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June 28, 2013

Technical Director, File Reference No. 2012-260
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
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Via Electronic Mail: director@fasb.org, File Reference No. 2012-260.

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

Dear Sir/Madam:

Standard & Poor's Ratings Services appreciates the opportunity to provide the Financial Accounting Standards Board (FASB, or the Board) comments on its Proposed Accounting Standards Update, *Financial Instruments – Credit Losses (Subtopic 825-15)* (the Proposed Update).

The views expressed in this letter represent those of Standard & Poor's Ratings Services, and do not address, nor do we intend them to address, the views of any other affiliate or division of Standard & Poor's Financial Services, LLC. We intend our comments to address the analytical needs and expectations of our credit analysts.¹

Standard & Poor's Ratings Services strongly supports the FASB and International Accounting Standards Board (IASB) efforts to strengthen the accounting recognition of credit losses by replacing the current incurred loss model with a model that recognizes expected risks. We believe the current incurred loss model delays the recognition of financial instrument credit losses, a concern highlighted during the recent financial crisis by the Financial Crisis Advisory Group and one that we have previously expressed to the Board.² We believe a forward-looking accounting model that incorporates a broader range of credit quality information will improve the usefulness of financial reporting. We favor an approach to expected credit losses that most timely and effectively recognizes changes in expected underlying cash flows of financial instruments. While we recognize that no accounting model is without flaw, we favor the FASB's Current Expected Credit Loss Model (CECL)

¹ The opinions stated herein are intended to represent Standard & Poor's Ratings Services' views. Our current ratings criteria are not affected by our comments on the Proposed Update.

² See "Standard & Poor's Comments on the FASB's Proposed Changes to Accounting For Financial Instruments, Derivative Instruments, And Hedging Activities", published on Oct. 15, 2010 on Global Credit Portal – RatingsDirect (www.globalcreditportal.com).

over the IASB's proposal (referred to as the Credit Deterioration Model, CDM, or more commonly the Three-Bucket Model). We believe the FASB's single measurement approach is conceptually simpler and less ambiguous than the IASB's dual measurement approach, providing better information related to credit losses for our analytical purpose.

We summarize the key highlights of our letter below:

- Global convergence on accounting for credit losses is imperative. We rate companies globally and to the extent significant differences remain in the accounting for credit losses, key reported financial metrics will not be comparable -- to the detriment of investors and other users of financial information.
- We believe a forward-looking single measurement approach (such as FASB's CECL model), coupled with comprehensive quantitative and qualitative disclosures, will better help analysts evaluate the adequacy of a company's credit loss reserves and provide greater insight into management's credit loss expectations that reside within its existing financial asset portfolios.
- Estimation reliability concerns should not stand in the way of improved accounting and financial reporting. We prefer companies to reflect expected credit losses in a timely manner. To the extent management has concerns over the reliability and predictability of forecasted information, we prefer they derive their most informed estimate and disclose the amounts and basis for those estimates (this may include reverting to plausible historical trends for longer-term horizons).
- The new disclosures in the Proposed Update are too broad and lack a robust framework. We believe the Board should consider standardizing certain disclosures to improve the quality and comparability of credit loss information. We offer several suggestions, including providing sufficiently robust roll-forward information, which users would find more decision-useful.
- We believe the scope of this proposal should be limited to financial assets that are measured at amortized cost. Debt securities that are measured at fair value with changes reported in Other Comprehensive Income (OCI) (currently classified as Available-for-sale) should be excluded, as the fair value of these instruments already contemplates credit risk.
- We favor the FASB's proposed CECL Model over the IASB's proposed CDM approach, primarily because the latter may not fully address our concerns about the timely recognition of credit losses. We believe the IASB's proposal (which imposes a dual measurement approach) is more complicated and ambiguous, adding unnecessary complexity to the accounting for credit losses.
- We are pleased the Proposed Update maintains the current approach for recognizing and measuring interest income, and does not link it to the accounting for credit losses. We believe a company's recognition of contractual interest (reflecting the

compensation a lender receives for taking on credit risk) should not be commingled with how management addresses credit loss provisioning.

U.S. GAAP and IFRS Convergence is Imperative for Financial Instrument Impairment Accounting

We acknowledge the considerable efforts the FASB and IASB (collectively, the Boards) have undertaken to converge the accounting for financial instruments, but the proposals put forth relating to credit loss impairments remain markedly different. If the FASB moves forward with its single-measurement approach for credit losses (i.e., lifetime losses) and the IASB proceeds with its dual measurement approach (i.e., 12 months of expected credit losses are recognized first, followed by lifetime losses if the assets demonstrate significant deterioration), key reported financial metrics for global peers will not be comparable. Such an accounting and reporting result will not benefit investors and users of financial statements. Financial instrument impairment accounting is inherently complex and subjective, under any accounting construct, whether extant or proposed. Further complicating impairment analysis with two markedly different accounting objectives for measuring credit losses will create unnecessary reporting and market confusion, in our view.

We believe convergence between U.S. GAAP and IFRS should be a significant consideration and a priority for the FASB and the IASB in their respective deliberations of the proposals. We strongly encourage the Boards to reach a globally converged solution (considering our comments in this letter). The recent financial crisis highlighted differences in accounting practices among financial institutions in particular, so we believe converging accounting standards is imperative, and greatly relevant to our credit analysis.

A Single Measurement Approach Based On Expected Credit Losses Provides More Informational Value to Analysts

We believe a single measurement approach to expected credit losses, coupled with comprehensive disclosure, could better help analysts evaluate the adequacy of a company's credit loss reserves. Rather than the sudden surge in credit losses that many companies recognized during the financial crisis under the current incurred loss model, losses under an expected credit loss model would be recognized earlier, providing more informational value to analysts, in our view. Credit losses that are reflected timelier in earnings and equity (capital) give analysts greater insight into the quality of equity (capital) and management's loss expectations about the credit risks in their financial asset portfolios. Peer outliers and financial-asset trouble spots could more easily be identified, allowing analysts to examine changes in the context of a company's risk position and risk management practices.

As it relates to financial institutions more specifically, product pricing generally includes a margin sufficient to cover an institutions' expected credit losses on its assets, leaving capital to supposedly protect against unexpected losses. Current accounting is deficient in capturing expected credit losses which requires analysts to view capital absorbency and credit risk from various perspectives. For example, in our risk-adjusted capital framework that we use to analyze banks, we calculate normalized losses based on assumptions of average credit

losses over a normal 12-year credit cycle, and use it to influence our assessment of a bank's risk position.³

A single measurement approach would also provide more decision-useful value in our ratio analysis, allowing analysts to evaluate reported changes without the added hurdles of analyzing asset transfers which could distort ratio relationships such as loan loss provisions to gross or nonperforming loans for a financial institution. Period-over-period changes in an allowance (reserve) balance could be separated into changes in volume across different loan types, changes in management expectations about the existing credit risk in the portfolio in relation to historical experience, and changes in management's macroeconomic assumptions taking into account their view of the credit cycle. We believe a dual-measurement model would add unnecessary complexity to that analysis.

Estimation Reliability Concerns Should Not Stand In The Way of Improved Accounting And Financial Reporting

The FASB's proposed approach requires companies to estimate all contractual cash shortfalls over the term of a financial asset such as loans, so some market participants--especially preparers--have expressed concerns about the efficacy of such estimates, particularly over longer-time horizons. We do not believe such concerns should stand in the way of improved accounting and delay the recognition of expected credit losses. Without prescribing a set method, the Board has highlighted that it expects estimates of credit losses to be largely informed by historical loss information for financial assets of a similar type and credit risk. This information would then be evaluated in the context of how those historical loss patterns differ from what is currently expected (which would be based on current conditions and reasonable and supportable forecasts). We believe this is a reasonable approach, but prefer that companies disclose how they would apply various qualitative adjustments to historical loss experience in calculating an estimate of their allowance. A similar issue regarding subjective predictions applies under current accounting. Based on our observations, the qualitative adjustments companies make to their historical loss experiences may be meaningful at times, but we seldom find such adjustments disclosed.

We appreciate that management teams' forecasting abilities and loss estimation techniques may differ - because of the broader forecasting capabilities available to a firm or limitations for a particular asset class (e.g., credit cards). Company management will likely need to look at internal and external sources of guidance. However, we prefer companies reflect expected credit losses in the timeliest manner, based on all the relevant information management have available to them. Again, to the extent management has concerns over the reliability and predictability of forecasted information, we prefer they derive their most informed estimate, which may include reverting to historical trends, evaluated in the context of how those historical loss patterns differ from what is currently expected (based on current conditions and reasonable and supportable forecasts). Under this approach, credit loss recognition would be most timely, in our view. We further believe these assumptions should be disclosed in a standardized manner (e.g., for the following 'x' financial asset, historical loss experience of 'y'% was applied to periods beyond 'z' years). With sufficiently robust disclosure, users

³ See "How Standard & Poor's Uses Normalized Losses In Its Bank Ratings Methodology, published on March 16, 2013 on Global Credit Portal – RatingsDirect (www.globalcreditportal.com).

would be in a position to analyze emerging trends and determine how current estimates fare in the context of management's risk pricing strategies and prior expectations.

Users Need Robust and Comparable Disclosures About The Drivers of Expected Credit Loss Reserves

The Proposed Update introduces several new disclosures to help users understand the loss content in a company's portfolio of financial assets and how management's estimate of expected credit losses changed since the prior reporting period. However, we believe the new disclosures are too broad and lack a robust framework that could provide more decision-useful information. Insufficient transparency in the accounting for credit losses--particularly given the nature and extent of assumptions and judgment applied in its determination--weakens more robust analysis of companies and how they compare relative to their peers.

To improve the usefulness and comparability of credit loss information, we believe the Board should consider standardizing certain disclosures and mandating the use of more harmonized tabular presentation. Under current financial reporting requirements, the volume of credit risk disclosures has increased, but we often find the information presented is inconsistent, and at times, deficient in reporting a complete picture of a company's exposure to credit risk.⁴ Greater flexibility in disclosure requirements can, at times, lead to less decision-useful information. In our view, greater standardization and granularity related to the drivers of credit loss allowances, in particular, could facilitate more refined analysis across companies and over time.

We believe such standardized disclosures should include:

- Roll-forward information of loan loss provision by portfolio segment, with further breakdown by asset class.
- Qualitative discussion for all meaningful period-over-period changes in roll-forward components, particularly new annual loan provisions – sometimes referred to as the 'cost of risk'.
- Sufficiently robust disclosure of the qualitative adjustments made to adjust historical quantitative loss experience (e.g., the percentage of the allowance comprised of qualitative compared with quantitative data).
- Clear definitions of credit loss policies applied, including definitions for performing compared with nonperforming loans, charge-off policies by asset class, modification and forbearance activities and other terms where consistency in practice may be warranted.
- Granular breakdown of key assumptions used in the assessment of current conditions and reasonable and supportable forecasts.
- The type and extent to which assumptions were applied to financial assets with long term horizons (e.g., historical loss experience of 'x'% was applied to periods beyond 'y' years).
- Qualitative discussion of key differences period over period, including particular areas where measurement uncertainty may exist (e.g., new loan products, geographic or loan concentration risk, recovery success assessment, or specific exposures that

⁴ See "A Case For Greater Disclosure, Transparency, And Uniformity In U.S. Banks' Financial Reporting", published Dec. 10, 2012 on the Global Credit Portal – RatingsDirect (www.globalcreditportal.com).

may warrant further discussion in order for users to achieve a more complete picture of credit risk).

- Improved disclosure about the history of performing and nonperforming Troubled Debt Restructurings (TDRs).

Banking regulators often require more standardized disclosure of capital and other information than the Boards which we find beneficial to our analysis⁵. We welcome the FASB developing such type of disclosure (in collaboration with the IASB) for credit loss reserves prior to issuing its final proposal--and potentially for other key reporting areas--within a more comprehensive disclosure framework.

A Comprehensive Disclosure Framework Would Benefit Capital Markets

We encourage the FASB to move forward with developing a disclosure framework jointly with the IASB. Disclosures are a key facet in analyzing a range of information related to financial instrument assets including credit losses. We previously discussed the importance of relevant disclosures related to the classification and measurement basis of financial instruments in our comment letter.⁶ We believe this is just as important--if not more so--for the disclosures of financial instrument credit losses. Improved disclosures considered within a comprehensive disclosure framework should better enable forward-looking analysis, which is why we emphasize the importance of this over-arching project.

The Scope of The Proposed Changes Should Be Limited To Financial Assets Measured At Amortized Cost

While we support the FASB's objective of simplifying accounting rules by adopting a single impairment model for all financial instruments, we believe the scope of this proposal should be limited to financial assets measured at amortized cost. Debt securities measured at fair value, with changes reported in OCI (currently classified as Available-for-sale), should be excluded. Because these financial instruments are recorded at fair value (which already contemplates credit risk in the measurement) we do not believe it would be helpful to users to have such financial assets included within the scope. Debt securities recorded at fair value are often used to manage other exposures on a company's balance sheet, and may be analyzed differently than a loan (which is reflected at amortized cost). The current U.S. GAAP accounting model--splitting Other Than Temporary Impairments (OTTI) into earnings charges and equity reduction thru (OCI--is well understood by many investors and users.

While we previously favored improvements made during the financial crisis (increasing the transparency of OTTI credit losses), the assumptions used to calculate expected credit losses for debt securities measured at FV-OCI should be similar (e.g., lifetime duration) to those used for other financial assets (per the current Proposed Update) to ensure comparability

⁵ See "Standard & Poor's Ratings Services Supports The Basel Committee on Banking Supervisions Proposals To Improve Banks' Definition of Capital Disclosure Requirements", published on Feb. 20, 2013 on the Global Credit Portal – RatingsDirect (www.globalcreditportal.com).

⁶ See "The FASB's Disclosure Framework Potentially Will Change The Financial Reporting Landscape", published on Dec. 7, 2013 on the Global Credit Portal – RatingsDirect (www.globalcreditportal.com) (or see S&P Ratings Services Disclosure Framework Comment Letter #46).

with other financial assets. Furthermore, we also recognize that differences in OTTI accounting treatment between U.S. GAAP and IFRS currently exist in this area, and therefore believe the Boards should work towards achieving a converged solution.

We Favor The FASB's CECL Model Over The IASB's CDM

We support an approach to credit losses that most timely and effectively recognizes changes in expected underlying cash flows of financial instruments. We therefore support the FASB's CECL model over the approach in the IASB's CDM. We believe the CECL model, which requires management to record an allowance for all contractual cash flows that it doesn't expect to collect, to result in superior reporting of financial instruments on the balance sheet. Unlike the IASB's proposed approach, the FASB's model does not contain any threshold or triggering event prior to recognizing expected credit losses (which we prefer); we also believe the 12-month threshold is arbitrary (i.e., it is not clear why 12 months is better than any other cut-off period such as 24 or 36 months, particularly because we understand some companies currently carry credit-loss reserves longer than 12 months, potentially resulting in a reduction of credit loss reserves, if the IASB proposal is applied). Without the added subjectivity a triggering event entails, the allowance for credit losses under the FASB's proposed approach would reflect adjusted loss expectations at each reporting period for existing financial asset balances. We expect changes in loss expectations over time to provide valuable information to users about the appropriateness of initial estimates made and management's view of how those estimates change in response to market developments.

We recognize that some market participants have concerns about the optimal economic depiction of a lending transaction, but, because the credit risk of a financial asset such as a loan changes over time, we believe the CECL model better reflects the economics of lending. The income statement reflects increased or decreased credit risk exposure during a reporting period based on changes in the credit loss expectations reflected on the balance sheet.

The IASB Approach May Not Be Timely Enough, And Is Less Likely To Dampen Credit Loss Pro-Cyclicality

The IASB's proposed approach may not fully address our concerns over the timely recognition of credit losses. Under the IASB's proposed model, company managements would measure credit loss allowances based on either a 12-month expected credit loss or, if credit risk has "significantly deteriorated," over a financial asset's lifetime. For loans that are performing (the vast majority of most banks' loan portfolios), the IASB model would only reflect a portion of expected credit losses. Managements would then have to determine which loans not only deteriorated, but "significantly deteriorated" in accordance with the principles of the IASB proposal. We believe this will likely result in a cliff effect similar to that which is widely criticized under current accounting. Consequently, we believe the IASB's model is less likely to dampen the pro-cyclical effects of loan losses, because loan loss allowances may start to rise only after the start of an economic downturn, and spike once the economy takes its sharpest turn for the worse.

Revenue And Expense Matching Concerns Should Not Hinder Improvements Associated With The CECL Model

We recognize that capital market participants have expressed concerns about the appropriate matching of credit losses to the associated interest revenue, particularly under the CECL model. However, our observations generally agree with the FASB in that credit losses tend to exhibit a lumpy pattern, i.e., they tend to occur shortly after a loan is originated, rise rapidly in the early years, and then taper off as a loan approaches maturity. Therefore, unlike interest income, credit losses do not occur ratably over the life of an instrument. Attempting to arbitrarily link credit losses with the recognition of interest income creates accounting fiction and could, in our view, distort key earnings measures such as net interest margin (NIM) for financial institutions and earnings-based measures for other companies more broadly.

We expect changes in period-over-period allowances to provide users with meaningful information about management's portfolio of loans and its ability to price risk. Under similar conditions, we also expect greater volatility in earnings measures will arise for those companies that may be rapidly growing its loan books, entering into new products, or originating or purchasing longer-duration loans. In many of these cases, it seems reasonable, that higher--and potentially more volatile--allowances may be warranted as expected credit losses are assessed.

We Favor The Current Decoupling Of Interest Income From Credit Losses

We are pleased the Proposed Update maintains the current approach for the recognition and measurement of interest income and does not link it to the accounting for credit losses. We believe a company's recognition of contractual interest, which reflects the compensation that a lender receives for taking on credit risk, should not be commingled with how management addresses credit loss provisioning. The contractual (or effective) interest rate on a financial instrument such as a loan should not be adjusted until the loan is deemed to be nonperforming: At that point, we believe income accrual should cease. As an example, we use financial metrics such as NIM to provide information on margin trends and a financial institution's ability to maintain balance between pricing power and funding costs. Therefore, we agree that any potential credit losses should be addressed through the allowance.

The proposal introduces new guidance on nonaccrual principles that are similar to the regulatory guidance provided for U.S. banks. We believe this guidance, applicable to a broader base of entities, is useful because it creates greater comparability between regulated and non-regulated entities, and believe accounting standard setters (including the Boards) should find ways to work with bank regulators to reconcile differences in other key definitions, such as nonperforming assets.

Purchase Credit Impaired (PCI) And Originated Loan Accounting Will Be Better Aligned, But Purchased Non-Credit Impaired Accounting May Differ

We support the changes that make the measurement of PCI assets consistent with the measurement of originated assets. The Proposed Update requires the purchase discount associated with expected credit losses to be recognized as an allowance for credit losses at the acquisition date, which differs from current accounting guidance that recognizes it over time. Any subsequent changes to the underlying cash flows of PCI assets (both favorable and

unfavorable) would immediately flow through the allowance for credit losses, which we believe is an accounting improvement.

While changing the accounting for PCI assets to be more consistent with originated assets, the Proposed Update does not seem to change the accounting for purchased financial assets that are not credit impaired. Because expected credit losses on such assets cannot be established at acquisition, the accounting will differ. We believe that, to further improve consistency and comparability, the accounting treatment should be the same for PCI and purchased financial assets that are not credit impaired, i.e., an estimate of cash flows not expected to be collected related to originated and purchased assets should flow through the allowance for credit losses upon acquisition.

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We thank you for the opportunity to provide our comments, and we would be pleased to discuss our views with members of the FASB or your staff. If you have any questions or require additional information, please contact the undersigned.

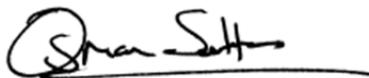
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