

May 31, 2013

Technical Director Financial Accounting Standards Board 401 Merritt 7, PO Box 5116 Norwalk, CT 06856

Re: Comments on Proposed Accounting Standards Update: Financial Instruments—Credit Losses; File Reference No. 2012-260

To the Technical Director:

The Kansas Credit Union Association (KCUA) is pleased to provide our comments to the Financial Accounting Standards Board (FASB) regarding the proposed accounting standards update on accounting for credit losses for financial instruments. KCUA advocates on behalf of 91of the 99 Kansas credit unions which serve over 626,000 members.

We strongly oppose FASB's proposed accounting standards update. The proposed changes will have a detrimental impact on the Kansas credit union industry. Here is what some of our members shared about the proposal:

The inclusion of future predictions creates such a high degree of subjectivity that I believe it will be detrimental to the ALLL calculation. Even predicting the timing of business cycles is impossible to accomplish with any degree of accuracy. ...I don't see any benefit to this proposed change in the accounting standard.

The valuation of a Loan Loss Allowance will become even more of a process of "art" rather than "science" and possibly result in significant volatility in financial reporting that is simply unjustified.

#### **KCUA's Concerns**

The credit union industry is highly regulated by both state and federal financial regulators which subject each credit union to a high level of safety and soundness scrutiny. The proposed changes undermine the ability of the regulators to establish regulations that reflect the ongoing accounting standards needed to keep credit unions viable. The proposal seemingly ignores the regulators' need to have some control of the accounting methods used by credit unions.

The proposal indicates that one objective is to provide financial statement users with more decision-useful information about the expected credit losses on financial assets, yet the proposed information to be provided is not relevant to the credit union regulators, the primary users of credit unions' financial statements.

As stated earlier by one of our members, the inclusion of future predictions creates such a high degree of subjectivity that it will be detrimental to the ALLL calculation.

## **Proposal's Impact on Credit Unions**

Another major concern involves your requirement for credit unions to recognize on the balance sheet, the current loss expectations in the Allowance for Loan and Lease Losses (ALLL). This change would cause an immediate increase to the ALLL of credit unions that could have a drastic impact of the financial statements of credit unions. The change could lead to a decrease in earnings which would result in a reduced capital ratio. This change could trigger prompt corrective action (PCA) implications for many credit unions that currently have no PCA concerns.

This proposal will require credit unions to expend extensive financial and technical resources to comply with the changes. As credit unions expend resources to comply, we believe some credit unions will not be able to afford the costs which in turn could lead to consolidation of credit unions.

### **Compliance Challenges**

The new credit losses model effectively requires entities to predict/forecast the extent and timing of future losses. Most, if not all, credit unions will be severely challenged to predict the extent and timing of such losses with any degree of accuracy. Even a credit union with adequate data sets and modeling capability may have difficulty in accurately predicting the future losses. Even the best data and modeling would be based on subjective analysis in the end.

A particular challenge presented by the proposal is that it precludes the use of static statistical models, making it practically impossible for the credit union to apply a statistical thought process to its loan portfolio in order to estimate future expected losses. This constant regeneration of loss projections based on future economic conditions makes the challenge even a little more impossible.

The proposal appears to require credit unions to stop using or rely less on models based on homogenous pools and models using historical loss ratios, in lieu of more complex models, again leading to use of more resources to comply. This will lead to more (especially smaller) credit unions which are unable to comply with the new credit loss standards. The credit union will be forced to spend more on modeling, more on updating core processing systems to comply with the new credit loss standard and likely, more on audit expenditures to test the compliance of the new modeling systems.

All of this makes it difficult to see that the benefit of the new credit loss standards outweighs the costs of the new credit loss standards.

## **Questions Left Unanswered**

Why has FASB openly rejected the credit loss standards proposed by International Accounting Standards Board (IASB)? The IASB proposal provides that a credit union would only recognize a portion of expected credit losses until a specific recognition trigger has been met. The IASB's credit losses model utilizes the following two-bucket approach:

- 1. 12-month expected credit loss (Bucket 1): Only requires full expected loss recognition when there is a significant increase in credit risk since origination or acquisition.
- 2. Lifetime expected credit loss (Bucket 2): For all other assets, credit losses are recorded based on the probability of a default occurring in the next twelve months.

The IASB's proposal certainly helps to fulfill one of FASB's stated objectives by eliminating the multiple credit impairment models but also preserves a piece of the current credit losses standard by allowing the credit union to consider the probability of default when determining expected losses.

It is concerning that FASB appears to be abandoning the respected and certainly reasonable efforts of the IASB in order to justify their desired ends of requiring credit unions to forecast future expected credit losses.

# What Should FASB Consider Going Forward?

- a) The changes are unlikely to benefit either the regulators as the primary users of a credit union's financial statements or the credit unions.
- b) The regulatory agencies should become a close working partner as you move forward considering that they will be the key enforcement tool for any new standards.
- c) The FASB should revisit the proposed IASB model because we believe it is better matched to fulfill the needs of the FASB while providing a model that credit unions are more able to comply with.

We appreciate this opportunity to express our views on the credit losses proposed accounting standards update. Should you have any questions about our comments, please do not hesitate to contact me.

Sincerely,

Jerel Wright

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