TOYOTA MOTOR CREDIT CORPORATION

May 30, 2013

Technical Director
Financial Accounting Standards Board

Re: Exposure Draft – Proposed Accounting Standards Update, *Financial Instruments (Topic 825): Credit Losses*

Dear Sir or Madam:

Toyota Motor Credit Corporation (TMCC, we, our) appreciates the opportunity to comment on the Proposed Accounting Standards Update, *Financial Instruments (Topic 825): Credit Losses* (the Exposure Draft or ED), recently issued by the Financial Accounting Standards Board (the Board or FASB).

TMCC provides automotive financial services, offering an extensive line of financing options to Toyota customers and dealers in the United States and Puerto Rico. Our financing products include retail and commercial leases and loans to Toyota customers as well as wholesale financing, term loans, revolving lines of credit and real estate financing to vehicle and industrial equipment dealers. In addition, we hold approximately $3 billion of marketable debt securities, all of which are classified as available-for-sale and recognized at Fair Value through Other Comprehensive Income (FV-OCI).

We understand the Board's desire to improve the reporting of expected credit losses to address the perceived delayed recognition of credit losses in the aftermath of the economic crisis that began in 2008. We believe that the standard currently proposed in this exposure draft would not have resulted in the recognition of the dramatic losses actually sustained during the economic crisis as the data with which forecasts would have been made, even under this proposed model, would not have predicted such unprecedented economic events.

That being said, our comments are focused not on trying to identify losses for events we experienced during 2008. Instead we are focused on what makes sense during the normal course of our business. In considering the proposed model, we could incorporate much of the exposure draft as written without significant cost and effort for our retail loan and lease receivables. The proposed model is not operable, nor does it align well with the business purpose and objectives, for our investments in debt securities.

Our key comments are outlined below. Additionally, we have included our responses to the Board's questions as an Appendix.

<u>We conceptually support the Board's proposed credit loss model, although we have some concerns for debt securities measured at FV-OCI</u>

For loans, leases and debt securities measured at amortized cost, we conceptually support the Board's proposed model as it results in a better, more meaningful, measurement within the statement of financial position, although we acknowledge the unfavorable ramifications within the statement of financial performance. Conceptually, credit losses will be front-loaded which will not match the revenues earned by entities that take on the risk of incurring those losses. Additionally, we believe there is an inherent "double-counting" of credit losses when a discounted cash flow method is used. The proposed standard will require entities to discount expected cash flows, which already incorporate the expectation of non-payment based on credit risk, at the effective (i.e. credit adjusted) interest rate. We are able to accept these limitations since:

(1) There is currently no matching today. The "compensation" earned via higher interest rates for assets with increased credit risk is recognized over the life of the asset while credit losses are rarely ratably incurred. While the proposed standard might force a further deviation of matching by recognizing all credit losses upfront, it does not result in the loss of a conceptually sound matching principal.

(2) Given our relatively static portfolio segments, we do not expect to experience a significant impact on our operations after the impact of first-time adoption.

(3) We do not believe that the limitations to the statement of financial performance discussed above outweigh the benefit to the financial statement user of achieving a more meaningful measurement within the statement of financial position.

We struggle a bit more conceptually as we look to apply this standard to debt securities measured at FV-OCI. While we can appreciate the Board's desire to have a single model for impairment of debt securities, we believe there are fundamental differences between securities measured at amortized cost and those measured at FV-OCI. Securities held at amortized cost reflect an entity's business purpose of holding those securities until maturity for the purpose of collecting contractual cash flows. For these securities we agree that the most critical information in assessing impairment is lifetime credit loss. However an entity's purpose for hold securities measured at FV-OCI is more dynamic. From a statement of financial position perspective, these securities are carried at fair value, which already reflects the current expectation of lifetime credit loss. From a statement of financial performance perspective, an entity is not necessarily concerned solely with the security's credit component, but rather an entity is concerned with the fair value of the asset as a whole. Furthermore, we are unclear as to how the "Day One" credit loss concept will be applied to FV-OCI securities. The recognition of an immediate (i.e. "Day One") credit loss on a FV-OCI security, whether on an individual or a portfolio basis, would result in the statement of financial position not being reflective of fair value. We do not agree with this approach since the fundamental measurement of FV-OCI securities is fair value.

It is important to consider an entity's business model and strategy in determining the manner in which impairment losses are recognized, and for that reason we hesitate to combine these securities with those measured at amortized cost. The other-than-temporarily impairment (OTTI) standard today accommodates the dynamic nature of these investments; and in situations where an entity intends to hold the asset, the current standard already requires the recognition of a lifetime expected credit loss. For FV-OCI securities, the existing OTTI standard is more conceptually sound and should continue to be applied going forward.

Further, we highlight that while on the surface the proposed standard is "one model", in practice there will be different processes for determining credit impairment for assets held at amortized cost, such as originated loans, versus those measured at FV-OCI. Therefore any perceived "simplification" or "consistency" by having, in principal, a single model will be significantly diminished.

<u>We have significant operability concerns for debt securities measured at FV-OCI</u>

Aside from some of our conceptual concerns, the standard as written would impose significant operational challenges. The data and processes we have for our loans and leases are drastically different from that of our investments in debt securities. For our retail loans and leases, we have extensive historical data and a very detailed, specific understanding of our customers, our operating environment, and our industry. We can identify the key factors affecting our credit losses, we can customize a credit loss model to our business, and we have significant resources dedicated to calculating and fine-tuning this critical estimate every quarter.

Such detailed credit impairment processes do not exist for our securities measured at FV-OCI. In order to implement this standard we would likely look to fair value as the starting point and then bifurcate that fair value into its credit, interest rate, and liquidity components. This is a very difficult and time-consuming process and is nearly impossible for those securities measured at fair value via a market quote. While we do this today under the current OTTI standard, the instances in which we are required to do so are relatively infrequent, so it is operable. However, it would be extremely difficult for us to apply this bifurcation process to our entire portfolio on a quarterly basis. It would require additional resources, both internal and external, and would be an expensive operation.

We considered whether the practical expedient proposed by the Board would eliminate some of this burden, and found it unlikely to provide relief. The practical expedient gives relief to those securities, on an individual asset basis, that have fair value above cost <u>and</u> have an expectation of insignificant credit loss. We believe the application of the practical expedient will be challenging for several reasons:

(1) Operationally the effort required to track when a security meets or does not meet the criteria (i.e. when an allowance needs to be assessed vs. reversed) would be challenging to apply on an individual asset basis to our entire portfolio in a timely manner. Instead of going through the effort of pulling individual securities in and out of the allowance each quarter, we would likely elect a process for establishing a credit allowance on FV-OCI securities and apply it consistently to all individual assets at each reporting date.

    We are currently experiencing a period of record-low interest rates. If interest rates start to rise within the next few years, our portfolio is likely to experience movement from unrealized gains to unrealized losses. This would result in our not being able to apply the practical expedient for the majority of our debt securities.

(2) The practical expedient as written could force us to recognize a credit allowance on debt securities because of interest rate changes, even when the credit risk remains unchanged, which seems counterintuitive to the objective of the standard and is somewhat confusing to investors. The same issuer with the exact same credit profile could have a credit allowance or no credit allowance based purely on the timing of when that security was purchased.

(3) The term "insignificant" is vague. Clarity should be provided to ensure consistent application. For example, is an AAA credit rating indicative of an "insignificant" credit loss estimate, an AA, an A? We suggest the FASB consider using the IASB's threshold, which looks to debt securities below BBB- for a lifetime credit assessment.

Should credit impairment of FV-OCI securities remain within the scope of this standard, we believe a more workable practical expedient will be necessary. To make this practical expedient more operational, we propose the following options:

Option 1 (*Preferred*) – Broaden the practical expedient to be applicable when *either* the fair value of the asset is greater than (or equal to) amortized cost <u>*or*</u> the expected credit losses are insignificant (which would be clearly defined per item (3) above)

Option 2 - Eliminate the fair value criteria. While the fair value of the asset may "make-up for" potential credit losses (i.e. a credit loss has occurred however it is less than the effect of the change in interest rates of the security), conceptually those non-credit changes are irrelevant to the determination of whether or not a credit loss has occurred, which is the stated objective of this proposed standard. Instead, the practical expedient should look only to the expected credit loss component. As such, a credit allowance would only be required if the credit profile of the security upon purchase is more than insignificant (as clearly defined), or if an existing security experiences a downgrade in its credit profile (i.e. a credit rating downgrade, negative movements in credit default swaps, etc). This would remove the burden of calculating a credit loss for any security with a credit rating of BBB- or higher (if, for example, a BBB- rating was determined to be of "insignificant" credit risk) each quarter. Similar to the fair value of these securities, we acknowledge that entities should be required to have controls and procedures in place to validate the credit ratings received by outside credit rating vendors.

This option would also help appropriately balance the cost-benefit of the proposed standard. If a debt security has a strong credit rating, then the calculated credit allowance would not likely be significant. To force the calculation of an allowance on these securities, whether or not market changes have put them in an unrealized gain or loss position, would require significant effort on the part of preparers which would not likely result in the recognition of a meaningful credit allowance or provide much benefit to the users of the financial statements.

Option 3 – Allow the practical expedient to be applied on a portfolio of assets. In other words, if we have a bond portfolio that in aggregate meets the stated practical expedient criteria, no allowance would be required.

Due to the conceptual concerns previously highlighted, combined with the significant operability challenges, we recommend that the Board exclude FV-OCI securities from the scope of this standard. We question whether the existing concerns related to the current OTTI accounting merit such wholesale changes, especially given the significant operational burden it will present for preparers. If improvements to the impairment accounting for FV-OCI securities are desired by the Board and the investor community, we believe these improvements should be made within the confines of the OTTI guidance, and not through incorporation within this standard.

<u>The forecasted data required to be incorporated into the calculation of credit losses should be more specific and concrete</u>

Conceptually we support the Board's proposal to recognize a credit loss for all contractual cash flows not expected to be collected. We agree that the baseline for this estimate would be historical loss experience, and adjustments should be made to reflect the expected impact of current conditions. Conceptually, we also agree with the idea of building in forecasts of future conditions, as theoretically this would give a better picture of all contractual cash flows that are not expected to be collected over the life of the asset. However, the practical application of building in these forecasts will present significant issues for preparers. Our concerns related to these forecast adjustments are focused primarily on achieving consistency across entities and being supportable to our auditors and internal stakeholders.

Consistency Concerns
While this standard will be applicable to all companies under US GAAP, the forecasting sophistication of each company is different. While some companies have significant resources that can be brought to bear to obtain and interpret forecasted economic data, other companies simply do not have the business

structure to commit the same level of resources. Some companies will be able to comfortably forecast 12 months, others could comfortably forecast 24 months, and others may even be able to comfortable forecast multiple years. Some entities may look to one economist's data, which is reasonable, while others may look to a different set of data, which is also reasonable. Due to the latitude that entities have in applying the proposed standard, even when the standard is applied correctly and with the fullest diligence, it will result in different information being presented to the users of the financial statements. Disclosure may clarify how a company is using various forecasted assumptions, but ultimately it is not reasonable for users of the financial statements to sort through the differing assumptions, forecast terms, and timeframes to reconcile results across entities.

Auditability Concerns
In our business, the allowance for credit loss is one of our most critical accounting estimates. Understandably, this estimate is subject to significant scrutiny by management, our audit committee and our auditors. To introduce additional adjustments, based purely on forecasted data without specific perimeters will expose us to considerable pressure. The effort required to get our internal stakeholders and auditors comfortable that our data sources, assumptions, and estimates for forecasted data are reasonable and supportable will be incredibly difficult and time consuming, especially in our already tight reporting timeframe.

If the Board moves forward with a required forecast adjustment in determining expected credit losses, we ask the Board to provide specific boundaries and guidelines for building in these estimates. Refer to the Appendix for a more detailed discussion.

<u>The current expected credit loss model (CECL) will be operationally difficult to apply to certain loans</u>

Our consumer loan portfolio consists of a high-volume of similar contracts for which we have significant historical and economic data to support our credit loss model. For these loans, the CECL model will not present significant operability issues. However, significant operability constraints do exist as we look to apply the proposed model to the lower volume, high dollar value loans within our dealer portfolio segment. The historical loss data available for these loans is more limited and specific to individual dealers and regions, thus making it difficult to project a reasonable historical baseline over the life of new loans.

Furthermore, the forward-looking industry and economic data currently available to us is tailored more towards our consumer loans. While many of these forecasts may also be applicable to our dealer loans, the methodology and the impact that these data points will have on our more individualized dealer loans will differ from that of our large homogenous population. Additionally, we will need to incorporate new forecasts specific to these loans and it is unknown whether this data is readily available to us, particularly at the level needed for these individualized dealer loans.

We appreciate the opportunity to express our opinion on this matter and would be pleased to discuss our comments in greater detail.

Sincerely,

Jeffrey Lankey

Financial Controller

APPENDIX

Scope

Question for All Respondents

Question 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?

TMCC Response:

No. We believe impairment of debt securities measured at FV-OCI should continue to be recognized in accordance with existing OTTI guidance. Within its Basis for Conclusions section of the ED the Board states that it found no conceptual or practical reasons to justify a different credit loss measurement objective for marketable debt securities as compared to debt instruments that are not securities. From a conceptual perspective we agree that there should be a consistent measurement objective (i.e. lifetime credit loss), however we believe the standard should reflect the fact that a lifetime credit loss measurement is only meaningful for FV-OCI securities when the intent is to hold those investments.

From a practical perspective, we have considerable concerns with the operability of the standard for FV-OCI securities:

- While the ED allows companies to perform its credit allowance on a portfolio of assets, we expect we will need to determine the expected credit loss on the individual-asset basis (regardless of whether a practical expedient is available). The standard as written does not lend itself to the pooling of investments in debt securities. We are likely to look to the fair value as a starting point for determining credit losses, and fair value is performed at the individual asset level.

- We do not have significant data on historical default and loss information for each debt security, nor do we have the specific entity and industry familiarity to identify the best assumptions to make adjustments to historical data for current events and forecasted economic trends.

- For debt securities in which we determine fair value based on a discounted cash flow model, we would look to that market value as an approximation for historical, current, and forecasted trends. It is difficult for us to separate the fair value amount into its interest rate, liquidity, and credit components. While we perform this today when applicable under the current OTTI guidance, it is only in limited instances when specific criteria have been met. To perform this analysis on an entire portfolio of securities on a quarterly basis would be prohibitively time-consuming and expensive.

- For debt securities in which a market quote is used to ascertain fair value, we have no access data to use to bifurcate the fair value into its various interest rate, credit, and liquidity components. The market quote has no cash flows associated with its value and there is no current need to perform such cash flow analyses. To implement this proposed standard, we would likely have to take the full market loss as a credit loss, which would grossly overstate the true credit loss associated with these securities.

- The proposed standard does not meet the cost-benefit threshold for FV-OCI instruments. The effort required will put a strain on an already complex process, requiring significant additional time and resources in order to discuss loss reserve modeling and assumptions in addition to the fair value discussions currently held at each reporting date. There seems to be relatively little benefit as most of the derived credit allowances will not be material due to the high-quality investment grade of our debt securities.

<u>Recognition and Measurement</u>

Questions for Preparers

Question 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?

TMCC Response:

Consumer lease and loans
As it relates specifically to our retail lease and loan receivables, we do not foresee a significant operability concern with basing our estimate on historical loss experience or with making adjustments for current conditions. However, we highlight that using our historical loss data becomes increasingly imprecise the longer the forecast horizon. We question, even though we operably can incorporate this data, whether we should as the resulting estimate will not be reliable past a certain period of time. With respect to the inclusion of adjustments based on forward-looking information as currently prescribed, we have both consistency and audit concerns.

Currently our model uses, as its baseline, historical loss experience both in terms of default frequency and severity. We then make further adjustments to reflect the impact of current conditions impacting our expected losses. We have data available to us for analysis purposes that could be used to generate forecast adjustments, but only for short term periods (primarily 18-24 months). Beyond this period our forward-looking estimates become imprecise and we would be uncomfortable including such estimates within our credit loss allowance.

With this in mind, we are comfortable with incorporating forward-looking data that we can reasonably estimate based on supportable forecasts (i.e. 18-24 months), meaning that the data is supportable from a source, controls and reliance perspective. We believe that we have access to the data to make these forecasts. We perceive the challenges would be the rigor necessary to withstand the internal and external audit scrutiny required to substantiate any forecast-based adjustments, as well as the lack of consistency that will result from the application of this standard across industries.

In order to alleviate consistency and audit concerns, the Board must put more specific perimeters around these forecasts. Specifically, we ask that the Board consider the following recommendations:

- Provide guidance (either explicitly within the standard or via implementation guidance) on the time period to be utilized for the historical data baseline. We do not recommend the Board provide a specific number of years, only that it provide a framework for companies to use in terms of what the Board deems acceptable. For example, the loss emergence period plus a specified standard deviation.

- Explicitly define the time period for entities to incorporate forecast adjustments. However, we do not believe any forecast beyond 24 months is effective as economic assumptions and trends become too unreliable at that point.
- Provide guidance (either explicitly within the standard or via implementation guidance) for when the Board believes a forecasted estimate becomes too unreliable to be incorporated into the estimate of credit losses. For example, a percentage of historical means or a specified error tolerance threshold.
- The current guidance instructs a preparer to consider “internally and externally available information considered relevant in making the estimate”. We suggest the Board be more specific in that the forecast adjustment should not be all “relevant” information that is reasonable and supportable but instead focus only on the “critical” information that is reasonable and supportable. Limiting the metrics included in the forecast to only those deemed “critical” will not only make the estimate more transparent, but will also ease the audit burden of proving why certain information that could potentially be “relevant” was not included in our estimate.

Dealer loans
With respect to our lower volume, high dollar value dealer loans, this model will introduce certain other operational challenges. Our credit model for these loans is fundamentally different from the model used for our homogenous loans. We would find it challenging to derive a reliable historical baseline for the life of these non-homogenous loans. Because these loans are more individualized, historical loss performance is not likely to be as predictive of future loss performance as with our consumer loans. We would struggle with the historical periods to include in our baseline as well as the significant judgments that we would need to “normalize” the data and tailor it to our expected future trends.

Additionally, incorporating forecasted data, especially forecasts beyond 12 months, will be more challenging. General market trends may not be applicable to the specific dealer groups for which we have issued loans, and reliable forecast metrics at the level necessary to be applicable to these loans may not be readily available.

Debt securities measured at FV-OCI
Applying the proposed standard to our debt securities measured at FV-OCI will be difficult as:

- We invest in securities generally through mutual funds, and we often do not have specific entity or industry knowledge with which to build a reliable estimate of future lifetime credit losses. We have limited access to historical and current events, and no specific entity knowledge with which to build future forecasts.

- To separate an asset in order to isolate its credit component requires significant judgment and effort, and today is only required in the case of an OTTI impairment. To perform this assessment on each individual security at each reporting date would be extremely time-consuming and would require additional resources and expense in order to achieve.

- Implementing the proposed standard for these securities would be operationally taxing. Our knowledge of historical data, current conditions, and meaningful forecast assumptions with regard to these securities is limited. We do not have the capacity to perform this level of credit loss assessment over every debt security in our portfolio in time to meet our reporting deadlines.

- There will be significant Sarbanes-Oxley implications, which will affect the operability of the proposed standard since we will have to develop significant new processes and procedures based on data we have not historically utilized.

Question 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?

TMCC Response:

Our current loss model for retail loans and leases already incorporates historical loss data and makes certain adjustments based on current conditions, which we often validate using various economic forecasting sources. These sources could be used to develop further adjustments to reflect forecasts for the next 18-24 months. As such, access to the necessary data during this period is not a concern for us. As previously mentioned, our concern lies with the consistency and audit issues that the use of forecasts could present if the FASB does not make these forecasts more specific.

For secured debt securities we could potentially look to the underlying collateral and obtain some level of data, although that data would have inherent limitations and would not be as robust as the data we have for our retail loans and leases. However for other debt securities (e.g. treasuries, corporate bonds) we utilize market quotes, which have no cash flow data for us to analyze and would make it nearly impossible for us to separately identify the relative credit components. Any attempt to generate cash flow models for these securities would be flawed as we have limited access to historical loss data and we would find it difficult to make well-informed judgments on the current conditions and supportable forecasts that are specific to each security's issuer and industry.

Due to significant data limitations for FV-OCI securities, we do not believe this standard is operable for FV-OCI securities. Instead, we believe these securities should remain under the current OTTI guidance.

Question 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?

TMCC Response:

As the Board has specifically clarified that both the roll-rate model and the probability-of-default model, which are currently the basis for our credit allowances, implicitly reflect both the possibility of a credit loss and the possibility of no credit loss, we do not foresee any significant operability concerns with respect to our loans and leases.

It would be difficult for us to explicitly run two scenarios for our debt securities measured at FV-OCI. As previously noted, we do not have reliable historical, current, or forward-looking data to run a full cash flow analysis where multiple scenarios are at play. Additionally, performing this analysis at the individual asset level would be extremely difficult. If we use fair value as a starting point and attempt to separately identify the credit component then the possibility of credit loss and no credit loss would be implicit at best, we could not explicitly demonstrate both scenarios. We reiterate that we believe these securities should be excluded from the scope of this ED. However, should the FASB decide not to exclude FV-OCI debt securities from the scope of this standard, at a minimum a "best estimate" should be allowed for FV-OCI debt securities.

Question 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?

TMCC Response:

As the Board has specifically clarified that both the roll-rate model and the probability-of-default model, which are the basis for our credit allowances, implicitly reflect the time value of money, we do not foresee any significant operability or auditing concerns with respect to our loans and leases.

Question 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 expected 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 assets 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?

TMCC Response: Not applicable

Question 14: As a practical expedient, the proposed amendments would allow an entity to not 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?

TMCC Response:

The practical expedient in the proposed standard is unlikely to provide relief. The practical expedient gives relief to those securities, on an individual asset basis, that have fair value above cost <u>and</u> have an expectation of insignificant credit loss. We struggle with the application of the practical expedient, as written, for a number of reasons:

(1) Operationally the effort required to track when a security meets or does not meet the criteria (i.e. when an allowance needs to be assessed vs. reversed) is challenging for us to apply on an individual level to entire portfolio of assets. Instead of moving specific individual securities in and out of the allowance, we would likely elect to apply the standard to all securities each quarter for ease of reporting.

We are currently in a period of record-low interest rates. If interest rates rise within the next few years our portfolio is likely to experience movement from unrealized gains to unrealized losses, which would prevent the use of the practical expedient.

(2) The practical expedient as written would cause us to recognize a credit allowance on debt securities because of interest rate changes, even when the credit risk remains unchanged, which seems counterintuitive to the objective of the standard.

As an example, if we purchase a treasury bond today, and interest rates remain flat, no allowance would be required as the fair value is above or equal to amortized cost and there is an insignificant credit risk associated with treasury bonds. However, if the market interest rates shift then that bond, which still has an excellent credit risk profile, would now need to be assigned a credit allowance.

(3) The term "insignificant" is vague. Clarity should be provided to ensure consistent application. For example, is an AAA credit rating indicative of an "insignificant" credit loss estimate, an AA, an A? We suggest the FASB consider using the IASB's threshold, which looks to debt securities below BBB- for a lifetime credit assessment.

Should credit impairment of these securities remain within the scope of this standard, we believe a more workable practical expedient, and one more in keeping with the conceptual objective of this standard, will be necessary. To make this practical expedient more operational, we propose the following options:

Option 1 (Preferred) – Broaden the practical expedient to be applicable when *either* the fair value of the asset is greater than (or equal to) amortized cost *or* the expected credit losses are insignificant (which would be clearly defined per item (3) above).

Option 2 - Eliminate the fair value criteria. While the fair value of the asset may "make-up for" potential credit losses (i.e. a credit loss has occurred however it is less than the effect of the change in interest rates of the security), conceptually those non-credit changes are irrelevant to the determination of whether or not a credit loss has occurred, which is the stated objective of this proposed standard. Instead, the practical expedient could look only to the expected credit loss component. As such, a credit allowance would only be required if the credit profile of the security upon purchase is more than insignificant (as clearly defined), or if an existing security experiences a downgrade in its credit profile (i.e. a credit rating downgrade, negative movements in credit default swaps, etc). This would remove the burden of calculating a credit loss for any security with a credit rating of BBB- or higher (if, for example a BBB- rating was determined to be of "insignificant" credit risk) each quarter. Similar to the fair value of these securities, we acknowledge that entities should be required to have controls and procedures in place to validate the credit ratings received by outside credit rating vendors.

Option 3 – Allow the practical expedient to be applied on a portfolio of assets. In other words, if we have a bond portfolio that in aggregate meets the stated practical expedient criteria, no allowance would be required.

Question 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 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?

TMCC Response:

Operationally, the proposed requirements related to placing loans on nonaccrual status will be difficult to apply to a portfolio of assets. Today we stop accruing interest when a loan is impaired, but that is only done for those loans individually evaluated for impairment. Loans within a portfolio that are collectively evaluated for impairment are not specifically identified for non-accrual, but are instead charged off when payments are no longer expected to be received or they have exceeded a specified number of days past due (e.g. 120 days).

Under the proposed standard, it is unclear as to whether this provision was intended to apply to all receivables, even those that are within a pool, or only those individually evaluated. Operationally we would find it challenging to separately identify loans within a pooled portfolio which we believe it is not probable we will receive substantially all of the principal or substantially all of the interest. For these pooled loans we believe the current charge-off methodology is sufficient and nonaccrual of interest for these loans is unnecessary.

In addition, this would be difficult to apply to our FV-OCI debt securities as we would have to develop new policies and procedures to track and estimate when nonaccrual should begin and which methodology should be applied upon recovery. Further guidance and clarification on how to apply nonaccrual status to FV-OCI securities would be helpful.

Questions for All Respondents

Question 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?

TMCC Response:

We believe there is no longer need for specified TDR accounting as the proposed standard already incorporates a lifetime credit loss estimate.

<u>Disclosures</u>

Questions for Preparers

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

TMCC Response:

We do not perceive any significant operability concerns or constraints in complying with the proposed disclosure requirements as they relate to our allowance for loan and lease credit losses. Complying with the required disclosures for our FV-OCI debt securities will be more challenging. The majority of the required disclosures will be new, requiring new processes and additional time and resources to complete in a timely manner. While the new disclosures will create additional strain on our resources, we do not believe the challenges in preparing the disclosures will be insurmountable.

Questions for All Respondents

Question 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?

TMCC Response:

We ask that the Board include additional, specific illustrative guidance as to how an entity should derive its adjustment for supportable forecasted information. The Board should include in the example how the determination was made as to what data was supportable and what data was not, how the time-frame of the forecast was derived (e.g. why 24 months of forward-looking data was supportable but 25 months was not), and what specific sources and assumptions were utilized. This would provide a framework to help entities apply the proposed principles-based standard.

Should securities measured at FV-OCI continue to be included within the scope of this standard, we ask the Board to provide detailed illustrative guidance on the recognition of a credit loss for FV-OCI assets, including examples of how a credit loss would be calculated on both a portfolio and an individual basis as well as detailed guidance on "Day One" recognition.

Transition and Effective Date

Questions for All Respondents

Question 20: Do you agree with the transition provision in this proposed Update? If not, why?

TMCC Response:

We agree with the Board's proposed cumulative effect transition method.

Question 21: Do you agree that early adoption should not be permitted? If not, why?

TMCC Response:

Yes. In order to preserve consistent reporting across all entities, we do not believe early adoption should be permitted. Given that the proposed standard will result in significant front-loading of credit losses, it would not be appropriate for some entities to report the full lifetime credit losses while others do not. Investors would not be able to perform meaningful comparisons of entities within industries and across industries.

Question 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?

TMCC Response:

Yes, so as to preserve consistency in reporting across all entities.

Questions for Preparers

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

TMCC Response:

Yes, we believe the transition provision in the proposed standard is operable.

Question 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?

TMCC Response:

We will need a minimum of two years to implement the proposed guidance. For our debt securities measured at FV-OCI and our dealer loans we will have to overcome significant operational hurdles and implement substantial new processes and procedures. From a retail loan and lease perspective, we might be able to mechanically update our model within a year, but we need an additional year to develop the appropriate documentation and process controls, promote management's understanding of the changes, and to meet audit requirements.