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June 7, 2013

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

Dear Ms. Cospers:

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

The Canadian Bankers Association<sup>1</sup> (“CBA”) appreciates the opportunity to review and comment on the Financial Accounting Standards Board (the “FASB” or the “Board”) Draft Accounting Standards Update Financial Instruments – Credit Losses (Sub-topic 825-15) (the “proposed ASU”).

We understand this proposed ASU is in response to the commitment of the G20 following the global economic crisis to address the notion of “too little, too late” with respect to credit loss provisioning. The CBA commends the efforts of both the FASB and the International Accounting Standards Board (the “IASB”) in their work to date to develop high quality converged standards in this area. Despite these best efforts, the proposed FASB and IASB accounting standards are not converged.

The Canadian banks strongly support harmonization of the FASB and the IASB accounting standards on credit losses, consistent with the harmonization sentiment expressed by the FASB in their March 28, 2013 news release announcing the extension of the comment deadline for the proposed ASU. Convergence is extremely important to provide banks globally a consistent reporting basis to ensure comparability of reported results is maximized. Additionally, if harmonization is not achieved, there will be an increased burden and cost for banks with significant U.S. subsidiaries that are required to report results under U.S. GAAP for regulatory purposes and under IFRS for public financial reporting. We believe that the maintenance of two impairment models will be costly, complex, and create undue confusion for users of the financial information. As a result, we strongly encourage the FASB and the IASB to develop a harmonized standard.

Although, in our view, an expected loss model does not meet the current framework under existing IASB and U.S. GAAP accounting standards, we are supportive of both the FASB and the IASB in their efforts toward developing an appropriate expected loss model that recognizes losses earlier than the existing incurred loss model.

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<sup>1</sup> The Canadian Bankers Association works on behalf of 55 domestic banks, foreign bank subsidiaries and foreign bank branches operating in Canada and their 275,000 employees. The CBA advocates for effective public policies that contribute to a sound, successful banking system that benefits Canadians and Canada's economy. The Association also promotes financial literacy to help Canadians make informed financial decisions and works with banks and law enforcement to help protect customers against financial crime and promote fraud awareness. [www.cba.ca](http://www.cba.ca).

In the FASB's current expected credit loss model ("CECL"), estimated lifetime credit losses would be recorded at loan origination. In our view, the recording of estimated lifetime loss on day 1 is conceptually flawed as it does not align with core accounting principles. Our rationale is as follows:

1. The loans on the date of origination are at fair value and priced at market conditions that capture an entity's expectation of credit losses over the life of the loan. The interest income from this originated loan is also recognized over the life of the loan. We do not believe that recognizing all interest earned over the life of the loan and total lifetime expected credit losses at inception is an appropriate reflection of the economics of the loan transaction. Instead, we believe that the model for recognition of credit losses after origination should consider the underlying credit quality of the loans and the credit deterioration that occurs over the life of the loans.
2. The CECL conflicts with existing U.S. GAAP where there are clear principles on contingency recognition in ASC 450 *Contingencies*, whereby contingencies are recorded when they are reasonably estimable and a threshold for recognition is reached.
3. Calculating lifetime expected losses will require considerable judgment and significant estimates and we do not believe this will lead to better information for financial statement users. It is generally acknowledged that longer-term estimates are less accurate. We believe that in order to ensure greater integrity of credit loss estimates, banks should be able to make an estimate of losses based on a reasonable, forward-looking timeframe in cases, for example, where the underlying credit quality of the asset is high and credit deterioration is not evident. This timeframe will generally vary by product type.

We acknowledge that there is a desire by regulators to have an accounting model that recognizes losses earlier. However, we would caution against using accounting standards to achieve regulatory results, and against publishing a standard focused on one industry, without due consideration of its applicability to the wide range of preparers. While there is an expectation that the CECL model will result in larger and earlier recording of reserves, the CECL model will be dependent on a bank's ability to make accurate long-term forecasts of economic downturns and credit deterioration. No model that uses assumptions and forward looking estimates will guarantee that pro-cyclicality is removed from the accounting result. We believe that the accounting model should remain true to the conceptual framework. All regulatory concerns should be addressed through the capital framework.

We request that this standard along with the suite of financial instrument standards and changes to insurance accounting that are being issued by both the FASB and the IASB have a single effective date. We believe that we will require 3 full years from issuance of the standard to assess, gather data, and modify systems where needed.

In summary, we believe the following points are critical considerations for the FASB in its next steps for the proposed ASU:

1. Recognition of expected lifetime losses on day 1 (loan origination) is not appropriate, and
2. The accounting standard must be based on a model where credit losses are recognized based on consideration of the underlying credit quality of the financial asset and credit deterioration over the life of the financial asset.

We are currently assessing the IASB's Exposure Draft Financial Instruments – Expected Credit Losses (ED/2013/3) and we will provide a copy of our comments to the FASB when we respond to the IASB. We thank you for taking our comments into consideration and look forward to future discussions on these issues.

Sincerely,

A handwritten signature in black ink, appearing to be "J. E. ...", is written over a light blue horizontal line.

cc: Leslie Seidman, Chair, FASB  
Russ Golden, incoming Chair, FASB  
Hans Hoogervorst, Chair, IASB

Attachment: Questions from FASB Proposed ASU

## QUESTIONS FROM FASB PROPOSED ASU

We have responded only to those questions directed to all respondents and questions for preparers.

### Scope

#### Question for All Respondents

**Question 1:** Do you agree with the scope of the financial assets that are included in the proposed Update? If not, which other financial assets do you believe should be included or excluded? Why?

**Response:** We concur with the scope of the proposed Update.

### Recognition and Measurement

#### Questions for Preparers and Auditors

**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?

**Response:** Many Canadian banks employ relatively sophisticated risk management processes and systems for tracking credit risk that are based on Basel approaches. The most significant challenge for the banks will be to incorporate this information to provide a reliable and appropriate measurement of loss. Measurement of loss over the lifetime of the loans is much longer than the approach required today and reduces the accuracy of the estimate of loss. Because the new credit loss measure becomes applicable to what banks refer to as the good book, banks have not historically tracked credit loss information for this book of loans. Our concern about such a significant estimate is that to the extent that the estimate is not reflective of actual losses, the change in estimate over time will flow through profit or loss. The resulting profit or loss volatility may be significant, and not explainable to investors and users of our financial statements.

In addition to the concern noted above at the individual bank level, we are concerned that there will be divergence in the application of assumptions, creating estimation / model risk that will reduce comparability among banks globally.

**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?

**Response:** Yes, Canadian banks currently believe they have historical loss data available since this information is factored into our current risk models through the base expected loss ("EL"), or other risk measures. Base EL would capture current conditions primarily through a point-in-time probability of default ("PD") based on current risk ratings. The banks have access to current data for reasonable and supportable forecasts, although a concern is that longer forecast horizons will produce less reliable results. For loan books with longer dated maturities, there is no amount of manual or system intervention that will yield a more accurate estimate. This issue and the recognition of lifetime expected losses on all financial assets at inception are our greatest concerns with the proposed CECL model.

**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 estimating 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?

**Response:** For the most part, current impairment models already reflect some PD and associated loss given default (“LGD”) or otherwise incorporate both the possibility that a credit loss results and the possibility that no credit loss results. Therefore, we believe that our measurement of estimated credit loss would comply with this proposed ASU requirement. We are concerned that there are situations where this requirement does not result in an appropriate measurement of credit losses as there may be loan or security portfolios that are fully insured by a credit-worthy sovereign (e.g., U.S. Treasury Bills). The FASB proposed ASU would require that some measure of credit loss be included in measuring credit losses for these portfolios. In certain circumstances, the credit loss for these portfolios may be nil and it is not clear that the proposed ASU would permit this result. We believe this is a shortcoming of the FASB expected loss model as the credit loss measure is not reflective of expected losses in this situation.

**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?

**Response:** The proposed ASU provides flexibility as to whether discounting is explicitly or implicitly incorporated into the impairment estimate. Importantly, the FASB clarified that there would be no requirement to reconcile an implicit approach to incorporating time value of money explicitly. Time value of money can be incorporated into impairment estimates in different ways. Banks apply sophisticated impairment models to estimate credit losses and these models, or the inputs used in these models (e.g., LGD), typically incorporate discounting. The models include various components and the specific mechanics of the model calculation may not be easily identifiable to a single requirement. For example, discounting may exist but at a rate higher or lower than what the FASB suggests. This does not mean that the accounting requirements for discounting are not met, but rather that an understanding of the components of the calculation and their interrelationship are needed. We also note that the models are developed and aligned with how banks identify and manage risk of credit loss. We believe that the accounting requirements for measurement of credit losses should leverage how banks manage this key business risk.

Furthermore, the FASB’s decision to incorporate time value of money may not be fully aligned with the IASB because the IASB ED provides a range of rates to use. This is concerning when we consider a scenario where we estimate the provision for credit loss on two identical portfolios using the same inputs except for a different discount rate. This would result in a different measurement of the credit loss provision, and potentially significantly so. This divergence in measurement would detract from global comparability of one of the key measures for banks. This is most concerning for the loans that we consider impaired (IASB stages 2 and 3 or “bad book” loans) where we record provisions based on known loss indicators. For these loans we believe that it is particularly important to have accounting standards that would permit a single measure of credit loss.

We support the FASB's position on the incorporation of time value of money and request that the FASB work with the IASB to have the IASB ED align to the FASB model for time value of money.

**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, purchased 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?

**Response:** We do not foresee any operational issues arising from the determination of the fair value discount embedded in the purchase price relating to credit at the date of acquisition as this is an existing requirement under the current U.S. GAAP and IFRS guidance.

The difference as at the date of acquisition would be in the classification of such credit related discounts as part of the allowance for credit losses or as a reduction to the loan balance in the form of a fair value credit mark, which is the treatment under current U.S. GAAP and IFRS guidance. Unless both Boards align, this could lead to a lack of comparability of results and statistics such as coverage ratios.

The accounting treatment for the impact of further credit deterioration subsequent to the date of acquisition would remain unchanged between current U.S. GAAP and IFRS guidance, and the proposed amendment with recognition through profit or loss and an increase to the allowance for credit loss ("ACL"). The difference subsequent to the date of acquisition would be in the treatment of improvements in credit quality. Although the determination and measurement of these improvements would remain unchanged, they would no longer be recorded as an increase to the yield over the remaining life of the loans through interest income. Instead, these improvements would be recognized immediately as a reversal in impairment losses and a reduction in the ACL. This change in U.S. GAAP treatment is an area of convergence with IFRS which we support.

**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?

**Response:** Yes. We recommend removing the first criterion that the fair value of the individual financial asset is greater than (or equal to) the amortized cost basis of the financial asset. This is because fair value being less than the amortized cost basis is not always indicative of a credit change. It is possible that the fair value of a financial asset declines as interest rates increase without a corresponding change in the underlying credit quality.

**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?

**Response:** Under U.S. GAAP, this would not result in a change in practice for financial assets where an entity does not expect to receive payment of the principal. In situations where cash payments are no longer being received on the loan, there would be no impact of the change in guidance. Similarly, where the expectation is that it is not probable that substantially all of the principal will be collected, the treatment of subsequent cash payments will not change from current U.S. GAAP treatment. That is, application will be first to outstanding principal, then to previously written off amounts, and only when both those have been recovered would any interest be recognized. We ask the FASB to harmonize with the IASB in this area. Under existing IFRS, as well as the IASB ED, the non-accrual concept does not exist. Instead, when it becomes probable that the entity will not receive substantially all of the principal or interest on a loan, the entity continues to recognize interest income but then records an increased credit loss provision.

For collateral-dependent lending arrangements where the value of the collateral held would cover the principal balance outstanding but the collectability of contractual interest is not probable, this new guidance would be a significant change in current practices. This is because cash payments would be recognized as interest income to the extent that interest was contractually due in the reporting period. These loans would effectively continue to accrue interest despite being impaired. This would cause confusion as these loans are still referred to as non-accrual loans under U.S. GAAP.

### Questions for All Respondents

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

**Response:** We do not believe the distinction between troubled debt restructurings and non-troubled debt restructurings continues to be relevant. When evaluating the strength of credit quality in the portfolio, the current expectations of future losses for measurement purposes are: i) what is relevant regardless of whether concessions have or have not been granted in the past since presumably any previous activity / behavior will be considered in estimating future expected cash flows, and ii) the relevant historical information about any given borrower should be reflected in future estimates. We recommend harmonization with IFRS on this issue.

### Disclosures

#### Questions for Preparers and Auditors

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

**Response:** The Canadian banks will be able to provide the disclosures requested. Some additional disclosures will be required in order for a user to understand how an entity calculates expected losses. However, we note that the proposed disclosures are extensive and we have a concern that financial statement users may experience disclosure overload. This volume of information will be more than banks have historically disclosed. The inclusion of specific loss factors, or other granular model inputs, will lead to detailed disclosures of how model inputs form part of the model output, which is not necessarily meaningful information to financial statement readers. In order to make the disclosure meaningful to investors, and given the importance of management’s judgment to the final credit loss provision, we would

have to provide more granular disclosures about the management estimation process, which may not be well understood by the reader.

## **Implementation Guidance and Illustrations**

### **Questions for All Respondents**

**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?

**Response:** No. The CBA feels that the transition guidance is not sufficient to ensure that the guidance is applied as intended by the FASB and on a consistent basis among preparers. The CBA requests the FASB provide specific examples to illustrate assessment of credit losses on a pool of assets.

We also request that the FASB provide transition examples for both performing and non-performing debt securities that are in the amortized cost and FV-OCI categories under the proposed recognition and measurement guidance by FASB.

## **Transition and Effective Date**

### **Questions for All Respondents**

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

**Response:** No. The CBA believes that the standard should be based on transition provisions that require retrospective application without restatement of prior periods. An entity would record an adjustment to its opening allowance for credit losses (as at the beginning of the fiscal year when this standard becomes effective) to reflect the opening allowance in accordance with the new loss methodology with the offset to opening retained earnings. We believe this is the appropriate approach as hindsight would make it inherently difficult to estimate the allowance appropriately in prior periods.

In respect of purchased credit-impaired ("PCI") loans, we believe that transition clarification should be provided to ensure that there is no requirement to re-measure the initial credit mark.

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

**Response:** While we do not oppose an early adoption alternative, early adoption of the credit loss provisions should only be permitted in conjunction with early adoption of all other components of the financial instruments project.

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

**Response:** The same effective date should apply to both public and non-public entities in order to ensure consistent application and reporting by foreign bank U.S. banking subsidiaries. Without consistent effective dates, it is possible that the statutory financial statements and related regulatory filing could be on a basis that is different from our public U.S. peers. If the FASB and the IASB are able to achieve standards that permit a consistent measure of credit loss, we believe that it will be important to ensure the same effective date. This is important so that when a U.S. foreign banking subsidiary reports its financial results they are consistent with the information included in the consolidated group reporting to avoid undue complexity of reversing U.S. GAAP and applying IFRS.

## **Questions for Preparers and Auditors**

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

**Response:** Consistent with our response to question #20 above, we believe that the transition provision needs to be retrospective without restatement of prior periods.

**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?

**Response:** Once a final standard is published by both the FASB and the IASB, the Canadian banks estimate that they will need at least 3 full years to be able to fully implement the standards. This timeframe is based on transitioning to both the FASB and IASB credit loss standards for the same reporting period and having to fully interpret all the complexities of both the recognition and measurement standards as well as the credit loss standards. The CBA would like the FASB to provide a single effective date for all components of the financial instruments project including alignment with IASB and applicable regulatory effective dates, and ensure that banks with non-calendar year ends (e.g., October 31 for Canadian banks) have a full 3-year implementation period.