

TO: director@fasb.org, File Reference 2012-260

FROM: Randy Chambers, Chief Financial Officer

Marcus Bowen, CPA, Controller

Self-Help Credit Union, Self-Help Ventures Fund & Self-Help Federal Credit Union ("Self-Help")

DATE: 5/31/13

SUBJECT: Comment on Proposed Financial Instruments-Credit Losses Standard

### **About Self-Help**

Self-Help is a family of credit unions and charitable not-for-profit organizations that together provide financing, technical support, consumer financial services and advocacy for those left out of the economic mainstream, with total combined assets of \$1.75 billion. Since Self-Help's founding in 1980, the organization has reached out particularly to female, low-income, low-wealth, rural and minority communities across North Carolina, California, Washington, D.C., Chicago, Illinois, California and many other communities.

We help borrowers nationwide build wealth by providing fair and responsible loans to businesses, consumers and prospective homebuyers. We strengthen under-served communities by financing nonprofits, child care centers, community health facilities, public charter schools, and residential and commercial real estate projects.

We provide responsible financial services through our network of state- and federally-chartered credit unions. Over time we have demonstrated that low-income borrowers pose no greater credit risk than other borrowers. Our borrowers have proven their determination to repay their loans, build their businesses, improve their communities, and build wealth through home ownership and home equity.

#### Summary

Self-Help does not support the FASB's general proposal to move to an expected loss model. We believe that the standard has two substantial problems – operational impact and financial statement transparency. In particular, we believe the proposal will create substantial operational burdens on small institutions.

We have also provided our response to the question raised in your exposure draft related to acquired credit impaired loans.

## **Operational Impact**

The median U.S. credit union has \$20 million of assets and under 10 employees. The average non-profit, non-depository, federally-certified community development financial institution ("CDFI") – organizations like Self-Help Ventures Fund – is even smaller at \$5 million in assets. Most smaller financial institutions -- particularly those that serve minority and underserved communities – don't have the technical or staffing resources to accurately forecast reasonable and supportable expected losses for a loan portfolio. Most such institutions have neither an on-staff CPA nor financial forecasting expertise.

Because such institutions lack these resources, they will be required to pay for the following related to forecast expected future losses:

1) Consultants, economists, statisticians, and credit analysts to provide "reasonable and supportable forecasts that affect the collectability of the financial assets' remaining cash flows" to satisfy auditor and examiner requirements (Question 9)

Note that even the best forecasts will be inaccurate as it is nearly impossible to predict major events that would forecast expected losses over the life of a loan portfolio. Historical loss data, if available, is not necessarily reliable or accurate in forecasted expected losses over the life of the loan. Because of inaccurate forecasts, the information is not "decision useful" (Question 10, 11)

2) Increased audit fees for the extra work and time require to audit and test these assumptions (Question 9).

We believe that Self-Help's experience – that of a mid-sized financial institution – is instructive here. Partly as a result of increasingly complex, analytically-driven GAAP standards related to fair value accounting, credit quality disclosures and other new standards, Self-Help's annual external audit fees have grown more than five-fold in ten years to over \$500,000 per year.

3) Increased staffing expenses allocated to educate current staff about the changed standard and additional time spent developing, refining, and implementing a new ALL methodology. Significant staff time would also be spent evaluating debt covenants, net worth requirements, lending policies, and communication with third parties about the significant increases in the ALL due to the change in methodology. (Question 9)

Just as Self-Help has increased our external audit fees over the past decade, we have more than doubled our accounting and financial forecasting staff, almost entirely driven by the need to model and disclose various items dictated by GAAP in the past few years.

Because of the aforementioned excess costs, the proposed expected loss standard would only further accelerate the elimination of smaller financial institutions without the necessary resources to implement the proposed standard. This ultimately hurts the consumer with fewer banking and financial services options; particularly minority and underrepresented consumers that are disproportionately served by smaller credit unions, community banks and non-depository CDFIs.

#### **Financial Statement Transparency**

While we believe that the Board may be giving short shrift to the operational burdens created by this proposal, particularly on smaller institutions, we also do not see that it necessarily improves the quality, and therefore, transparency, of a financial institution's financial statements for the user. The proposal has the following deficiencies:

- 1) Violating the matching principal as future projected expenses from the loans would be recognized at once while the related income streams are recognized over the life of the loan. As we are sure the Board is aware, loans are priced to cover losses over the life of a portfolio through a portion of gross interest revenue. Recognizing 100% of the likely losses on a loan at origination whilst deferring income grossly misstates the profitability of an institution and the value of its assets.
- 2) Increased volatility in earnings resulting from large fluctuations of management estimates related to expected, but unknown, future losses. We appreciate the Board's sensitivity to recent economic crisis, whereby financial institutions were woefully underreserved for the events of the past 5+ years. However, the crisis was primarily the a result of the creation of poorly-understood, complex financial instruments that were certain to fail (payment option ARMs, exploding ARMS, no doc loans, etc) and the models supporting those instruments rather than the result of banks being under-reserved for extraordinary losses.

It is troubling that the unintended consequences of the standard would include a significant burden on smaller financial institutions catering to underrepresented populations.

Our state and federal credit union examiners are the primary interpreters of GAAP standards for most credit unions. In our experience, these examiners bring great expertise in credit risk, interest rate risk and other financial risks. However, they are generally not CPAs nor accounting experts. They understand expected loss models that are based on historical charge-offs with some additional factors representing observable key performance indicators – delinquency, credit quality, employment, housing markets, etc. – but may have a harder time implementing the proposed standard.

Sadly, the hundreds of thousands of dollars that Self-Help has spent on financial statement preparation and reporting, creates very limited value for us. Our financial statement users – which include sophisticated users such as major national commercial and investment banks, large foundations and regulators – rarely give us the feedback that the new standards have made it easier to understand our financial position. The involvement of an econometric model increases skepticism and concern precisely because each entity has a different model and it's too complex for the user to understand.

# **Acquired Credit Impaired Loans (Question 13)**

As the "credit portion" of the discount on credit impaired loans is already determined in current acquisition accounting, we do not foresee any additional operability constraints in determining the discount embedded in the purchase price that is attributable to credit at the date of acquisition. In fact, we agree with the proposal that classifies the "credit discount" into the ALL. It is operationally easier and is easier to understand for financial statement users. However, including the "credit discount" within the allowance and not changing to an "expected loss" model, would have an ALL that has a "prospective/expected loss" component for purchased credit impaired loans and a "current/incurred" loss model for non-purchased loans. While potentially confusing, there is a fundamental difference between loans acquired with deteriorated credit quality and loans originated by the financial institution.