

May 31, 2013

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

**RE: Proposed Accounting Standards Update: Financial Instruments – Credit Losses – Subtopic 825-15; File Reference No. 2012-260**

VIA ELECTRONIC MAIL: [director@fasb.org](mailto:director@fasb.org)

Dear Technical Director,

The Michigan Credit Union League (MCUL), the statewide trade association representing 98% of the credit unions located in Michigan and their 4.5 million members, appreciates the opportunity to comment on the Proposed Accounting Standards Update: Financial Instruments – Credit Losses; Subtopic 825-15 (File Reference No. 2012-260). FASB has stated they will consider received comments on the proposed accounting standards update before issuing amended accounting standards and the MCUL welcomes the opportunity to provide industry expertise on the effects of the proposed changes on Michigan credit unions.

Based on the exposure draft the MCUL understands that the foundation of the proposals objectives is to:

- Make financial statements reviewed by investors more “decision-useful” in terms of exposure to risk for expected credit losses;
- Replace the current impairment model with a model that recognizes expected credit risks;
- Require consideration of a broader range of reasonable and supportable information, such as environmental risk factors, to inform credit loss estimates; and
- Reduce the complexity of current U.S. GAAP impairment models with a consistent measurement approach.

Although the MCUL understands that these changes have been proposed in response to the Financial Crisis Advisory Group’s recommendation to explore alternatives that would use more “forward-looking” information than the current incurred loss model, we feel that proposed amendment does not meet the needs of the credit union

industry and falls short of providing any useful information to our member/owners; therefore the MCUL strongly opposes the proposed changes to the Accounting Standards.

Credit unions are not-for-profit cooperative financial institutions owned by their members (customers). The primary users of the financial reports prepared for credit unions are our regulatory agency, the National Credit Union Administration (NCUA), state specific examination agencies, and individuals on the Board of Directors for the credit unions. The NCUA, state examiners and board members are sophisticated financial report reviewers. In addition to financial reports they also review all credit union loan and delinquency reports as well as in-depth asset-liability reports to understand the true financial position of each credit union both as of the date of reporting and with future projections that test forthcoming liabilities and risks the institution may be exposed to. Our industry does not interact with outside investors, and therefore these proposed changes, if required for credit unions, will negatively impact credit unions without any positive effect that may be otherwise intended. Additionally, the amended reporting requirements will not have any impact on the actions of the investment community in regards to credit unions.

In the main provisions of the Exposure Draft it states that “the proposed amendments would require an entity to impair its existing financial assets on the basis of the current estimate of contractual cash flows not expected to be collected on financial assets held at the reporting date.” The Allowance for Loan and Lease Loss (ALLL) is an estimate and currently is the most subjective portion of a credit unions financial reporting. Creating a more subjective calculation with additional estimation does not provide more sound information, it creates disparity in reporting and increases the ability of financial institutions to manipulate the calculation to best suit their reporting needs.

FASB has stated that this proposal has been introduced “to provide financial statement users with more decision-useful information about the expected credit losses on financial assets and other commitments to extend credit held by a reporting entity”; and was introduced due to “delayed recognition of credit losses associated with loans” after the global financial crisis. The assumption that any accounting process will predict a nationwide recession and corresponding global financial crisis is absurd. According to the Congressional Research Service the Great Recession began in 2007, however the recession was not recognized by the Federal government until mid-2008 (Labonte, M., The 2007-2009 Recession: Similarities to and Difference from the Past, 10/6/10). If the collective statisticians, economists, and researchers that study the United States cannot determine when the country has entered a recession, it is unreasonable to believe that a reporting method of tracking probable loan loss will better predict probable economic trends and their future impact.

Michigan credit unions use a very sound method of determining their loss reserve and calculating an allowance for loan and lease loss which follows GAAP and is accepted

by their examiners. If a loan account has demonstrated, through a non-payment event, that there is a likelihood of default the loan has an individual reserve calculated for it. For all loan portfolios a general reserve is calculated on the pool of loans based on the historical loss for each specific loan type taking into account economic reviews and predictions and specific analysis of historical and future predictions focused on each credit unions specific membership composition. Using a more subjective method of calculating the reserve that requires complex statistical analysis will increase the cost of the analysis without providing more decision useful information, and result in severe effects on small entities including small and mid-size credit unions.

Credit unions are very conservative lenders, which is evidenced by the lower delinquency and charge off ratios throughout the global financial crisis as compared to other financial institutions. The actions and lending practices of credit unions were not the cause of the financial crisis. Credit unions responsibly lend to their member-owners taking into account each person's ability to repay loans. This is evidenced by U.S. Credit Union/Commercial Bank Comparisons on delinquency and loan chargeoffs as published by the National Credit Union Administration (NCUA) and Federal Deposit Insurance Corporation who report the following:

Year	Loan Delinquency Ratio		Net Chargoff Ratio	
	Credit Unions	Banks	Credit Unions	Banks
2007	0.93%	1.33%	0.51%	0.62%
2008	1.37%	2.95%	0.84%	1.32%
2009	1.82%	5.60%	1.21%	2.60%
2010	1.76%	4.96%	1.42%	2.67%
2011	1.60%	4.14%	0.91%	1.61%

If credit unions are forced to institute a new ALLL calculation it will not change the actual safety and soundness of credit unions; however this change could create the perception that there are additional new risks and possible troubled conditions without an actual change in a credit union's degree of safety and soundness.

The MCUL is concerned with the unintended consequence of a change to the ALLL calculation. The new provisions in the ALLL calculation will be more expensive to calculate and will drastically increase the reserve credit unions will be required to hold for potential credit losses. These increased costs are associated with several factors:

- The proposed changes in the ALLL will cause an immediate required increase in credit union's ALLL and corresponding reserve account balances which will result in an immediate reduction in retained earnings. This will cause many credit unions' capital ratios to fall below regulatory requirements and cause Prompt Corrective Action and ongoing regulatory scrutiny.

- Credit unions will have to develop or purchase through third party sources extensive, complicated statistical models to meet the complex requirements of the proposal.
- Resources will be expended to meet the in depth individual loan analysis that will be necessary to determine fair market values for ALLL calculations.
- Changes in the ALLL calculation will require expensive information technology programing upgrades and updates.
- Due to the complexity of the newly proposed process auditing costs will increase which will negatively impact credit union expenses.

These increased costs, which do not correspond to increased risk to credit unions for extending credit to members, will restrict credit available to consumers, especially marginal borrowers. As the U.S. economy begins to recover, restricting credit will not improve the overall American economic condition. This is supported by Federal Reserve Bank who stated that “a key ingredient of an economic recovery is a pickup in household spending supported by increased consumer debt” (Krainer, J. FRBSF, Consumer Debt and the Economic Recovery, 8/20/2012).

The FASB Financial Instruments – Credit Losses proposal asks for input on several questions that the MCUL would like to address.

*Question 1: Do you agree with the scope of financial assets that are included in this proposed Update?*

The MCUL does not agree with the scope of the financial assets that are included in the proposed update. As a part of the proposal the instruments that are classified as financial assets have been amended to include loan commitments (825-15-15-2 c). In order to reach accurate net income figures the matching principal of accounting is followed by the credit union community, so expenses incurred to earn the revenues recognized during the accounting period are recognized in that time period and not in the next or previous periods. If loan commitments are included in the requirement for ALLL calculations the expenses incurred for reserving against potential future losses will occur prior to any actual or potential income opportunity.

*Question 2: 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?*

The MCUL does not believe that recognizing credit losses as an issue of measurement provides more decision-useful information. Any measurement tool is only as effective as the accuracy of the information it is based on. The new proposed calculation is more subjective and therefore less accurate as a measurement tool

when used to review potential losses within one credit union or across the entire financial services industry. When financial statement users review an organizations safety and soundness their primary focus should be on the reliability and integrity of the information. Allowance estimates that are based on probable outcomes are estimates of potential cash flows that may not be received and therefore do not produce more accurate information to base financial decisions against.

*Question 3: 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?*

As mentioned above the MCUL does not believe that net amortized cost provides more decision-useful information. Any method that uses more subjective information, which would include determining the value of an asset based on the remaining cash flow expected to be received, does not provide accurate information that should be the basis for financial decisions. As stated earlier the ALLL is the more subjective calculation in the financial statement preparation process, and basing this calculation on further estimates will not make the ALLL a more accurate determination of a credit union's loan loss potential.

*Question 4: 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?*

Determining all expected credit losses will be difficult and costly for credit unions to determine, and based on the subjectivity of the analysis it will not provide more accurate information to base financial decisions on. Financial analysts have stated that recognizing all expected credit losses will at least double credit unions' reserve requirements and has the potential to eliminate any net income in the year it is mandated. The MCUL also disagrees with including cash flow prepayments in the calculation as they are not credit losses. Additionally, including loan commitments that may never be advanced into the ALLL will cause overfunding of the reserve, a practice that credit union examiners strongly discourage.

*Question 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 collectability of the financial assets' remaining contractual cash flows. Do you believe that expected credit losses based on this information provide decision-useful information?*

Credit unions currently base their ALLL general reserve calculation on historical information about past events in loan portfolios, historical loss on assets in pools of similar loans, and reasonable forecasts and economic trends that affect their

members and the communities the credit unions serve. The information currently provided to members, members of the board of directors and examiners is sufficient to review and judge the risks and credit portfolio management of loan delinquency and loss.

*Question 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?*

Currently based on requirements from the National Credit Union Administration (NCUA) all credit unions follow the NCUA's regulatory requirements, Appendix C to 12 CFR Part 741—Interpretive Ruling and Policy Statement on Loan Workouts, Nonaccrual Policy, and Regulatory Reporting of Troubled Debt Restructured Loans for nonaccrual status and accounting practices. This guidance states:

Credit unions must ensure appropriate income recognition by placing loans in nonaccrual status when conditions as specified below exist, reversing or charging off previously accrued but uncollected interest, complying with the criteria under GAAP for Cash or Cost Recovery basis of income recognition, and following the specifications below regarding restoration of a nonaccrual loan to accrual status. Credit unions may not accrue interest on any loan upon which principal or interest has been in default for a period of 90 days or more, unless the loan is both “*well secured*” and “*in the process of collection.*” Additionally, loans will be placed in nonaccrual status if maintained on a Cash (or Cost Recovery) basis because of deterioration in the financial condition of the borrower, or for which payment in full of principal or interest is not expected. For purposes of applying the “*well secured*” and “*in process of collection*” test for nonaccrual status listed above, the date on which a loan reaches nonaccrual status is determined by its contractual terms.

This requirement has satisfied all credit union financial statement users and has been deemed a safe and sound practice by the NCUA.

*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. Do you believe that the distinction between troubled debt restructurings and nontroubled debt restructurings continues to be relevant?*

Credit unions have very strict regulations related to accounting and treatment of troubled debt restructurings that follow GAAP. The MCUL agrees that loans that have demonstrated repayment difficulties and are classified as troubled debt restructurings

should be recognized separately from other modifications. Credit unions enter into loan modifications for many different reasons. Unlike other financial service providers often a credit union will modify a member's loan to provide them the lowest market interest rate available. This is done because a credit union collectively serves the financial best interests of its members. Credit unions, as non-profit entities, return income to their member/owners in lower loan rates and that often occur in the form of loan modifications. Additionally, credit unions will often modify a member's loans to compete with other financial institutions and retain the loans and corresponding interest income; rather than having the member refinance their loans with other financial institutions. In these circumstances the modification is not based on a credit event that foretells delinquency or risk of non-performance, and should not be treated as such.

*Question 19: Do you believe that the implementation guidance and illustrative examples included in this proposed Update are sufficient?*

The MCUL does not feel that the guidance and illustrative examples in the proposed update are sufficient due to the fact that the proposal does not provide concrete examples and guidance on which methods should be considered under specific conditions and for certain industries.

*Question 20: Do you agree with the transition provision in this proposed Update?*

Based on the calculations the MCUL has completed for member credit unions imposing the proposed update as a onetime event will eliminate net income for the majority of credit unions in Michigan with unextended loan commitments to members. The proposed change will also cause many credit unions capital ratio to fall into a classification requiring examiners to require Prompt Corrective Action (PCA) and threaten the existence of small credit providers based on their ability to successfully strategize and complete net worth restoration plans. It is important to point out that when these events occur they are not reflective of an actual risk the credit union is facing – but is being triggered by an accounting change that is being forced on credit unions as a one time event.

### Conclusion

MCUL respects the Financial Accounting Standards Board's willingness to consider the impact of the proposed accounting standards update on the credit union industry. As written, the proposal utilizes a "one size fits all" approach for financial institutions that fails to consider the unique characteristics and business model of credit unions, as not-for-profit cooperatives that have no real access to capital beyond retained earnings, and that do not have the outside investors that this proposal ultimately seems designed to protect. If passed, this proposal will have the very real effect of directly threatening the stability, safety, and soundness of an industry segment that has proved itself safe and sound; did not contribute to the financial crisis (and in fact helped communities and business weather the crisis with sound lending practices and

available credit); and that services over half of the population of the state of Michigan and 93 million members nationwide.

Further, the MCUL urges FASB to consider the advice and proposed regulatory change recommended by U.S. Representative Blaine Luetkemeyer (R-MO) who introduced the Community Lending Enhancement and Regulatory Relief Act (CLEAR Relief Act, H.R. 1750). As a part of the CLEAR Relief Act, Representative Luetkemeyer has proposed a requirement that the Financial Accounting Standards Board complete a cost/benefit analysis on generally accepted accounting principle changes. On behalf of Michigan's credit union industry, we disagree with FASB's proposed Accounting Standards Update for Financial Instruments – Credit Losses and respectfully request that the proposal be rescinded.

MCUL appreciates the opportunity to provide comment.

Sincerely,

A handwritten signature in black ink, appearing to read 'DA', is positioned above the typed name of the sender.

Dave Adams  
Chief Executive Officer