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May 31, 2013

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

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

Background

Credit Union of America (CUA) is a $515 million assets credit union in Wichita, Kansas. As a credit union, we are a not-for-profit, non-public organization that is cooperatively owned. We find it ironic that FASB is now proposing an expected loss model, because at one time we utilized an approximation of an expected loss model and were forced by earlier changes in FASB principles for ALLL determination to move toward the current incurred loss model.

General Comments

We believe the proposed ASU has shortcomings and flaws so severe that it cannot achieve the objectives of greater transparency or of empirically improving the statement of financial assets. Along the way, the proposal would impose costs and capital reductions on the non-public credit union industry while providing little if any substantive benefit to the credit union or the users of our audited financial statements.

There are significant weaknesses related to inclusion of "reasonable and supportable forecasts" in determining appropriate Allowance for Loan/Credit Losses (ALLL). First, forecasts of financial and economic data are notoriously inaccurate, and supposed expert forecasts often vary widely. Forecasts of economic and financial variables exhibit consistently high error rates, a finding well documented by numerous academic research studies and human experience. Second, forecasts often vary depending on the time horizon, such that they may be more/(less) favourable in the short term but differ over a longer time frame. While a rigidly fixed horizon will often be inappropriate, this will create the potential for disputes over the proper time horizon of forecasts. Third, the wide array of supportable forecasts will lend itself to intentional manipulation or management of losses. Fourth, a reader of financial statements will then require disclosures of the forecasting methodology, the various best, worst, most likely, and probability-based range of possible outcomes, and an understanding of why that actual forecast utilized meets standards of being reasonable and supportable. Fifth, development of forecasts and forecast methodology will vary substantively between firms, undermining comparability of financial results and reporting between firms, even within the same industry.

Collectively, the weaknesses of a forecasting-based ALLL substantively undermine the purported improvement in transparency and of balance sheet presentation.

The proposed ASU is in part a reaction to FASB's perception that assets were overvalued during the financial crisis that began in approximately 2008. The events leading to that crisis were not forecasted by any mass of economic experts. In fact, one of the most common components of forecast error is the tendency to forecast the future as a continuation of most-recent trends. The idea that an ASU requiring forecasts would have resulted in ALLL balances capable of absorbing losses that were outside of any prior experience is tenuous. Despite the severity of losses, the vast majority of financial institutions weathered the unexpected surge in loan losses reasonably well even under the incurred loss model.

The proposed ASU also abandons the fundamental principle of reasonably matching the recognition of revenue and cost. As proposed, the ASU would effectively require a financial institution to book all forecasted losses for new loans originated during the reporting period, despite the fact that income recognition will occur over the life of the loans. Even loans that will ultimately create losses will generate real income over their life. There is a potential to curtail credit availability to consumers, insofar as riskier and longer-term loans magnify this disparity of expense versus income recognition.

The proposal indicates that ALLL determination is to be based on the possibility that cash flows will occur or will not occur. This is a confusing and self-contradictory expectation. Similarly, the proposal indicates that a forecast isn't to be worst case, nor best case, nor a single most likely case. It seems as though FASB is leading toward some aggregation of multiple probability-based forecasts – about the most complex, time & resource costly method that could be required – and in the end it's still just a forecast that may prove to be close to reality or wildly far from the mark.

General Comments Specific to Credit Unions

Different Set of Users of Audited Financials – Credit unions are cooperatively-owned, not-for-profit organizations. The users of audited financial statements within a credit union are generally a small internal group such as the Board of Directors. Our credit union only receives requests for our audit report from examiners and from our Corporate Credit Union. It is inappropriate to impose complex and costly changes in ALLL determination on cooperatively-owned not-for-profit organizations, particularly when readership and use of audited financials is typically limited to the internal management and leadership of the organization.

Impact on Capital -- The proposed ASU would have adverse impact on CU capital. This would reduce net worth for some credit unions to a level that would trigger Prompt Corrective Action by regulators. This would be the by-product of a rule change that effectively requires organizations to suddenly record two or three times more risk on the balance sheet. This would occur despite the lack of fundamental change in the actual risk position or financial condition of the credit union. As a cooperative non-public organization that does not issue capital stock, the only way to build credit union capital is through earnings. The proposed ASU would thus have particularly adverse impact on not-for-profit cooperative organizations.

Specific Questions

FASB issued some specific questions in the proposed ASU, and our responses to selected questions are provided below.

<u>Questions for Users</u>

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 believe the present incurred loss model, though not perfect, is superior to the proposed ASU. It provides better comparability of financials between companies, and better comparability over time. We believe the incurred model is more transparent as a result of being less complex. As the ALLL computation incorporates error-prone forecasts, it will undermine its value to decision makers.

Considering the cost of complex computations of discounted cash flows under multiple sets of assumptions, and the inherent error rates of financial forecasts, we believe FASB should retain the incurred-loss model with its use of historical experience and Q&E adjustment factors.

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 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)?*

If lifetime losses could actually be forecasted years in advance, the proposed ASU could potentially provide decision-useful information. The problem is that financial forecasts have substantive inherent forecast error, both because of the tendency to forecast the future as an extension of current conditions and because forecasting error increases dramatically when the forecast extends to multiple years.

Stock market analysts who study a limited set of companies in order to forecast earnings a mere three months or less in the future have an average error rate of 44% (13-year study by A-N Research Corp; many other similar studies support similar results). Forecasts of financial variables exhibit such inherent error rates that we believe it is inappropriate for accounting rules to mandate the use of such forecasts, especially for something with the potential financial impact as ALLL computation.

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?*

No, we strongly believe that expected credit losses based on the proposed ASU would not provide decision-useful information. This would be the case because of the inherent weaknesses and errors of financial forecasts, and because of lack of comparability over time and between companies. It is likely that more time and resources would be expended on the mechanics of the forecasts and various loss probabilities of cash flows, than would be spent using the results for decisions.

Additionally, the idea that the expected losses (simultaneously) reflect both the possibility that a credit loss results and the possibility that no credit loss results is self-contradictory and contradicts the supposition that a model represents a reasonable and supportable forecast of the remaining contractual cash flows. This should not be an exercise in quantum physics, positing possible alternative outcomes and trying to guess which outcome will collapse to reality.

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 (favourable or unfavourable) would be recognized immediately for both purchased credit-impaired assets and non-purchased-credit-impaired assets provides decision-useful information? Do you believe that this is an improvement from the current model used for purchased credit-impaired assets?

My experience with purchased financial assets is somewhat limited, pertaining to merger accounting. If I am interpreting Question 6 correctly, I believe it makes sense to separate the credit loss component so it is not amortized against interest income. But the proposal still would expect complex forecasts of cash flows under multiple sets of assumptions and probabilities, which leads me to believe the incurred model remains a preferred approach for estimating the amount of credit losses.

Questions for All Respondents

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?*

We do not believe the disclosure proposals would provide decision-useful information. The data used in roll-forward disclosures, in particular, has generally been substantially prepared for regulatory Call Reports many months earlier than we will ever receive a completed audit report, so it is unlikely internal readers will find incremental value in re-hashing similar data in the roll-forward disclosure.

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

Yes. Audit time and cost will increase, yet resulting in no meaningful improvement in "decision-useful" information, particularly for non-public cooperatively-owned organizations such as credit unions. Core data systems do not have the capabilities to perform these types of cash flow calculations, and the complexity of doing so will require more companies to install and maintain costly sub-systems.

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

We agree that early adoption should not be permitted, as it will exacerbate lack of comparability of financial statements.

Question 22: *Do you believe the effective date should be the same for a public entity as it is for a non-public entity? If not, why?*

If FASB proceeds with implementation of the proposed ASU (or substantially retains the expected loss model), we believe different effective dates should be structured for public versus non-public organizations. In fact, we believe strongly that if the expected loss model is enacted, there should be a multi-year phase-in permitted for not-for-profit and non-public organizations. For credit unions in particular, the ability to phase in the financial impact over a period of several years would soften the substantive blow to net worth ratios.

Conclusion

We appreciate the opportunity to express our viewpoint and submit our comments on this FASB proposal. We respectfully urge FASB to exempt credit unions from the proposed disclosures, due to the concerns and reasons described above. If you have questions or want to request additional information, please contact me at 316-265-3272 ext. 140 or at PaulM@cuofamerica.com.

Sincerely,

Credit Union of America

/s/
Paul Meissner, SVP/CFO
Credit Union of America