

May 31, 2013

Financial Accounting Standards Board (FASB)  
401 Merritt 7  
P.O. Box 5116  
Norwalk, CT 06856-5116

RE: File Reference No. 2012-260

Dear FASB Technical Director,

I am writing on behalf of the California and Nevada Credit Union Leagues (Leagues), the largest state trade association for credit unions in the United States, representing the interests of more than 400 credit unions and their 10 million members. The Leagues appreciate the opportunity to provide comments to the Financial Accounting Standards Board (FASB) regarding its Proposed Accounting Standards Update on Financial Instruments – Credit Losses.

While the Leagues appreciate the FASB's continued efforts and recognize the difficulties in finalizing an impairment model, we strongly oppose the proposed Accounting Standards Update (ASU) for the reasons described below. The Leagues urge the FASB to continue their careful deliberation and recognize the unintended consequences and harm to the credit union industry that will result from this proposal.

#### Objectives Not Met

The stated main objective of the proposal is to provide financial statement users with more decision-useful information about the expected credit losses held by a reporting entity at each reporting date. As credit unions are member-owned, not-for-profit financial cooperatives, the primary users of credit unions' financial statements are the National Credit Union Administration (NCUA) and state credit union regulators. We do not agree that the proposed ASU will provide better or more decision-useful information to these users. In fact, since the ASU would require information that is highly judgmental and subjective, it will likely result in continuous, non-constructive discourse with the regulators in regard to the reasonableness of forecasts used. Further, due to the subjective nature of forecasting, there will be no consistency among peers and this inconsistency will be too great to make financial statements meaningful or reliable and will render comparisons with peer institutions useless. That is, the proposed changes will render financial statements *less* decision-useful to primary users.

The FASB has also stated that the recent global financial crisis highlighted the need for more timely financial reporting of credit losses and the use of more forward-looking information.

We do not believe that the current "incurred loss" model improperly delayed the credit loss recognition, nor do we believe that the proposed "current expected credit loss" (CECL) model would have prevented the extent of credit losses during the financial crisis – as no one would have predicted the extent and timing of the events that led to the "Great Recession."

#### Impact on Credit Unions

It is important that the FASB recognize the unique structure of credit unions and consider the significant harm the proposed ASU would cause to the credit union industry and its 96-plus million members. Credit unions are different from other financial institutions in that the Federal Credit Union Act (Act) limits our net worth to retained earnings only. Further, the Act also restricts the ability of the NCUA to adjust its regulations in response to changes in accounting standards, as is possible for other federal financial regulators.

The proposed ASU will result in credit unions having to dramatically increase their Allowance for Loan and Lease Losses (ALLL) reserves. Some estimate the proposal will double, triple, or even quadruple their ALLL balances. This ALLL adjustment will result in a significant reduction of credit unions' retained earnings, which can lead to a reduced net worth ratio. A reduction in net worth may cause some credit unions to fall under Prompt Corrective Action (PCA) rules imposed by the NCUA.

Another probable consequence of the proposal is that it will curtail lending. Credit unions and all lenders will likely be forced to make less risky loans as they cannot afford to recognize losses over the life of the loan up front while the interest income is recognized over time.

In this recovering economic environment, credit unions need to rebuild capital, make more loans, and help make their members' lives better. However, this proposed ASU will have the opposite effect and will negatively impact credit union members as credit unions try to restore their retained earnings through higher loan rates, lower dividend rates, and higher fees. In addition, credit union members and all financial institution consumers will have less access to credit.

#### Subjective: Judgmental Estimations

The proposed ASU would require the estimate of credit losses to include "reasonable and supportable forecasts" that affect the expected collectability of the assets remaining cash flows. Recognizing and measuring credit losses is inherently a subjective process. Add to that the requirement to forecast the future and the estimate becomes even more skewed. Professional economists cannot accurately predict nor agree on economic cycles, yet this proposed ASU presumes that financial institutions have that ability. The requirement to forecast future economic cycles would require a much greater degree of analysis, at a much higher cost, and still remain subjective.

We are particularly concerned about the highly judgmental and subjective nature of forecasting the future. First, there will be no consistency by preparers; estimations will vary and provide little relevance to the users of the financial statements. Second, we fear that credit unions will likely be embroiled in differences of opinions with their regulators in regard to the reasonableness of forecasts used. This could result in frequent adjustments to expected loss projections, cause volatility in ALLL reserves and earnings, and possibly subject credit unions to PCA implications.

We also are very troubled by the cost and complexity of complying with the proposed CECL model and forecasting requirements. We believe the proposed ASU will have a major impact on credit unions and could ultimately result in the consolidation or failure of credit unions that are unable to comply.

#### Accounting Principles

The proposed ASU contradicts the matching principle of accounting. The matching principle states that expenses should be recorded in the same period as the revenues that relate to those expenses. Under the proposal, interest income is recognized over the life of the loan while credit losses are recognized on day one – thus violating the matching principle. Losses should not be recorded before the loss is probable and can be reasonably estimated.

#### FASB Proposal Incongruent with IASB Proposal

The FASB and the International Accounting Standards Board (IASB) have been working jointly to achieve a convergence of standards, yet in July 2012 the FASB decided to develop a separate and different expected credit loss model.

The IASB's credit losses model is referred to a three-bucket impairment model that utilizes two different measurement objectives.

- 12-month expected credit loss (Bucket 1): This category would require 12-month expected credit losses as soon as a financial instrument is originated or purchased.

- Lifetime expected credit loss (Buckets 2): For all other assets, lifetime expected losses are recognized only when credit risk increases (or credit quality deteriorates) significantly and the resulting credit quality is below “investment grade.” Calculation of interest revenue remains unchanged.
- Lifetime expected credit loss (Buckets 3): Assets move to Bucket 3 when credit quality deteriorates to the point that credit losses are incurred or the asset is credit-impaired. Lifetime expected losses are still recognized; interest revenue is calculated differently.

The IASB model makes a distinction between loans with greater and lesser credit loss risk, while the FASB’s model treats all loans (both normal risk and significant risk) the same. We strongly recommend the FASB consider a credit impairment approach that is more in-line with the proposed IASB model, particularly the aspects that use a twelve-month forecast period for newly originated or purchased loans and the recognition of lifetime expected losses only when there are significant changes to credit risk or asset quality. If the FASB moves in this direction, a new proposal should be issued for comments from stakeholders.

### Summary

In summary, we strongly oppose the proposed ASU. We believe the stated objectives would not be met under the proposal and are not relevant to credit unions, the proposed changes will result in financial statements that are less reliable and useful, and the direct hit to credit unions’ ALLL reserves will cause significant harm to the credit union industry and their members.

We submit that the existing accounting principles, when properly applied and supplemented with appropriate disclosures, provide reliable and relevant information to the users of credit unions’ financial statements – our regulators. We urge the FASB to not replace the “incurred loss” model.” If the FASB does move forward with this proposed ASU, then we fervently request the FASB recognize the differences between credit unions and other financial institutions and allow credit unions to continue reporting credit losses under the current method.

Alternatively, if the FASB continues to seek a change to the impairment models, we urge the FASB to consider the IASB’s proposed “3-bucket” model that recognizes the differences between loans with greater and lesser credit loss risk.

Lastly, we propose there be an adequate phase-in/transition period for credit unions for any new standards, which should be coordinated with the implementation of the new international standards. We urge the FASB to work with the IASB to delay the effective date of final, consistent credit loss standards for at least three years – particularly for non-public reporting entities such as credit unions.

Thank you for the opportunity to comment on this proposed ASU and for considering our views.

Sincerely,

Sincerely,

Diana Dykstra  
President and CEO  
California Credit Union League

cc: California Credit Union League