS 9 that (a) the name of the credit exposure (for example, the borrower) matches the reference entity of the credit derivative, and (b) the seniority of the financial instrument matches that of the instruments that can be delivered in accordance with the credit derivative. For the reasons discussed below, Citi strongly recommends that the FASB incorporate the same guidance into its final standard on recognition and measurement.

In current U.S. GAAP (Topic 825, *Financial Instruments*), entities may elect the FVO 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. Reasons for this include:

- Creditworthiness of particular borrowers changes over time. For example, a financial institution could have a policy to risk manage exposures with credit derivatives if the borrower's internal or external credit rating declines to a certain level, or declines by a certain number of ratings categories. The financial institution would decide not to purchase credit protection on a particular borrower rated for example A at inception of a loan, but if the borrower's credit rating declined to BB+ the financial institution would look to manage any subsequent changes in credit risk with credit derivatives;
- Risk limits for particular borrowers change over time, based not only on the creditworthiness of the specific borrower, but on country/jurisdiction, industry and other factors;
- Total exposures to a particular borrower change over time, and include loans, debt securities, derivatives, clearing arrangements, and various other transactions. The financial institution may decide to purchase credit protection to manage its total risk exposure, as opposed to selling loans or debt securities or reducing/terminating other business arrangements; and
- The pricing and availability of credit derivatives change over time. For example, credit derivatives are not available for many counterparties until their total outstanding debt reaches a certain level, or until the counterparty supplements bank financing with bonds issued to the capital markets.

Citi believes 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 Citi would support highlighting such amounts in either a separate caption on the income statement or in the footnotes to the financial statements.

Question 16: Should financial liabilities subsequently be measured at amortized cost, unless certain exceptions are met? If not, why?

Citi agrees that financial liabilities should generally be recorded at amortized cost. We agree with the exceptions to this general principle noted in paragraph 825-10-35-9, and suggest that Board allow an option for entities to unconditionally elect to measure a financial liability at FV-NI or, at a minimum, in order to eliminate an accounting mismatch.

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?

Citi believes that the proposal appropriately aligns the measurement of nonrecourse liabilities with the financial assets with which they are settled. It also achieves the Board's objective of eliminating gains (losses) in the parent's income statement that will never be realized by the parent.

Considering that certain securitization vehicles with nonrecourse debt today contain non-financial instruments (e.g., foreclosed real estate property in a mortgage securitization vehicle), we believe that the measurement of nonrecourse debt should be aligned with both the financial and non-financial assets that will be used to settle the nonrecourse debt.

Further, in instances where the value of a nonrecourse liability is more reliably obtained than that of the financial assets (e.g., in secondary market trading of the financial liabilities), and where the liability is recorded at fair value, we believe it should also be acceptable that the same factors that are used in measuring the financial liabilities should be taken into account in measuring the associated financial assets.

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?

Citi agrees that, when an instrument classified as amortized cost, based on a business model of holding-to-collect contractual cash flows, is subsequently identified for sale, that the asset should continue to be classified as amortized cost and measured as amortized cost less impairment, with the recognition of any gain deferred until the sale is complete.

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?

Citi agrees with the proposed practicability exception for measuring equity investments without readily determinable fair values.

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?

Citi agrees with the proposal to evaluate the need for a valuation allowance on a deferred tax asset related to a debt instrument measured at FV-OCI separately from other deferred tax assets.

Question 21: 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?

Citi does not agree with the proposal to exclude hybrid financial assets from a bifurcation analysis for the reasons described in preceding sections of this letter. We believe that the bifurcation assessment should be symmetrical for hybrid financial assets and hybrid financial liabilities. The bifurcation concept is well understood and a necessary tool for separating complex 'leveraging' features from financial instruments managed in a hold-to-collect business strategy. Bifurcation of an embedded derivative feature thus allows a more appropriate classification of the host instrument and allows separate management of the risk in the embedded derivative. In disallowing bifurcation of hybrid financial assets,

the proposal requires classification at FV-NI for the entire hybrid instrument, which in turn creates greater restatement risk and net income volatility for instruments that would be more appropriately accounted for at amortized cost.

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?

Citi does not agree with the reclassification requirements in the proposal. As described in our response to Questions 10 and 11 above, we believe that the business model should be applied the level at which asset management decisions are made, which we believe to be the portfolio level. As a result the notion that a change in business model occurs only if "...determined by an entity's senior management as a result of external or internal change, must be significant to the entity's operations, and must be demonstrable to external parties" [paragraph 825-10-35-22] is too restrictive as changes at the portfolio level may not be significant to the overall entity's operations or demonstrable to external parties.

Question 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?

Citi strongly agrees with the proposed amendments to require an entity to separately present changes in fair value attributable to changes in instrument-specific credit risk in OCI for financial liabilities for which the entity has elected the FVO. We believe these amounts are not readily realizable and therefore recording them in earnings is not meaningful or relevant. We note that all major financial institutions present non-GAAP earnings excluding changes in fair value attributable to changes in instrument-specific credit risk, and many users remove these amounts when analyzing financial institutions. Additionally, we note that the proposed presentation conforms to the Basel III requirements to exclude changes in fair value attributable to changes in instrument-specific credit risk from Tier 1 capital. For all of these reasons, we believe that the proposed amendments improve financial reporting.

Additionally, we believe that the term "instrument-specific credit risk" may confuse some readers of the final standard and suggest that the Board use the term "reporting entity's own credit risk" consistent with paragraph 820-10-35-17.

Question 26: 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?

Citi agrees with the requirement in the proposal 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 FV-OCI. The proposed amendments in paragraphs 825-10-45-14 through 45-15 require a fair-value-based methodology. Current U.S. GAAP as applied by investment companies requires a cost-based method, as does the IASB's proposed approach in IFRS 9. We do not believe either calculation

method to be conceptually superior and, therefore, request that FASB permit either method as a policy election.

Question 29: Do you agree with the proposed disclosure requirements? If not, which disclosure requirement would you change and why?

Disclosures about fair value information for financial assets measured at amortized cost

Citi does not believe that the proposed fair value disclosure requirements in paragraph 825-10-50-34 for financial instruments that are measured at amortized cost will provide decision-useful information or incremental insight into the financial position and operating results of a reporting entity.

Currently, fair value disclosures provide insight into the valuation techniques and the relative observability of the inputs used to value all financial instruments. Under the proposed requirements, when financial instruments will be held and managed within a business model that has the objective of holding the instruments to collect the contractual cash flows, quantitative information about the unobservable inputs used in the fair value measurement will also be required. Given the limited population and plain nature of the assets and liabilities that are expected to qualify for measurement at amortized cost, and further because realization of the fair value of such financial instruments will be inconsistent with the business model under which they will be held, it is unclear what benefit or insight will be gained by financial statement readers through the disclosure of quantitative information about unobservable inputs about the fair value of items that are not measured at fair value on the balance sheet.

In a hold-to-collect business model, fair value information is not significantly utilized in making decisions and evaluating the financial performance of instruments measured at amortized cost, and is largely calculated only for purposes of required financial statement disclosures. It can be expected that management will utilize fair value information even less upon adoption of the proposed ASU because fewer financial instruments are expected to qualify for amortized cost. As a result, with fair value information for these instruments expected to become less important to decision-making and risk assessment by management, it is unclear why such information will be important to financial statement users.

With an expectation that the population of instruments that will qualify to be measured at amortized cost will decrease, we believe that the current level of fair value disclosure is sufficient and appropriate for assets and liabilities measured at amortized cost.

Disclosures about core deposit liabilities

Citi does not believe that the disclosures proposed in paragraph 825-10-50-39 for core deposit liabilities are operable. Concepts such as the weighted-average maturity period and estimated-all-in-cost-to-service rate would be internally generated and highly judgmental resulting in very little comparability between entities. Further, financial institutions generally consider core deposits to include instruments that do have a contractual maturity date if those instruments are expected to be continually rolled over. This is in contrast to the definition of core deposit liabilities in the proposal, which includes only those instruments that do not have a contractual maturity date.

We suggest that these disclosure requirements thus be eliminated from the final standard.

Question 30: 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?

Citi strongly supports the Board's decision to permit early adoption of presentation requirements related to changes in instrument-specific credit risk for hybrid financial liabilities that would qualify for the FVO under the proposed requirements. However in the interim period before the entire standard becomes effective, we believe this presentation should also be permitted for instrument-specific credit risk for financial liabilities electing the FVO under the current FVO rules that would no longer qualify once the final standard is effective.

Question 31: Should the effective date be the same for both public entities and nonpublic entities?

Citi has no strong opinion or preference regarding the appropriateness of a delayed implementation date for nonpublic entities.

Question 32: How much time is needed to implement the proposed guidance?

Citi believes that no less than three years would be required between the date of publication of the final ASU and the effective date for the application of the requirements contained therein.

Applying the proposed amendments, including an incorporation of our suggestions in the preceding sections of this letter, would require the application of new accounting models to a very large, and geographically dispersed, heterogeneous population of financial instruments. Implementing any proposed accounting guidance would also require that our internal control framework, ledger architecture, processes and documentation be updated.

We suggest that the Board align the effective date on this proposal with the effective date for the proposed Update to *Financial Instruments— Credit Losses* (Subtopic 825-15).

Question 33: Are the transition provisions in this proposed Update operable? If not, why?

Citi believes that the transition provisions in this proposed update are operable.

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?

Citi has concerns about the held-for-sale criteria in paragraph 323-10-15-20 as it may scope in other investments that are not managed on a fair value basis and would be more appropriately accounted for under the equity method. For example, tax credit partnership investments may include a put option at the end of the tax credit period. At the end of the tax credit period, the investor's return on investment is substantially complete and the investment has little to no remaining value. However, these investments may meet the held-for-sale criteria at initial recognition, because the put option may be interpreted as a potential exit strategy with a definite time frame for exit. We do not believe these

investments should be reported on a fair value basis when the objective is to hold them for full return of the investment. Please see our detailed comments in our response to Question 14.

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?

Citi does not agree with the one-step impairment model as proposed.

Paragraph 323-10-35-31A states that “[A]n investment in an equity method investee is impaired if it is more likely than not that the fair value of the investment is less than its carrying value.” We believe that fair value may thus be required to be calculated even when the triggers are not met if it is likely that fair value is below cost.

We also note that the impairment indicators listed are similar to those applied when assessing the impairment of equity securities under IFRS. However, applying the U.S. GAAP proposal would result in impairment being recognized immediately to the extent that fair value is determined to be below the carrying amount for that investment. In contrast, under IFRS an impairment would be recognized for equity securities only if the decline in fair value is significant or prolonged or when there is otherwise objective evidence of impairment. Further, IAS 36, *Impairment of Assets*, impairment is based upon the higher of the fair value less costs to sell and value-in-use.

We believe that impairment for equity method investments should be recognized in a similar way under U.S. GAAP – i.e., when significant or prolonged or when there is otherwise objective evidence of impairment, and as the difference between the carrying amount and the higher of fair value less costs to sell or the value-in-use. In the absence of these provisions we believe that applying U.S. GAAP in this area would result in greater income statement volatility as compared to IFRS. This volatility is at odds with the long-term nature of investments typically accounted for using the equity method.

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?

As described in greater detail in our responses to preceding questions, Citi believes that an unconditional FVO for assets and liabilities would result in more appropriate classification of instruments into measurement categories.