

FASB Credit Losses

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Respondent information

Type of entity or individual:

Industry Organization

Contact information:

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Questions and responses

1. Do you agree with the scope of financial assets that are included in this proposed Update? If not, which other financial assets do you believe should be included or excluded? Why?

No. As the CFO for a community bank, and as a preparer of our financial statements that are subject to audit & regulatory examination, , the proposal introduces even more unauditible / unexaminable judgement to the ALLL process than current GAAP.

2. The proposed amendments would remove the initial recognition threshold that currently exists in U.S. GAAP and, instead, view credit losses as an issue of "measurement" as opposed to an issue of "recognition" because the credit losses relate to cash flows that are already recognized on the balance sheet. Do you believe that removing the initial recognition threshold that currently exists in U.S. GAAP so that credit losses are recognized earlier provides more decision-useful information?

Absolutely not. Regulated financial institutions in the traditional business of community-based lending have had adequate and timely-provided-for ALLLs even during the most recent banking crisis. The cause of of the most recent crisis was the result of synthetic debt instruments created by Wall Street mega-institutions...not by inadequate ALLL accounting standards followed by community banking institutions.

3. As a result of the proposed amendments, the net amortized cost on the balance sheet (that is, net of the allowance for expected credit losses) would reflect the present value of future cash flows expected to be collected, discounted at the effective interest rate. Do you agree that the net amortized cost (which reflects the present value of cash flows expected to be collected) results in more decision-useful information than currently exists under U.S. GAAP?

Absolutely not. In community banks, well-underwritten credits often have multiple sources of repayment. Users of bank financial statements (including regulators) ultimately care about the recovery of the amounts owed...not about what a periodic fair value measurement is during a holding period.

4. The Board has twice considered credit loss models that would permit an entity not to recognize certain expected credit losses. In the January 2011 Supplementary Document, the Board considered a model that would permit an entity not to recognize some credit losses expected to occur beyond the foreseeable future. In the recent discussions on the three-bucket impairment model, the Board considered a model that would permit an entity only to recognize lifetime credit losses for loss events expected to occur beyond the 12-month horizon. Instead, the proposed amendments would require that at each reporting date an entity recognize an allowance for all expected credit losses. Do you believe that recognizing all expected credit losses provides more decision-useful information than recognizing only some of the expected credit losses? If not, how would you determine which expected credit losses should not be recognized (for example, 12 months or similar, foreseeable future horizon, initial recognition threshold, and so forth)?

No...incurred losses based on the initial recognition threshold should remain the model. Historical experience adjusted for currently-known qualitative & environmental factors provide sufficient timely recognition of credit losses in a "reasonable and supportable" manner already. Incorporating some sort of forecast for credit losses over the life of the loan not only is unreasonable and unsupported (much less auditable or examinable) it violates one of the most basic of accounting principles under the former FAS# 5. Namely, that liabilities (e.g. allowances) should be recognized when incurred and when they are probable and reasonably estimable. The proposed model is blatantly in conflict with this accounting principle.

5. The proposed amendments would require that an estimate of expected credit losses be based on relevant information about past events, including historical loss experience with similar assets, current conditions, and reasonable and supportable forecasts that affect the expected collectibility of the financial assets' remaining contractual cash flows. Do you believe that expected credit losses based on this information provides decision-useful information?

No.

6. For purchased credit impaired financial assets, the proposed amendments would require that the discount embedded in the purchase price that is attributable to expected credit losses at the date of acquisition not be amortized and recognized as interest income over the life of the asset. To achieve this result, upon acquisition the initial estimate of expected credit losses would be recognized as an adjustment that increases the cost basis of the asset. Apart from this requirement, purchased credit impairment assets would follow the same approach as non-purchased-credit-impaired assets. That is, the allowance for credit losses would always be based on management's current estimate of the contractual cash flows that the entity does not expect to collect. Changes in the allowance for expected credit losses (favorable or unfavorable) would be recognized immediately for both purchased credit-impaired and non-purchased-credit-impaired assets as bad-debt expense rather than yield. Do you believe that using the same approach to recognize changes in the credit impairment allowance for purchased credit-impaired assets and non-purchased-credit impaired assets provides decision-useful information? Do you believe that this is an improvement from the current model used for purchased credit-impaired assets?
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7. As a practical expedient, the proposed amendments would allow an entity not to recognize expected credit losses for financial assets measured at fair value with qualifying changes in fair value recognized in other comprehensive income when both (a) the fair value of the individual financial asset is greater than (or equal to) the amortized cost amount of the financial asset and (b) the expected credit losses on the individual financial asset are insignificant. The proposed amendments would require an entity to disclose the amortized cost basis of assets that apply this practical expedient each period. Do you believe that the practical expedient for some financial assets measured at fair value with qualifying changes in fair value recognized in other comprehensive income is reasonable? Why or why not?

No. Users of community bank financial statements want to see what principal and interest are owed. They already know what the potential effects on bank capital will be for changes on collectibility. Point-in-time fair value measurements of assets held to maturity are useless to community bank financial statement users.

8. The proposed amendments would require that an entity place a financial asset on nonaccrual status when it is not probable that the entity will receive substantially all of the principal or substantially all of the interest. In such circumstances, the entity would be required to apply either the cost-recovery method or the cash-basis method, as described in paragraph 825-15-25-10. Do you believe that this approach provides decision-useful information?

Yes.

9. The proposed amendments would require that an estimate of expected credit losses be based on relevant information about past events, including historical loss experience with similar assets, current conditions, and reasonable and supportable forecasts that affect the expected collectibility of the financial assets' remaining contractual cash flows. Do you foresee any significant operability or auditing concerns or constraints in basing the estimate of expected credit losses on such information?

Yes....reasonable and supportable "forecasts" are by definition, full of judgements that will be unauditable and unexamined and will generate huge GAAP vs. RAP differences again. The resulting differences will be less useful to community bank financial statement users under the new model than under the current model.

10. The Board expects that many entities initially will base their estimates on historical loss data for particular types of assets and then will update that historical data to reflect current conditions and reasonable and supportable forecasts of the future. Do entities currently have access to historical loss data and to data to update that historical information to reflect current conditions and reasonable and supportable forecasts of the future? If so, how would this data be utilized in implementing the proposed amendments? If not, is another form of data currently available that may allow the entity to achieve the objective of the proposed amendments until it has access to historical loss data or to specific data that reflects current conditions and reasonable and supportable forecasts?

Entities have access to historical loss data and a knowledge of current conditions. NOBODY has the ability to produce reasonable and estimable and auditable and examinable forecasts of the future.....The latest financial crisis would not have been impacted / changed in the least if we had a different credit loss measurement model.

11. The proposed amendments would require that an estimate of expected credit losses always reflect both the possibility that a credit loss results and the possibility that no credit loss results. This proposal would prohibit an entity from estimating expected credit losses based solely on the most likely outcome (that is, the statistical mode). As described in the Implementation Guidance and Illustrations Section of Subtopic 825-15, the Board believes that many commonly used methods already implicitly satisfy this requirement. Do you foresee any significant operability or auditing concerns or constraints in having the estimate of expected credit losses always reflect both the possibility that a credit loss results and the possibility that no credit loss results?

Absolutely....inconsistent forecasts across industries and across entities will create huge inconsistencies in financial statement comparability. This would be another violation of a long-standing accounting principle.

12. The proposed amendments would require that an estimate of expected credit losses reflect the time value of money either explicitly or implicitly. Methods implicitly reflect the time value of money by developing loss statistics on the basis of the ratio of the amortized cost amount written off because of credit loss and the amortized cost basis of the asset and by applying the loss statistic to the amortized cost balance as of the reporting date to estimate the portion of the recorded amortized cost basis that is not expected to be recovered because of credit loss. Such methods may include loss-rate methods, roll-rate methods, probability-of-default methods, and a provision matrix method using loss factors. Do you foresee any significant operability or auditing concerns or constraints with the proposal that an estimate of expected credit losses reflect the time value of money either explicitly or implicitly? If time value of money should not be contemplated, how would such an approach reconcile with the objective of the amortized cost framework?

13. For purchased credit-impaired financial assets, the proposed amendments would require that the discount embedded in the purchase price that is attributable to expected credit losses at the date of acquisition not be recognized as interest income. Apart from this proposal, purchased credit-impaired assets would follow the same approach as non-purchased-credit-impaired assets. That is, the allowance for credit losses would always be based on management's current estimate of the contractual cash flows that the entity does not expect to collect. Changes in the allowance for expected credit losses (favorable or unfavorable) would be recognized immediately for both purchased credit-impaired and non-purchased-credit-impaired assets as bad-debt expense rather than yield. Do you foresee any significant operability or auditing concerns or constraints in determining the discount embedded in the purchase price that is attributable to credit at the date of acquisition?

14. As a practical expedient, the proposed amendments would allow an entity not to recognize expected credit losses for financial assets measured at fair value with qualifying changes in fair value recognized in other comprehensive income when both (a) the fair value of the individual financial asset is greater than (or equal to) the amortized cost basis of the financial asset and (b) the expected credit losses on the individual financial asset are insignificant. Do you foresee any significant operability or auditing concerns or constraints in determining whether an entity has met the criteria to apply the practical expedient or in applying it?

Fair-value accounting in a held-to-maturity business model is generally meaningless to financial statement users. Further complicating it with this new proposal makes it even more meaningless.

15. The proposed amendments would require that an entity place a financial asset on nonaccrual status when it is not probable that the entity will receive substantially all of the principal or substantially all of the principal or substantially all of the interest. In such circumstances, the entity would be required to apply either the cost-recovery method or the cash-basis method, as described in paragraph 825-15-25-10. Do you believe that this proposal will change current practice? Do you foresee any significant operability or auditing concerns with this proposed amendment?

No....essentially this is current practice.

16. Under existing U.S. GAAP, the accounting by a creditor for a modification to an existing debt instrument depends on whether the modification qualifies as a troubled debt restructuring. As described in paragraphs BC45–BC47 of the basis for conclusions, the Board continues to believe that the economic concession granted by a creditor in a troubled debt restructuring reflects the creditor's effort to maximize its recovery of the original contractual cash flows in a debt instrument. As a result, unlike certain other modifications that do not qualify as troubled debt restructurings, the Board views the modified debt instrument that follows a troubled debt restructuring as a continuation of the original debt instrument. Do you believe that the distinction between troubled debt restructurings and nontroubled debt restructurings continues to be relevant? Why or why not?

No....not unless it is possible for a TDR to eventually be reclassified as a nontroubled debt after exiting a troubled period. The "once-a-TDR...always a TDR" treatment is not useful to a community bank financial statement user.

17. Do you believe the disclosure proposals in this proposed Update would provide decision-useful information? If not, what disclosures do you believe should (or should not) be required and why?

No....current methodology is well understood by users of community bank financial statements operating in a held-to-maturity business model.

18. Do you foresee any significant operability or auditing concerns or constraints in complying with the disclosure proposals in the proposed Update?

Yes.....forecasts are unauditable.

19. Do you believe that the implementation guidance and illustrative examples included in this proposed Update are sufficient? If not, what additional guidance or examples are needed?
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20. Do you agree with the transition provision in this proposed Update? If not, why?
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21. Do you agree that early adoption should not be permitted? If not, why?
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22. Do you believe that the effective date should be the same for a public entity as it is for a nonpublic entity? If not, why?

No....non-public entities should be exempt from the proposal altogether.

23. Do you believe that the transition provision in this proposed Update is operable? If not, why?

24. How much time would be needed to implement the proposed guidance? What type of system and process changes would be necessary to implement the proposed guidance?
Several years will be necessary to implement instrument-level data tracking before implementation will be possible for community banks.

Additional comments-updt. Please provide any additional comments on the proposed Update:

Mega-financial institutions on Wall Street and their ineffective regulation & oversight was the cause of the latest financial crisis, not an inadequate measurement of ALLL's in the financial statements of community banks. The new proposal will make our financial statements less useful and more confusing to our users. Therefore, it should not apply to us at all.

Additional comments-process. Please provide any comments on the electronic feedback process:

Excellent electronic feedback process.

Thank you.
