

May 15, 2013

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

Re: Proposed Accounting Standards Update: Financial Instruments—Overall (Subtopic 825-10) Recognition and Measurement of Financial Assets and Financial Liabilities

File Reference No. 2013-220

The Loan Syndications and Trading Association (LSTA)¹ appreciates the opportunity to comment on the Proposed Accounting Standards Update, Financial Instruments—Overall (Subtopic 825-10) Recognition and Measurement of Financial Assets and Financial Liabilities (the "proposal").

We commend the FASB for attempting to simplify the accounting for financial assets and financial liabilities by proposing a more principles-based approach. Additionally, we commend the FASB (the "Board") and IASB for the efforts to achieve substantial convergence for recognition and measurement of financial assets and financial liabilities. The LSTA has primarily focused on the impact of the proposal to loan accounting (unless otherwise indicated) and is generally concerned that the proposed cash flow characteristics and business model analysis will have the unintended consequence of increasing the volume of loans that are accounted for as FV-NI and FV-OCI. However, we have several additional concerns with the proposal; specifically, we find the cash flow characteristics test in need of improvement in regards to the application to hybrid financial instruments and beneficial interests in securitized financial assets. The proposed replacement of the clearly and closely related analysis for hybrid financial instruments under current U.S. GAAP ("GAAP") to the solely payments of principal and interest (SPPI) model will result in an increase of the number of instruments requiring a detailed analysis under a model lacking sufficient clarity. We are not supportive of the new SPPI model and prefer the existing clearly and closely related analysis for hybrid instruments. We also believe that the business model application guidance is

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¹ The LSTA represents over300 of the largest US and foreign banks, broker dealers, hedge funds, mutual funds, insurance companies, and institutional investors. The LSTA was founded in 1995 with the objective to improve liquidity and transparency in the floating rate corporate loan market. As the principal advocate for this asset class, the LSTA fosters fair and consistent market practices to advance the interest of the marketplace as a whole while promoting the highest degree of confidence for investors of corporate loans. The LSA undertakes a variety of activities to develop policies and market practices designed to advance just and equitable marketplace principles and to encourage coordination with firms, facilitating transactions in loans and related claims.



unclear. In the attached appendix, we have answered specific questions that highlight our views and concerns regarding the proposal. While our responses may not necessarily represent unanimous views of all members of the LSTA, they do represent the views of majority of the LSTA accounting committee members.

We truly appreciate the opportunity to share the loan industry's perspective on the proposal. If you have any questions concerning our comments or suggestions, please contact Sherif Sakr at (212) 436-6042, Melanie Pinto at (917) 363-9796 or Ellen Hefferan at (212) 880-3013.

Yours truly,

Sherif Sakr

Co-Chair LSTA Accounting Committee

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Appendix

Question 2: Do you agree with the industry-specific specialized guidance scope exceptions in paragraph 825-10-15-9? If not, why? What would you propose instead?

We are supportive of the industry-specific specialized scope exception in paragraph 825-10-15-9.

Question 3: The proposed amendments would require an entity to classify financial assets into the appropriate subsequent measurement category (that is, at amortized cost, at fair value with qualifying changes in fair value recognized in other comprehensive income, or at fair value with all changes in fair value recognized in net income) on the basis of the contractual cash flow characteristics of the instrument and the business model within which financial assets are managed. Does the classification of financial assets based on the cash flow characteristics and the business model assessment provide decision-useful information? If yes, how will this classification influence your analysis of the entity? If not, why?

Conceptually, the mixed measurement attribute model for which a measurement other than fair value through net income (FV-NI) is based on both (a) the cash flow characteristics, and (b) the business model appears appropriate and consistent with the framework in IFRS 9, *Financial Instruments* (IFRS 9), which we support in the interest of convergence. However, we do have some concerns relating to the basis for defining the cash flow characteristics and the principles associated with the business models, as addressed further in our responses to Questions 7 through 11 below. More specifically, the proposal limits the types of permitted sales in order to qualify for "hold-to-collect" measurement at amortized cost, which is more restrictive than the principles followed today under ASC 310-10-35-47 that considers intent and ability to hold for the foreseeable future. Consequently, this change in principle may result in many loans being measured at fair value recognized in other comprehensive income (FV-OCI) as financial institutions sell, from time to time, for many reasons other than credit deterioration (e.g., credit risk concentration) even though their primary business model may be hold-to-collect.

Question 4: Do the proposed amendments appropriately convey the principle associated with the contractual cash flow characteristics assessment? If not, why? What would you propose instead?

We have concerns about the contractual cash flow assessment which we have detailed in our responses to the questions below.

Question 5: The proposed amendments define principal as the amount transferred by the holder at initial recognition. Should the definition of principal be expanded to include repayment of the principal amount at maturity or other settlement? If so, what instruments would fail (or pass) the contractual cash flow characteristics criterion as a result of this change?

We do not believe the definition of *principal* should be expanded as suggested because the meaning of "or other settlement" is unclear, but do believe the definition needs to include the



"repayment of the principal amount at maturity". However, rather than defining *principal* and determining if cash flows are solely payments of principal and interest, the LSTA proposes that the cash flow test should determine whether, at inception, an entity expects to recover its initial net investment in the financial instrument, excluding premiums or discounts that are to adjust yield to a market rate at the purchase date, an underlying principle provided in ASC 815.

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

We find the existing guidance under current GAAP addresses a number of different security types and features that are not contemplated in the SPPI test (e.g., guidance formerly in DIG B16, B40 and C22). Also, please refer to our responses to Questions 7 through 11, which highlight our concerns regarding the cash flow test.

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?

There are several areas of concern that we request the Board reconsider. While we agree that the classification and measurement of financial assets should be based upon the contractual cash flow characteristics, we believe the proposed guidance in this area needs improvements. Rather than create a completely new and untested model, which requires an evaluation if cash flows are solely payments of principal and interest (SPPI), we believe this assessment should be based principally upon the "clearly and closely related" concepts (e.g., double-double test) existing incurrent GAAP for evaluating embedded derivatives pursuant to ASC 815. The existing embedded derivative guidance is sufficiently developed, well understood and appropriately applied in practice. We believe this guidance generally achieves the objective of the SPPI test without unforeseen consequences. Additionally, the cost of introducing a new principle outweighs the benefit particularly when the result of the new principle may generally yield similar outcomes as the clearly and closely related principles in ASC 815 when applied to the population of financial instruments that are currently analyzed under existing GAAP. In addition, as discussed in more details in our response to Question 15, similar to hybrid financial liabilities we prefer retaining the bifurcation model for hybrid financial assets. This promotes a single model for the same hybrid financial instrument, whether held or issued. However, if the Board decides not to allow bifurcation for financial assets, we still recommend leveraging the "clearly and closely related" principles in lieu-of the proposed SPPI test.

We believe practice will analogize to the "clearly and closely related" principles where sufficient application guidance exists. The impact of incorrectly classifying an instrument in the proposed model is more punitive than current GAAP. Under the current model, if an embedded derivative should have been bifurcated but initially was not, the entity is required to restate prior earnings for the retrospective fair value impact of that feature. However, the derivative features requiring



bifurcation in most loan products are mostly immaterial and the impact of interpretive error is insignificant. Under the proposed model, if the same error is made, the entity is required to restate the retrospective gain or loss for the entire instrument, including changes in interest rates since inception. A material error could likely occur under the proposed model as the interest rate changes for the entire instrument would more than likely exceed the embedded derivative feature.

Further, the illustrations provided within the proposal generally result in similar conclusions as those reached within existing "clearly and closely related" guidance. However, the Board seems to have the intent of capturing other types of embedded features that the current "clearly and closely related" guidance doesn't contemplate, evidenced by the proposal of the new SPPI assessment. We recommend amending the current "clearly and closely related" guidance to address those items within a well-established model in place currently rather than adopt a completely new model. Therefore, we fail to see the benefits of abandoning the existing "clearly and closely related" guidance for a completely new model that is unproven and conceptually unclear.

The current bifurcation model facilitates effective economic hedging strategies and promotes consistent treatment with other non-hybrid financial instruments. Bifurcation of the embedded feature permits an organization to isolate and hedge the risk inherent within each component of the instrument more easily as derivative instruments generally are entered into to mitigate a particular risk. Bifurcation of the embedded feature also allows effectiveness of the hedge relationship to be tracked more reliably. Requiring the embedded derivative remain within the hybrid instrument is not consistent with the risk management strategies employed for these instruments and accordingly, will exacerbate accounting measurement mismatches. For example, companies may use freestanding derivatives to economically hedge bifurcated derivatives, which are typically the primary source of a hybrid instrument's volatility. If the entire hybrid instrument is subsequently measured at fair value, the freestanding derivative will not be effective at offsetting the volatility of the hybrid instrument other than the risk of the embedded derivative.

The Boards' proposed guidance for hybrid instruments does not represent an improvement to financial reporting. Rather, we believe it would be more appropriate to account for the host contract in accordance with the business strategy and cash flow characteristics for the host instrument rather than defaulting to FV-NI. Such a model would promote consistency with other non-hybrid instruments with similar business strategies. Accordingly, the proposed guidance for hybrid instruments should be modified to provide preparers an option either to bifurcate embedded derivatives or measure hybrid instruments at FV-NI. We provide the following suggested approach:

- Step 1: Business Strategy Managed on a Fair Value Basis
 - o If the entire financial instrument is managed on a fair value basis, FVNI
 - o If no, go to step 2



- <u>Step 2 Cash flow test</u> Can instrument be settled in a way that the investor or lender (holder) would not recover substantially all of its initial recorded investment?
 - o If yes, then measure at FV-NI
 - o If no, then go to Step 3
- <u>Step 3: Hybrid financial debt instrument test</u> Are there embedded features not clearly and closely related to the debt host contract? [using the FAS 133 tests]
 - o If yes, then hybrid financial asset requiring bifurcation of the embedded derivative
 - o If no, then go to Step 4
- Step 4: Business model test for debt-like instruments
 - o If hold-to-collect based on primary intent of business with infrequent sales or insignificant sales (individually or in aggregate even if frequent), then amortized cost
 - o If hold-to-collect and sell, then FV-OCI
 - o All other including originated to sell, then FV-NI

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?

Financial assets with embedded features that do not significantly impact the fair value or cash flows should not require FV-NI classification. The proposal appears to target features beyond embedded derivatives that typically require bifurcation under existing guidance. These other features often are insignificant to the overall fair value or cash flows of the asset. We do not believe entire financial assets should be classified and measured based on insignificant embedded features. As a result, we believe this guidance puts too much weight on the contractual cash flow test and inappropriately diminishes the relevance of an entity's business model to the classification and measurement of financial assets.

Embedded features that modify the economic relationship between principal and interest

The proposed amendments do not contain sufficient application guidance in assessing the modified economic relationship and basic loan products would fail to qualify for amortized cost under this test. We support using the clearly and closely related test to identify any embedded features as this test has been in practice for many years (refer to our response in Question 7) and we are not aware of any investor concerns with it. Under current guidance, the "host" contract is the benchmark instrument. This benchmark instrument exists in the market versus the proposal to use a hypothetical financial asset in paragraph 825-10-55-19. Determining a benchmark instrument for the modified economic relationship test seems judgmental and only increases complexity.

If the FASB decides to keep the SPPI test rather than retain the clearly and closely related guidance, the benchmark instrument should not be a hypothetical instrument, but an instrument that is traded in the market. The requirement to match the reset frequency date to the reset tenor date should be removed. For example, adjustable-rate mortgages ("ARMs") would fail the modified economic relationship test as ARMs reset periodically (every year, 3 years or 5 years) and the reset date does not usually match the reset on the interest rate index (typically



1M LIBOR). The lender intent for these types of loan products is to receive principal and interest for the consideration of time value of money and credit risk; therefore, these types of financial assets should be eligible for amortized cost.

Embedded features such as prepayment options, extension options and contingent features

For financial assets that contain embedded features other than terms that modify the relationship between principal and interest, such as prepayment or extension or contingent features, it is unclear whether the Board intended for the benchmark instrument concepts – and by extension, the significance threshold for insignificant embedded features - to apply. The proposal only mentions the benchmark instrument guidance in relation to terms that modify the relationship between principal and interest. This guidance suggests a quantitative evaluation, which includes a significance threshold for insignificant embedded features. Application of the benchmark instrument guidance is noticeably absent in the guidance for evaluating embedded features other than those that modify the economic relationship between principal and interest. This proposed guidance is largely qualitative and does not contain a similar significance threshold for insignificant embedded features. As such, terms of this nature that result in insignificant cash flow or fair value changes may cause FV-NI treatment. We conceptually disagree with this premise which seems to inappropriately overweight the classification decision on the nature of the embedded feature rather than a consistent principle focused on the significance of the cash flows or fair value changes relating to the embedded feature. We believe the Board should modify the guidance, including consistent consideration for a significance threshold for insignificant embedded features as amended for our recommendations in the prior paragraph.

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?

In addition to the concerns already raised regarding the contractual cash flow characteristics assessment for loans, we do not believe the proposed look-through approach is appropriate for beneficial interests in securitized financial assets. We believe beneficial interests should be evaluated similar to other debt instruments in that, if under the contractual terms of the beneficial interests the investor expects to recovers substantially all of its initial net investment (e.g., cash flows represent time value of money, credit risk and liquidity risk), then the beneficial interests would meet the contractual cash flow characteristics. The proposed look-through approach requires an analysis of not only the terms of the underlying collateral but also whether the underlying collateral's contractual cash flows meet the SPPI test. We do not believe determining the principal amount, as defined by the proposal, of the underlying collateral to ensure it meets the SPPI test is relevant to determine classification and measurement. Current GAAP requires an in-depth analysis of the contractual terms of the beneficial interest and understanding of the nature and amount of all the assets, liabilities and other instruments, such as derivatives and guarantees within the securitization structure. The current embedded derivative model (formerly in DIG C22 and DIG B40) for beneficial interests identifies synthetic credit risk and other features that may not be clearly and closely related to the beneficial interest. It would



be operationally challenging to expand the analysis beyond the current GAAP requirements to obtain the information on the amount the trust paid for the underlying collateral in order to determine the principal amount. Refer to response to Question 5 regarding our concerns with the proposal's definition of principal.

Should the Board decide to continue to require a look through to the underlying collateral, we have two recommended modifications to the proposed model that would reduce our concerns regarding the appropriateness of applying the model to beneficial interests.

First, we believe a significance threshold, aligned with current guidance in formerly found in DIG C22, should be introduced into the criteria in proposed 825-10-55-26 b.2.i. and b.2.ii. so that if the underlying pool includes instruments that do not reduce cash flow variability or align the cash flows of the tranches of the beneficial interests with the cash flows of the pool of underlying instruments, they would still pass the cash flow characteristics assessment if they are considered insignificant. For example, in most collateralized loan obligations (CLO), the investment manager is permitted to sell credit protection, typically in the form of credit default swaps (CDS) up to a certain percentage of the pool (e.g., 10%). Many times, this is a short term situation as the cash instrument is not available in the market. An insignificant amount, such as 10%, of the underlying collateral that does not meet the cash flow characteristics criteria, should not render all tranches issued from that securitization as failing the cash flow characteristic assessment, resulting in all tranches being measured at FV-NI.

Second, we propose the credit risk criterion in 825-10-55-26c be removed. This criterion causes inconsistent accounting for financial assets with similar credit risks. Certain debt instruments that are not part of securitization may have similar or lower subordination or credit quality to a beneficial interest and qualify for amortized cost. We do not agree with the conceptual basis for this criterion.

Without modifying the model in the proposal, we believe subordinated tranches would fail the cash flow characteristics assessment and be reported at FV-NI, when the business model (i.e., the expectation is that initial net investment will be recovered) for the instruments may be similar to other debt that is reported as either amortized cost or FV-OCI. Our proposed approach is more reasonable and would be more aligned with the views already expressed.

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

As highlighted in Response 3, we support a mixed measurement attribute model predicated on (a) looking at the nature of the instrument based on a cash flow test, and (b) basis for which the asset (within a portfolio) is managed by the entity under the business model test. However, we believe that the business model as described in the proposal is too restrictive limiting sales, principally, to situations of significant credit deterioration akin to the permitted sales guidance provided for debt securities under ASC 320. Financial institutions have implemented controls, policies and procedures under the current accounting model to address the frequency of transfers of loans from the amortized cost portfolio when a decision to sell a loan



has been made. We do not see the issue with occasional sales being permitted for reasons other than credit deterioration and the need to implement the proposed restriction.

To determine whether cash flows are expected to be collected from contractual cash flows, one should consider the nature and extent of sales conducted over time including the level of sales activity, as well as the reason for any sales. The primary business model may be to hold-to-collect cash flows but this should not preclude sale transactions from time to time. In this context and in line with IFRS 9, consideration should be given to infrequency of sale transactions or insignificance both individually and in the aggregate. (IFRS 9 ED2012/4 B 41.3)

Question 11: Do the proposed amendments provide sufficient application guidance and illustrations on how to distinguish among the three business models, including determining whether the business model is to manage assets both to collect contractual cash flows and to sell? Do you agree with the proposed guidance provided to describe those business models? If not, why?

We do not agree that the proposed amendments provide sufficient application guidance and illustrations on distinguishing among the three business models.

The proposed guidance is not sufficient in clarifying the level at which the business model is assessed. It is unclear to us if the business model concept is applied at the segment, legal entity or portfolio level. A legal entity could have multiple business models within it and a business segment may manage assets with different objectives due to varying risks. For example, an asset-liability management business model may include both assets with the intent to "hold and sell" and assets with the intent to sell. Additionally, that same business model may invest excess cash in reverse repurchase agreements as part of its investment strategy. In this example, the asset-liability management business model has all three categories within it (FV-OCI, FV-NI and amortized cost, respectively).

Per the proposal (paragraph 825-10-55-28), the classification of a financial asset (that meets the contractual cash flows characteristics criterion) is determined at recognition by the entity's key management personnel on the basis of how the asset will be managed together with other financial assets within a distinct business model. In the example above, the asset-liability management business model is a distinct business that could be managing various types of risk such as interest rate, credit and liquidity risk. The management of these risks requires various types of investment strategies that may result in all three categories utilized within the same portfolio.

We would propose that the business model application is not prescribed at a particular level but rather include a requirement for entities to determine the level of application as a matter of their own policy, at least at the portfolio level, with the appropriate disclosure requirements to provide sufficient transparency and promote comparability.



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?

The classification and measurement model should not contain an explicit tainting notion but should rely on the principle and exercise of professional judgment. However, it seems that there is an implicit tainting notion in the proposed model that is more restrictive than what exists today for loans held-for-investment (refer to our response in Question 10). Many banks have loans held-for-investment with the true intention to hold them for the foreseeable future. As the business environment changes, banks currently have the flexibility to sell loans held-for-investment without calling into question their business model.

As noted earlier, financial institutions have established policies and procedures requiring documentation and approvals of any sales from the amortized cost portfolio and thus we do not believe the occasional sales need to be restricted to situations where credit has deteriorated. Entities could be required to make disclosures regarding the expectation for infrequent future sales based on reasons that do not call into question whether the business model has changed.

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?

As highlighted in our comment letter to the Board dated September 30, 2010, the LSTA believes the classification and measurement of a loan commitment should be consistent with the entity's ultimate business purpose and strategy for extending the underlying loan. However, we have general concerns relating to the proposed cash flow test and business model test for determining measurement of the underlying loans and such concerns will equally apply to the loan commitments. Unless the conditions to qualify for measurement at amortized cost are relaxed (notably increase in financial instruments accounted for as FV-NI or FV-OCI due to the application of the SPPI model and preclusion from occasional sale of loans under a "hold-to-collect' business model), this proposal as written will result in many loan commitments being measured at FV-OCI when the probability of exercise is more than remote. Thus, we propose that transfers from the amortized cost portfolio are not restricted to situations where there is credit deterioration, but that occasional sales are also permitted in circumstances that are not the result of a change in business model.

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

We agree with the initial measurement principles for financial instruments. However, we do recommend that the basis of conclusions discussion regarding when a transaction price includes consideration for something other than the financial instrument be brought forward to the body of the final standard rather than remaining in the basis for conclusions. We would also



recommend reordering of the discussion when it is brought forward to the body of the standard. The discussion of this topic begins on paragraph BC149. However, it is not until paragraph BC156 that a reader learns that it is the Board's belief "...that most lending activities fall within the realm of normal or customary lending activities that would be excluded from the application of the guidance in the proposed Update on whether the consideration includes something other than the financial instrument." We believe this is a significant point, and it would be helpful if this guidance was at the beginning of the discussion, which should be included in the body standard.

Question 15: The proposed amendments would eliminate the unconditional fair value option (for financial instruments within the scope of this proposed guidance) in existing U.S. GAAP and, instead, permit an entity to elect to measure at fair value, with all changes in fair value recognized net income, all of the following:

- a. A group of financial assets and financial liabilities if the entity both:
 - 1. Manages the net exposure relating to those financial assets and financial liabilities (which may be derivative instruments) on a fair value basis
 - 2. Provides information on that basis to the reporting entity's management.
- b. Hybrid financial liabilities that meet certain prescribed criteria.
- c. Financial assets that meet the contractual cash flow characteristics criterion and are managed within a business model that has the objective of both holding financial assets to collect contractual cash flows and selling financial assets (in accordance with paragraph 825-10-25-25(b)).

Do these options provide decision-useful information? If not, why?

We do not support the proposed amendments to eliminate the unconditional fair value option. The proposal significantly limits the ability to elect the fair value option for financial instruments which do not meet any of the three criterion outlined in the proposal. While the Board acknowledges in paragraph BC320 of the proposal situations under which entities commonly elect the current unconditional fair value option, the proposal does not address all such situations and as a result may have significant implications on some of the preparers who, for example, currently elect to apply the unconditional fair value option in lieu of applying the requirements of hedge accounting which are often applied to issued plain vanilla liabilities that do not meet any of the conditions outlined in the proposal. With the uncertainty associated with the timeline of the hedge accounting project we encourage the Board to retain the current unconditional fair value option.

Additionally, the proposal seems to suggest that the elimination of the unconditional fair value option will increase comparability and reduce implementation cost in certain situations. We believe that the appropriate disclosure requirements, most of which exist under ASC 825 provide sufficient disclosures to provide sufficient transparency and promote comparability. Additionally, in our view the cost associated with the elimination of the unconditional fair value option and the potential resulting implications for additional costs and complexities which often result when applying the hedge accounting model in ASC 815 outweighs the benefits of



eliminating such election particularly as entities who have elected the fair value option have invested in implementing the appropriate processes and controls for documenting, tracking and disclosing instruments subject to fair value option election. We do support, however, the parameters for fair value option election outlined in paragraph 825-30-25-2 of the proposal when there is an accounting mismatch (converging with IFRS 9) and believe an entity should be permitted to elect the FVO to avoid the operational burden of bifurcation.

If the Board decides to proceed with its proposal, we strongly encourage the Board to provide additional clarifying guidance regarding the meaning of "net exposure" for a group of financial assets and financial liabilities as outlined in the proposal. Additionally, we are concerned about the ambiguity in proposal's reference to information being provided "on that basis to the reporting entity's management."

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

We agree that financial liabilities should be subsequently measured at amortized cost except as required by 825-10-35-10 and 825-10-35-11 or if the financial liability was eligible for fair value option (please refer to our responses to Questions 15 and 17.)

Question 17: The proposed amendments would require a nonrecourse financial liability that is settled with only the cash flows from the related financial assets (see paragraph 825-10-35-11) to be measured on the same basis as those assets. Do you agree with the proposed amendments? If not, why? What would you propose instead?

We agree with the Boards measurement alignment of nonrecourse liabilities to that of the related assets. However, we request the Board consider whether this measurement alignment should also be permitted for nonrecourse debt related to nonfinancial assets. We believe the measurement attributes of nonrecourse debt should be aligned whether the assets are financial or nonfinancial as true nonrecourse debt should not create earnings volatility purely due to measurement differentials as recently supported by the EITF in recent discussions². Additionally, current nonrecourse debt issued from common mortgage securitization vehicles sometimes contain nonfinancial instruments in the form of real estate owned which would potentially prevent many nonrecourse liabilities from being measured based on the related assets. We don't believe this is a reasonable outcome for a seemingly inconsequential factor.

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² Emerging Issues Task Force meeting discussion held March 14, 2013 in which a final conclusion was reached on Issue 12-G, Accounting for the Difference Between the Fair Value of Asset and Fair Value of Liabilities of a Consolidated Collateralized Financing Entity.



Question 18: The proposed amendments would require financial assets measured at amortized cost that are subsequently identified for sale to continue to be classified and measured at amortized cost less impairment and would prohibit recognition of the gain, until the sale is complete. Do you agree with the proposed classification and measurement requirements? If not, why?

We agree with the prohibition of gain recognition until the sale is complete, however, we do not see the reason for a change from the current accounting guidance that requires loans to be transferred from amortized cost portfolio at lower of cost or fair value. Financial institutions have implemented controls, policies and procedures to transfer loans from the amortized cost portfolio at lower of cost or fair value. We believe the cost of implementing this change outweighs the benefits and transfers at lower of cost or fair value (versus amortized cost less impairment) address any earnings management concerns.

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?

The accounting model for evaluating embedded features in assets and liabilities should be similar. An asymmetrical model for evaluating embedded features in assets apart from those within liabilities isn't conceptually sound as the holder of a debt instrument may be required to classify the instrument as FV-NI but the issuer would be required to bifurcate the embedded feature. The embedded feature would be separately recognized for the issuer but embedded within the value of the overall instrument for the holder. We don't believe the assessment of embedded features should be dependent on whether the instrument is held as an asset or liability as the same conclusions should be reached for an embedded feature present in both a financial asset and liability. Additionally, the proposal further complicates the existing accounting framework rather than simplifying the guidance as an incremental assessment is required for financial assets while at the same time maintaining the existing model for financial liabilities. As a result, we now have two models to assess similar embedded features within financial instruments solely dependent on whether the instrument is held as a financial asset or financial liability. Additionally, embedded features of nonfinancial instruments have yet another set of assessment guidance to apply. This results in a complex set of accounting guidance to evaluated similar embedded features across the various instruments. Therefore, we suggest the Board reconsider a consistent model for assessing embedded features across financial instruments.

Question 22: The proposed amendments would require reclassification of financial assets when a change in business model occurs and prescribes how those changes should be subsequently accounted for. Do you agree with the proposed amendment on reclassifications? If not, why?

We agree with the reclassification requirements prescribed in the proposal when there has been a change in business model. However, as previously noted, we disagree with the restriction



of occasional sales from the amortized cost portfolio for reasons other than credit deterioration. Please refer to our response to Question 12.

Question 23: The proposed amendments would require public entities to parenthetically present fair value for items measured at amortized cost on the face of the statement of financial position. Does that presentation requirement provide decision-useful information? If not, why? What would you propose instead?

We believe that presenting fair value information for items measured at amortized cost on the face of the statement of financial position will impede understandability of the financial information presented and confuse investors as these financial instruments are not measured at fair value. Fair value information is already presented in the footnotes to the financial statements and we believe that is the appropriate location for this information.

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 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 to begin with. We believe 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. We believe 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.

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?

We agree with the requirement to present fair value changes attributable to instrumentspecific credit risk in other comprehensive income for liabilities for which an entity has elected the fair value option.

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?



The proposed amendments (within paragraphs 825-10-45-14 through 45-15) would require calculation of foreign currency gains/losses using a fair value based method for financial instruments measured at FV-OCI, and to report those gains/losses in net income. We do not disagree with using a fair value based calculation method based on theoretical grounds. However, for entities that do not currently utilize the fair value based calculation method (e.g., that currently utilize a cost based method), significant development time and effort may be required to achieve a new fair value based calculation methodology, the benefits of which may in our opinion not justify the cost. Our preference would be for the Board to permit that either a cost based calculation method or a fair value based calculation method be used.

Moreover, under IFRS 9, although foreign currency gains/losses on financial instruments classified as at FV-OCI would also be recognized in net income, the IASB will require that a cost based calculation method be used (IASB ED/2012/4, *Classification and Measurement: Limited Amendments to IFRS 9*, paragraph B5.7.2A). In the interests of achieving convergence where possible, and for practical considerations, we request the Board to consider also allowing for a cost based calculation method to be utilized.

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?

We do not object to the proposed early adoption provisions.

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

The implementation of proposed guidance will represent major changes to current processes, controls and systems, and will vary based on the size, nature and complexity of the reporting entity. LSTA believes a minimum of four years will be necessary to fully and appropriately implement the proposed changes given the scope of the amendment and the major implementation considerations which need to be addressed. We also believe that the effective date for the Proposed Accounting Standards Update—Financial Instruments Overall should be the same as the effective date for the Proposed Accounting Standards Update—Financial Instruments—Credit Losses.

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

We believe the transition provisions are operable.