From: Gregg Nelson [mailto:gln@us.ibm.com]

**Sent:** Sunday, June 02, 2013 8:31 PM

To: Director - FASB

Subject: File Reference No. 2012-260, Proposed Accounting Standards Update: Financial Instruments

(Topic 825-15) – Credit Losses

Importance: High

June 2, 2013

Ms. Leslie F. Seidman, Chairman Financial Accounting Standards Board 401 Merritt 7 P.O. Box 5116 Norwalk, CT 06856-5116

(sent via e-mail to <u>director@fasb.org</u>)

Re: File Reference No. 2012-260, Proposed Accounting Standards Update: Financial Instruments (Topic 825-15) – Credit Losses

Dear Ms. Seidman:

The International Business Machines Corporation ("IBM" or "the company") appreciates the opportunity to comment on the proposed Accounting Standards Update: Financial Instruments (Topic 825-15) – Credit Losses (the "proposed ASU" or "exposure draft (ED)").

IBM creates business value for clients and solves business problems through integrated solutions that leverage information technology and deep knowledge of business processes. These solutions draw from an industry-leading portfolio of consulting, delivery and implementation services, enterprise software, systems and financing. The company's activities generate significant trade, lease and loan receivables. The company also has a captive financing organization which facilitates client acquisition of the company's product and services. Over sixty percent of the company's receivables are considered investment grade. In addition, as part of its cash and risk management programs, the company routinely invests in short term investment grade debt securities. Historically, the company has experienced minimal losses on its receivables and debt securities.

We commend the recent efforts of the FASB and the IASB to align the model for credit losses; however, we continue to encourage the Boards to seek convergence on this topic which is critical to financial reporting in a global economy. We are generally supportive of a single attribute impairment model, which we believe is preferable to the "three bucket model" that was previously being considered by the Board. However, we have conceptual issues with certain aspects of the cumulative expected loss model proposed by the Board. Specifically, we do not agree with the requirement to record lifetime losses on investment grade assets, including trade receivables and debt securities. We strongly encourage the Board to revisit the conceptual basis for requiring credit impairments to be recorded on investment grade assets. Other concerns we

have with the proposed model are as follows:

Practical expedient. Paragraph 825-15-25-2 states that an entity may elect to not recognize expected credit losses for a financial asset measured at fair value with qualifying changes in fair value recognized in other comprehensive income. We believe the practical expedient is too narrowly scoped, and that the criteria to qualify for the practical expedient should be amended. The scope should be expanded to all financial assets. We do not agree that a loss should be recognized up-front on an investment grade asset. Additionally, we believe that the two criteria stated in the ED to qualify for application of the practical expedient should be amended. Those criteria require that a qualifying asset must have a fair value equal to or greater than amortized cost, and that expected credit losses on the individual financial asset must be insignificant. We believe that the first criteria should be removed as it is primarily a reflection of interest rate risk and is not reflective of credit risk.

Time value of money. It is not clear to us that amortized cost reflects a time value of money component. Therefore, it is not clear that time value is implicitly considered in the model as the ED states. We would recommend that the Board provide additional guidance on acceptable methods to apply the model, and remove the discussion and requirement to include time value of money as an explicit requirement of the standard. We believe the discussion of time value of money as an explicit requirement may cause confusion.

Loan commitments. The scope of the proposed ASU includes loan commitments, unless those commitments are unconditionally cancellable. The proposed ASU is silent on the inclusion of credit enhancements or collateral requirements in calculating the expected losses on loan commitments. We believe including credit enhancements and collateral requirements in the calculation of losses on loan commitments is consistent with the objectives of the proposed model. We recommend the Board clarify the ability to include credit enhancements and collateral requirements on loan commitments, similar to the guidance provided for other in scope items.

Credit enhancements. Paragraph 825-15-25-6 of the proposed ASU states that, "The estimate of expected credit losses shall reflect how credit enhancements (other than those that are freestanding contracts) mitigate the expected credit losses on financial assets...." We are in agreement with the inclusion of credit enhancements in the calculation of expected losses; however, we believe the definition of freestanding contracts included in the standard and elsewhere in the codification could lead to confusion on which enhancements are allowed to be included. Consider a financial guarantee contract with a third party that qualifies for the scope exception under FAS 815, and, therefore is not reflected on the financial statements. This type of a financial guarantee could be considered to meet the first criteria of a freestanding contract as defined in the glossary, "Separate and apart from any of the entity's other financial instruments or equity transactions." We also note that in practice currently instruments with a third party have generally been considered a strong indicator of a freestanding contract. While we agree

that instruments such as credit default swaps should not be considered in calculating credit losses, we believe that a third party financial guarantee contract that qualifies for the scope exception under ASC 815 and credit insurance should be included in the calculation of credit losses. We recommend that the Board expand the guidance on credit enhancements to include financial guarantee contracts subject to the scope exception in ASC 815 and credit insurance.

*Non accrual status*. Paragraph 825-15-25-10 codifies the guidance related to non accrual status. The company's current policy with respect to non accrual status is to apply cash receipts first against the principal outstanding; any cash received in excess of principal payments is recognized as interest income. We have concerns about the dual approach model for non accrual status. We believe the current non accrual policy that the company has elected is appropriate, and that the ED should allow a policy election to apply payments against principal outstanding.

*Disclosure*. The ED requires disclosure for investments in debt securities that is aligned to current disclosures for loans. We believe requiring a rollforward of debt instruments will be of limited value to users of financial information as much of this information is already included in the Statement of Cash Flows. Additionally, the credit risk of loans and debt securities are managed in different ways, and the disclosures of information used to manage these risks should be aligned to the debt instrument. Therefore, we recommend that there should not be a requirement for a rollforward for debt securities, and the Board should reconsider the disclosure requirements for debt securities.

Thank you for the opportunity to comment on this proposal. If you have any questions or wish to discuss any topic further, please do not hesitate to contact me at 914-766-2008.

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