



May 31, 2013

Ms. Susan M. Cosper
Technical Director
Financial Accounting Standards Board
401 Merritt 7,
P.O. Box 5116
Norwalk, CT 06856--5116

Re: Proposed Accounting Standards Update: Financial Instruments—Credit Losses (Subtopic 825-15)

File Reference No. 2012-260

The Loan Syndications and Trading Association (LSTA)¹ appreciates the opportunity to comment on the Proposed Accounting Standards Update – Financial Instruments—Credit Losses (Subtopic 825-15) (the proposal).

We commend the FASB for attempting to improve the recognition and measurement of impairment for financial instruments, but we have several concerns with the proposal. One of our main concerns is the lack of convergence with the IASB’s model for impairment of financial assets. Because the impairment guidance is a topic that has critical importance to the global capital markets, we believe that it is imperative that the FASB and IASB (the “Boards”) work together to develop a converged impairment model. The LSTA also is concerned with recognizing *all* expected credit losses and is supportive of a framework for recognizing losses expected to occur within a period that can be reliability estimated, but no less than 12 months. We also favor the current OTTI model for debt securities as it is well understood and has been tested through part of the financial crisis. In the attached appendix, we have answered specific questions that highlight our views and concerns regarding the proposal.

¹ The LSTA represents over 300 of the largest US and foreign banks, broker dealers, hedge funds, mutual funds, insurance companies, and institutional investors. The LSTA was founded in 1995 with the objective to improve liquidity and transparency in the floating rate corporate loan market. As the principal advocate for this asset class, the LSTA fosters fair and consistent market practices to advance the interest of the marketplace as a whole while promoting the highest degree of confidence for investors of corporate loans. The LSTA undertakes a variety of activities to develop policies and market practices designed to advance just and equitable marketplace principles and to encourage coordination with firms, facilitating transactions in loans and related claims.



We truly appreciate the opportunity to share the loan industry's perspective on the proposal. If you have any questions concerning our comments or suggestions, please contact Sherif Sakr at (212) 436-6042, Melanie Pinto at (917) 363-9796 or Ellen Hefferan at (212) 880-3013.

Yours truly,

A handwritten signature in black ink, appearing to read "Sherif Sakr". The signature is fluid and cursive, with a long horizontal stroke at the end.

Sherif Sakr
Co-Chair LSTA Accounting Committee

A handwritten signature in black ink, appearing to read "Ellen Hefferan". The signature is cursive and elegant, with a prominent initial "E".

Ellen Hefferan
Co-Chair LSTA Accounting Committee



Question 2: *The proposed amendments would remove the initial recognition threshold that currently exists in U.S. GAAP and, instead, view credit losses as an issue of “measurement” as opposed to an issue of “recognition” because the credit losses relate to cash flows that are already recognized on the balance sheet. 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?*

We understand the reason for the removal of the initial recognition threshold that currently exists in U.S. GAAP and the FASB’s objective of recognizing credit losses earlier, however we have concerns, which are highlighted in our response to Question 4 below.

Question 3: *As a result of the proposed amendments, the net amortized cost on the balance sheet (that is, net of the allowance for expected credit losses) would reflect the present value of future cash flows expected to be collected, discounted at the effective interest rate. 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?*

We agree that net amortized cost provides more decision-useful information than currently exists under U.S. GAAP

Question 4: *The Board has twice considered credit loss models that would permit an entity not to recognize certain expected credit losses. In the January 2011 Supplementary Document, the Board considered a model that would permit an entity not to recognize some credit losses expected to occur beyond the foreseeable future. In the recent discussions on the three-bucket impairment model, the Board considered a model that would permit an entity only to recognize lifetime credit losses for loss events expected to occur within a 12-month horizon. Instead, 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? If not, how would you determine which expected credit losses should not be recognized (for example, 12 months or similar foreseeable future horizon, initial recognition threshold, and so forth)?*

We do not believe that recognizing *all* expected credit losses provides more decision-useful information. We believe that an expected credit losses model will provide more decision-useful information to the extent that such information is reliable, however we will be stating the obvious when we highlight that such reliability decreases the longer the duration of the asset subject to the credit impairment analysis. The LSTA supports a framework for recognizing expected credit losses whereby the loss estimate is based on the amount of credit losses expected to occur within a period that can be reliably estimated, but no less than 12 months. Some refer to this framework as (“foreseeable future with 12 months floor.”) We acknowledge the lack of clarity and diversity in interpretation of what constitutes a “foreseeable future”, and hence our preference is to focus the estimate on the period in the future where inputs for calculation of



credit losses are reliable. Additionally, we do not believe that there is one size fits all definition that could encompass all types of assets classes or facts and circumstances which could vary from one lender to the other depending on their degree of forecasting sophistication and experience with different assets classes within their portfolio. Accordingly, we believe that defining the ‘period that can be reliably estimated’ should be based on such unique facts and circumstances of each asset class which ought to be disclosed within the notes to the financial statements in sufficient level of adequacy to ensure that such information is provided to users to allow for comparability of one lending organization to the other.

Additionally, we encourage the FASB to consider reintroducing a recognition threshold to the credit impairment model. As currently drafted the proposal would result in increases/decreases in the allowance as origination volume increases/decreases, regardless of changes in credit quality which is due to the requirement for expected credit losses to reflect at least two possibilities, one of which that a credit loss exists. We believe that such outcome does not provide decision-useful information, which should otherwise be focused on changes to credit standing of the borrowers.

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?*

We agree that an estimate of expected credit losses is appropriate. However, we have concerns that even if macro-economic factors exist to derive forecasts, the extent to which the assumptions of the future need to be tested to demonstrate effective correlation between the macroeconomic indicator and either (a) credit delinquency or (b) change in loss rate, will be difficult in the context of “reasonable and supportable” forecasts and whether management’s projections of the future are truly auditable.

This requirement would appear to run contrary with ASC 825, *Fair Value Measurements* (ASC 825). When one measures the fair value of an asset, it must be valued at the measurement date. However, if the asset is backing a collateral dependent loan, this would imply that the ASC 825 fair value would be adjusted for future valuation evolution of the underlying asset, e.g., real estate, corporate aircraft, etc. (this point appears to be implied when reviewing 825-15-28 to 31 example 3). In addition, this requirement would appear to be operationally difficult to implement, especially for loans for smaller-dollar equipment purchases.

Overall, we support the consideration of some forward looking information. The LSTA acknowledges that forecasting future events increases subjectivity and can result in a lack of comparability across financial institutions. In our view, an impairment model that considers events over the period that can be reliably estimated, but no less than 12 months would result in a better measure of such expected cash flows at the reporting date. Any potential risks beyond the period that can be reliably estimated that may arise should be addressed in the Management



Discussion & Analysis (MD&A) concerning possible future trends and uncertainties that could impact the loss reserves. In other words, discuss possible trending risks in the MD&A and do not quantify the impact to the loss reserve. Please also see our response to Question 4.

Question 6: *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 amortized into and recognized as interest income over the life of the asset. To achieve this result, upon acquisition the initial estimate of expected credit losses would be recognized as an adjustment that increases the cost basis of the asset. Apart from this requirement, purchased credit-impaired assets would follow the same approach as non-purchased-credit-impaired assets. That is, the allowance for 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 believe that using the same approach to recognize changes in the credit impairment allowance for purchased credit-impaired assets and non-purchased-credit-impaired assets provides decision-useful information? Do you believe that this an improvement from the current model used for purchased credit-impaired assets?*

We agree that the same approach should be used to recognize changes in the credit impairment allowance for purchased credit-impaired assets and non-purchased-credit-impaired assets and believe this approach is an improvement from the current model used for credit-impaired assets.

Question 7: *As a practical expedient, the proposed amendments would allow an entity not to 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 amount of the financial asset and (b) the expected credit losses on the individual financial asset are insignificant. The proposed amendments would require an entity to disclose the amortized cost basis of assets that apply this practical expedient each period. Do you believe that the practical expedient for some financial assets measured at fair value with qualifying changes in fair value recognized in other comprehensive income is reasonable? Why or why not?*

We prefer the application of the existing OTTI model to securities at every balance sheet date versus applying the model proposed as we believe it is well understood and was well tested through part of the financial crisis. The current loss model for debt securities was revisited only 4 years ago with the issuance of FSP FAS 115-2. At that time, the FASB eliminated the probable trigger for OTTI’s and the changes made to the model were effective when applied throughout a significant part of the financial crisis. We are not aware that the model received the same criticism as the loan model from a “too little, too late” perspective and addressing that criticism is one of the key objectives in proposing the expected loss model. Introducing a new



model for debt securities would have a cost associated with it and, we do not believe that the costs outweigh the benefits.

Should the FASB decide to continue to pursue an expected loss model for securities, we do not believe the practical expedient is a reasonable approach to identify assets for which a credit loss allowance would be unnecessary. Although fair value in excess of amortized cost could be a good indication that there is an insignificant amount of credit losses expected on a debt instrument, expected credit losses may also be insignificant when the fair value of the instrument is less than amortized cost. For example, when applying the practical expedient, an instrument may not require a credit loss allowance one quarter because it is in an unrealized gain position; however, with rising interest rates and no change in the credit quality of the instrument, it may require a credit loss allowance the next quarter because it is no longer in an unrealized gain position. We note in the basis for conclusions in the proposal that in an effort to minimize the cost of compliance when expected credit losses are insignificant, the Board decided to allow a practical expedient for those instruments reported at FV-OCI. To that end, and given the practical expedient is not useful in rising interest rate environments, we believe the practical expedient would be more effective in minimizing cost if it was applied to all FV-OCI instruments where the expected credit losses are insignificant, regardless of whether or not the fair value of the instrument is greater than amortized cost.

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?*

We understand that the Board decided to provide specific guidance for nonaccrual assets in this proposed Update to promote consistency and comparability between regulated and non-regulated entities (paragraph BC44).

As highlighted in paragraph BC43, regulatory instructions for certain financial institutions currently mitigate this concern by requiring that interest accrual cease when collection of principal, interest, or both becomes doubtful (nonaccrual practices that are permissible under existing U.S. GAAP).

Per review of the Bank Accounting Advisory Series issued by the Office of the Comptroller of the Currency (“OCC”) in June 2012 Section 2B, *Nonaccrual loans*, in response to Questions 1 the Staff indicate that “The call report instructions require that, when doubt exists about the ultimate collectability of principal, wholly or partially, payments received on a nonaccrual loan must be applied to reduce principal to the extent necessary to eliminate such doubt. Placing a loan in a nonaccrual status does not necessarily indicate that the principal is uncollectible, but it generally warrants revaluation.”



Therefore, the proposal that “an entity shall cease its accrual of interest income when it is not probable that the entity will receive substantially all of the principal or substantially all of the interest” (ASC 825-15-25-10) does not appear appropriate. This guidance provides the definition for when a loan is impaired (ASC 310.10.35-17/FAS 114. 8) rather than when interest income accrual should cease. Furthermore, the “probable” threshold in practice means greater than a 75-80% probability whereas “doubtful” is more akin to greater than 50% or a “more likely than not” threshold.

Overall, the Board’s criteria for nonaccrual appears inconsistent to the guidance provided by the OCC; therefore, contrary to the Board’s intent that they were promoting consistency between regulated and non-regulated companies (paragraph BC 44).

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 collectability 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?*

We believe that banks would need considerable resources to collect the data on historical losses in order to build their forecasts of expected credit losses. Smaller banks face the greatest challenges since they are often resource constrained. Additionally, banks must collect data specific to their lending geography as opposed to using available industry data, which will require significant investments in time and resources which smaller banks may not necessarily possess.

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?*

We believe that many community banks don’t have a historical loss database and would have to build the data infrastructure. Rather than using generic loss data, banks must gather data specific to their lending footprint. In order to avoid selection bias, models must be tested on a data sample which is not the same as the one used to construct the models themselves i.e., the data must be large enough to encompass both purposes; a large volume of data must be collected, which may not be readily available. Additionally, loss migration and vintage curves need to be built for each portfolio in order to estimate the amount and timing of expected losses and



community banks may not have the expertise to perform this type of modeling. This will add to the complexity and require considerable resources.

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 establishing 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?*

We believe that the concept of having at least two possible scenarios (a credit loss result and a no credit loss result) is not clearly articulated in the proposal. While the proposal indicates that a probability-weighted calculation is not required the proposal can be read as implying a need to do probability weighting.

In addition, there is a question as to whether “at least two scenarios” is operational and well understood.

Examples:

- Larger-balance loans for business working capital purposes. In the event that the loan is considered impaired, a reserve review would consider the most likely outcome that in certain cases could result in “0” reserve if determined based on facts and circumstances that there is no credit loss result. However, there may be circumstances where a loss event is contemplated, but there is more than one possible outcome that depends on the facts and circumstances including future performance of the business (post turnaround or debt restructure) and/or any associated guarantees or third party financial support. Consequently the “credit loss result” may consider the best estimate, most likely outcome of loss, or even a reserve based on a minimum amount, if there is no one better estimate in a dollar value range per ASC 450/FIN 14. We find it unclear whether the FASB’s proposal eliminates ASC 450/FIN 14 guidance as well as most likely outcome or best estimate when determining the value assigned to the “credit loss result”.
- Fully secured collateral dependent loans. If an asset-backed loan is fully secured by the fair value of the underlying collateral then by virtue of the proposed practical expedient there is no estimated credit loss (ASC 825-15-55-6). However, given the “at least two scenario” approach (ASC 825-15-25-5), it is unclear whether the preparer is required to aggregate all fully secured collateral dependent loans and establish a portfolio-level reserve based on at least two scenarios. This introduces a level of conservatism not founded in the U.S. GAAP conceptual framework.



- Direct financing leases. While the LSTA is responding in the context of loans, the issue highlighted in the comments above for of collateral dependent loans could equally be applied to these leasing instruments, which have both credit risk and, for the non-financial component, asset risk.

Therefore, we recommend that the existing guidance for determining a best estimate in US GAAP is retained as:

a) Fully secured collateral dependent loans – the concept of determining at least 2 loss scenarios is not applicable by virtue of the practical expedient; the estimated credit loss result can be “0”.

b) For loans subject to portfolio level reserve determination, e.g., small dollar homogenous loans in a pool, the concept of determining at least 2 loss scenarios would not be applicable given the estimation will consider some form of historical loss rate analysis.

c) For larger-balance loans not performing to contractual terms, for measurement of credit loss, consideration should be given to probability weighted analysis that would consider possible outcomes and retain existing guidance associated with application of FAS 114 including FIN 14 concepts.

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?*

We agree that the time value of money should be contemplated in the estimate of expected credit impairment losses for financial instruments with a tenor over twelve months and do not foresee any significant operability concerns.

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, purchase 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?

We agree with the proposed model and do not foresee any significant operability concerns in determining the discount embedded in the purchase price attributable to credit at the date of acquisition. Also please see our response to Question 6.

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?*

We do not foresee significant operability concerns with the application of the practical expedient.

Should the FASB decide to modify the practical expedient as we suggest in our response to Question 7 above, the operational requirements to support that the expected credit losses are insignificant are the same as what would be required if the proposal is adopted as currently written. The proposal basis for conclusions notes that FV-OCI instruments are more frequently measured on an individual basis because the business model involves selling individual assets. We agree with the comments in the basis for conclusions and as a result of the individual measurement of FV-OCI assets, we can more easily determine if the expected credit losses are insignificant. With many debt instruments, market information is available (e.g., implied credit spreads, public ratings, public financial information, etc.) that may be used to adequately support an assertion that expected credit losses are insignificant.

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?*

From a regulated bank perspective, we are concerned about the proposed wording of this amendment compared to the existing OCC definition of a non accrual asset (see response to



Question 8 above). We would like further clarification of the term “probable” within this proposal and ask that probable be defined as a 75 – 80 % likelihood of occurrence.

We also believe that the proposal should clarify that performance under the original loan terms should be used for determining when a troubled debt restructuring (“TDR”) is returned to accrual status. Additionally, from an operational perspective, the proposal may change the practice for some banks given the difference between the proposal and current regulatory guidance.

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 trouble debt restructuring. As described in paragraph BC45-BC47 of the basis for conclusions, the Board continues to believe that the economic concession granted by a creditor in a trouble 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 trouble debt restructuring as a continuation of the original debt instrument. Do you believe that the distinction between trouble debt restructurings and nontroubled debt restructurings continues to be relevant? Why or why not?*

We do not believe that the distinction between TDR and non-TDR would be relevant under the proposed expected loss model. All loans would be reported with an allowance equal to the amount expected not to be collected.

The TDR designation would no longer have an impact on the reserve under the Current Expected Credit Losses (“CECL”) model. In addition, discontinuing the current accounting for TDRs would bring U.S. GAAP closer to convergence with the IASB standards since the TDR concept does not exist in IFRS as an accounting concept. We do believe that providing some disclosure of the types and amounts of modifications in the restructuring period might be appropriate.

Question 17: *Do you believe the disclosure proposals in this proposed Update would provide decision-useful information? If not, what disclosures do you believe should (or should not) be required and why?*

Banks have been complying with enhanced credit disclosures since 2011. Preparing those disclosures has been very time intensive, particularly for smaller banks that tend to be resource constrained. It is unclear whether readers of financial statements are getting much decision useful information from those credit disclosures. However, we do believe the information included in the roll forward of the allowance for loan losses required in the disclosures may be useful to readers of financial statements who wish to understand the credit profile of a bank. Given the volume of information that is required to be disclosed – specifically related to 825-15-50-8: ‘Allowance for Expected Credit Losses’, the FASB should consider reducing the scope of some



of the disclosures to save time and costs of implementation for preparers without detracting from the quality of decision useful information.

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

Some of the disclosures would require banks to disclose proprietary information. Specifically, the requirement for banks to disclose how expected loss forecasts were developed includes proprietary information. Additionally, considerable resources would have to be expended to comply with the proposed disclosures. This will be a challenge for many of the smaller banks that tend to be resource constrained.

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?*

We observed that none of the illustrative examples in the proposal are debt securities. We would suggest a collateralized-loan-obligation (“CLO”) example would be helpful given the non-recourse nature of the beneficial interests issued from the securitization.

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

We do not note any significant issues with the transition provisions proposed.

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

We do not object to the prohibition against early adoption.

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

We believe the prospective transition provisions are 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?*

The implementation of proposed guidance will represent major changes to current processes, controls and systems, and will vary based on the size, nature and complexity of the reporting entity. LSTA believes a minimum of four years will be necessary to implement the proposed changes given the scope of the amendment and the major implementation considerations which need to be addressed. We also believe that the effective date for the Proposed Accounting Standards Update—Financial Instruments Overall, Recognition and Measurement of Financial Assets and Financial Liabilities should be the same as the effective date for the Proposed Accounting Standards Update—Financial Instruments—Credit Losses.