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September 29, 2010

Technical Director
File Reference No. 1810-100
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, Connecticut 06856-5116

Via Email to director@fasb.org

RE: File Reference No. 1810-100, Proposed Accounting Standards Update, *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities*

Dear Technical Director:

We are pleased to comment on FASB's Proposed Accounting Standards Update, *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities*. We support the Board's objective to reduce the current complexity that exists today with the mixed attribute model. After careful consideration, we do not support many of the provisions of the proposal as currently drafted, and have particular concerns regarding subsequent measurement and credit impairment provisions.

We support the Board's objective of simplification by reducing the number of models used for financial instruments. However, we believe the various accounting models that have emerged over time were in response to the unique attributes of various types of financial instruments as well as management's business practices. We agree with reducing the number of models, however, believe the models should be different than those the Board has proposed.

We support the Board's goals of increasing the relevance provided by the accounting model for financial instruments while providing simplification, and believe some of the proposed changes make progress toward both objectives. We also understand that the Board believes that both fair value and amortized cost are the relevant measures for financial instruments and as such, proposes to provide both measures in the basic financial statements. However, we believe that introducing fair value into the basic financial statements for virtually all financial assets and liabilities would have a significant negative impact on the relevance and reliability¹ of financial information.

¹ Relevance and reliability are the two primary qualities that make accounting information useful for decision making as noted in Statement of Financial Accounting Concepts (SFAC) No. 2, *Qualitative Characteristics of Accounting Information*.

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We agree with using fair value for financial instruments held for short term purposes, including loans to be sold and trading securities. However, we do not believe that fair value is the most relevant measure for financial instruments which are held for collection or repayment. To be relevant to users, the financial information must be capable of making a difference in a decision by helping users to form predictions about the outcomes of past, present, and future events or to confirm or correct expectations. The majority of financial instruments are routinely settled with the counterparty, at par through collection or payment. The most common examples of such instruments are debt, loans and financial institution deposits. Because the vast majority of financial instruments which are held for collection or repayment are settled at par rather than fair value, the predictive outcome will not be fair value but rather amortized cost.

To be reliable to users, the financial information must be verifiable. We do not believe that providing fair value in the basic financial statements for financial instruments held for collection or payment provides increased reliability because we do not believe it can meet the level of verifiability as described in SFAC 2, "a quality that may be demonstrated by securing a high degree of consensus among independent measurers using the same measurement methods". Specifically, we are concerned that the introduction of level three measurements into the basic financial statements will purport a precision level that does not exist. Because active markets often do not exist for such instruments, fair value must be determined through valuation techniques using level three inputs. Such techniques provide useful information, yet their outputs are often wide ranges of equally plausible results. Valuation techniques resulting from use of level three inputs, no matter how faithfully prepared, lack sufficient verifiability and reliability to be the basis for valuing such classes of financial instruments.

We are also concerned with diminished comparability between entities. The significance of information, especially quantitative information, depends greatly on the user's ability to relate it to some benchmark. We believe the subjectivity required in order to determine the fair value for the majority of financial instruments (which will be valued using level three inputs) will result in diminished meaningful comparisons for users.

In addition to our primary concerns, there are other considerations. First, we believe that providing both amortized cost and fair value introduces unnecessary complexity to the basic financial statements. Second, providing fair value for financial instruments collected or paid at par is not reflective of the business practices of management. The proposal provides for subsequent measurement dependant upon management's intent for the financial instrument but the proposal does not consider how the financial instruments are managed (that is, management's business practices) because management does not typically use fair value for these financial instruments. The core business model for most financial institutions is to generate profits based on margin, rather than market gains and losses. There are economic reasons why the vast majority of such contracts are settled at par rather than traded at fair value, principally the execution costs, effort and a business strategy to serve customers. Lastly, valuation techniques using level three inputs, are not only inferior to level one and level two inputs, but they are also much more expensive in terms of dedicating more internal resources and, in some cases, engaging third parties. We are concerned that the potential benefit of providing fair values in the basic financial statements does not outweigh the costs, particularly for smaller entities.

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For these reasons, we support continued fair value disclosures in the footnotes rather than presentation in the basic financial statements for financial instruments held for collection or payment, other than debt securities and equity securities. We believe the fair value with changes in other comprehensive income (OCI) model should be used for debt securities held for liquidity management.

We are also concerned with several aspects of the proposed credit impairment model. As addressed further in our responses to specific questions, we have particular concerns regarding the use of cash flows and recording losses over the life of the loans. We believe the incurred loss model is a conceptually sound approach to measuring credit impairment. However, we are concerned with the suggestion in the proposal that losses should represent losses over the life of the asset pool and believe this would represent a significant change in practice.

We believe that the proposed model, which requires the use of a life of the loan concept coupled with cash flow information based solely on past and current conditions, will create real pro-cyclicality. In periods of high credit impairment, the recorded loss amounts will be exaggerated, because entities will have to consider that high loss rates will continue indefinitely. Conversely, during periods of lower credit impairment, entities will have to assume that the low loss rates will not reverse. We believe the end result will be unintended pro-cyclicality. As such, we recommend the incurred loss model should be retained. We have provided specific recommendations for the Board's consideration on this matter in our responses to Questions 37, 40, 46 and 47.

Our responses to the proposal's questions are included in the attachment. We have also included a section for other commentary on the proposal.

Please contact James A. Dolinar or Sydney K. Garmong should you have any questions.

Cordially,

Crowe Horwath LLP

Crowe Horwath LLP

Attachment

Responses to the Proposal's Questions

Scope

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

For loan commitments, we recommend providing a practical scope exception for those loans that are proposed to be carried at fair value with changes in other comprehensive income (OCI). The sheer volume of loan commitments that would be subject to this provision far exceeds the current volume of loans held for sale. Further, the financial statement impact is short term since loan commitments are typically outstanding for only short periods of time. As such, we believe loan commitments for loans that will be held for collection should be afforded a practical exception.

Question 2: The proposed guidance would require loan commitments, other than loan commitments related to a revolving line of credit issued under a credit card arrangement, to be measured at fair value. Do you agree that loan commitments related to a revolving line of credit issued under a credit card arrangement should be excluded from the scope of this proposed Update? If not, why?

We agree loan commitments for credit card arrangements should be excluded from the scope for practical reasons. While we agree with the Board, in paragraph BC134, that conceptually all types of loan commitments should be included within the scope, we believe that loan commitments for all lines of credit, as a practical matter, should be excluded. Some of the practical reasons listed for the exclusion of credit card loan commitments are also relevant for other types of revolving loans (i.e., generally small balances, the revolving nature of lines of credit, and the high volume). We believe the revolving nature of any line of credit, not just credit cards, will be a challenge to monitor and to determine the fair value of the loan commitment.

Question 4: The proposed guidance would require an entity to not only determine if they have significant influence over the investee as described currently in Topic 323 on accounting for equity method investments and joint ventures but also to determine if the operations of the investee are related to the entity's consolidated business to qualify for the equity method of accounting. Do you agree with this proposed change to the criteria for equity method of accounting? If not, why?

We do not agree with the proposed change to accounting for equity method investments. We have read the Board's reasoning in paragraphs BC24-25 and it is not clear why the Board is changing the accounting for these types of investments. We are not aware of problems in accounting for equity method investments that the proposal would address. The proposed guidance would provide added complexity to an area that is already understood by preparers, users and auditors. In addition, we are especially concerned about smaller investments (3-5% previously in EITF Topic D-46, *Accounting for Limited Partnership Investments*) in limited partnerships and other limited liability corporations that currently follow equity method accounting. These types of investments are primarily in private entities, where there may be limited information available to determine fair value. The current equity method of accounting provides a practical and useful approach in accounting for these types of investments.

Initial Measurement

Question 8: Do you agree with the initial measurement principles for financial instruments? If not, why?

Yes, we agree with the initial measurement principles as described in paragraph 12. From a practical standpoint, the transaction price for financial instruments should approximate fair value unless there is evidence to the contrary as described in paragraphs 14-17.

Question 9: For financial instruments for which qualifying changes in fair value are recognized in other comprehensive income, do you agree that a significant difference between the transaction price and the fair value on the transaction date should be recognized in net income if the significant difference relates to something other than fees or costs or because the market in which the transaction occurs is different from the market in which the reporting entity would transact? If not, why?

We agree that in situations where the entity has reason to believe the transaction price differs from fair value, those differences should be analyzed to identify, and account for, the differences. Further, we concur that a significant difference, other than those due to fees and costs, alternative markets or where the difference is not identifiable, should be recognized in net income.

Question 10: Do you believe that there should be a single initial measurement principle regardless of whether changes in fair value of a financial instrument are recognized in net income or other comprehensive income? If yes, should that principle require initial measurement at the transaction price or fair value? Why?

We do not believe there should be one initial measurement principle. Rather, the initial measurement, as proposed in paragraph 12, should reflect management's intent for holding the instrument. For financial instruments held for the short term, we believe the initial measurement should be fair value. For financial instruments held for collection and those expected to be repaid, we believe the transaction price for those financial instruments should approximate fair value unless there is evidence to the contrary.

Question 11: Do you agree that transaction fees and costs should be (1) expensed immediately for financial instruments measured at fair value with all changes in fair value recognized in net income and (2) deferred and amortized as an adjustment of the yield for financial instruments measured at fair value with qualifying changes in fair value recognized in other comprehensive income? If not, why?

We agree that the treatment of transaction fees and costs should be based on the entity's classification of the financial instrument. For instruments which are measured at fair value with changes in earnings, we believe the fees and costs should be immediately recognized in earnings because the entity does not intend to hold the financial instrument for collection or payment. For instruments held for collection or repayment, the fees and costs should be deferred, consistent with the entity's intent for that instrument.

Question 12: For financial instruments initially measured at the transaction price, do you believe that the proposed guidance is operational to determine whether there is a significant difference between the transaction price and fair value? If not, why?

Yes, we believe the proposed guidance is operational, as proposed in paragraphs 14-17 including the three examples in the Implementation Guidance.

Subsequent Measurement

Question 13: The Board believes that both fair value information and amortized cost information should be provided for financial instruments an entity intends to hold for collection or payment(s) of contractual cash flows. Most Board members believe that this information should be provided in the totals on the face of the financial statements with changes in fair value recognized in reported stockholders' equity as a net increase (decrease) in net assets. Some Board members believe fair value should be presented parenthetically in the statement of financial position. The basis for conclusions and the alternative views describe the reasons for those views. Do you believe the default measurement attribute for financial instruments should be fair value? If not, why? Do you believe that certain financial instruments should be measured using a different measurement attribute? If so, why?

We do not agree the default measurement should be fair value with changes in earnings. Rather, we believe the initial measurement should be determined based on management's business purpose for the financial instrument.

We agree with the Board's recommendation for two primary subsequent measurements – one for instruments for which an entity intends to hold for the short term (such as trading) and one for instruments for which an entity intends to hold until maturity, either through collection or repayment, other than debt and equity securities. However, we disagree on the proposed methodology for subsequent measurement. Further, we believe a third subsequent measurement is warranted for debt securities, as described below.

We concur with the proposal that instruments which are held for the short term should be carried at fair value with changes in earnings (such as loans held for sale and trading portfolios). While we understand the reasoning of providing both fair value and amortized cost (i.e., users are provided both fair value and amortized cost), we believe that introducing fair value into the basic financial statements for virtually all financial assets and liabilities would have a significant negative impact on the relevance and reliability of financial information which would be reflected in the basic financial statements as well as adding unnecessary complexity to the basic financial statements.

To be relevant to users, the financial information must be capable of making a difference in a decision by helping users to form predictions about the outcomes of past, present, and future events or to confirm or correct expectations. The majority of financial instruments are routinely settled, with the counterparty, at par through collection or payment. The most common examples of such instruments are debt, loans and financial institution deposits. Because the vast majority of financial instruments which are held for collection or repayment are settled at par rather than fair value, the predictive outcome will not be fair value but rather amortized cost.

Secondly, providing fair value for financial instruments held for collection or repayment in the basic financial statements is not representative of how management operates its business. While the proposal provides for subsequent measurement dependant upon management's intent for the financial instrument, the proposal does not consider how the financial instruments are managed, that is, management's business practices. Management does not typically use fair value to manage these financial instruments. The core business model for most financial institutions is to generate profit based on margin, rather than market gains and losses. There are economic reasons why the vast majority of such contracts are settled at par rather than traded at fair value, principally the execution costs, effort and a business strategy to serve customers.

Further, providing fair value introduces unreliability into the basic financial statements because of the subjectivity of determining fair value for financial instruments that are not routinely traded (for example, loans and deposits). To be reliable to users, the financial information must be verifiable. We do not believe that providing fair value in the basic financial statements provides reliability because we do not believe it can meet the level of verifiability, as described in SFAC 2, “a quality that may be demonstrated by securing a high degree of consensus among independent measurers using the same measurement methods.” We are concerned the introduction of level three measurements into the basic financial statements will purport a level of precision that does not exist. Because active markets often do not exist for such instruments, fair value must be determined through valuation techniques using level three inputs. Such techniques provide useful information, yet their outputs are often wide ranges of equally plausible results. Valuation techniques resulting from use of level three inputs, no matter how faithfully prepared, lack sufficient verifiability and reliability to be the basis for valuing such classes of financial instruments. Lastly, valuation techniques using level three inputs, while inferior to level one and level two inputs, are much more expensive in terms of dedicating more internal resources and, in some cases, engaging third parties.

We are also concerned with diminished comparability between entities. The significance of information, especially quantitative information, depends to a great extent on the user’s ability to relate it to some benchmark. We believe the subjectivity that would be required in order to determine the fair value for the majority of financial instruments (which will be valued using level three inputs) will result in diminished meaningful comparisons for users.

Lastly, we are concerned that the benefit of providing fair value in the basic financial statements will not outweigh the related costs, particularly for smaller entities. For all of these reasons, we believe the appropriate measurement for financial instruments, held for collection or repayment, (such as loans held in portfolio, debt and deposits) is amortized cost, with fair value disclosure, other than debt and equity securities.

In evaluating the different models that have evolved over the past decades, we believe different models have emerged due to the uniqueness of the varying types of financial instruments, management’s business practices and the lack of verifiable and reliable valuation techniques to determine fair value. For financial institutions, the investment portfolio is primarily used for liquidity management which is driven by loan demand and customer deposit behavior. The fair value is typically verifiable and is meaningful to users. As such, we believe the fair value with changes in OCI model should be used for those debt securities which are held for liquidity management. For debt securities which are used for trading activities, the subsequent measure should be fair value with changes in earnings.

Also, we do not understand why the election must be made on a portfolio basis as is suggested in paragraph 22. Rather, we believe the election should be on an instrument by instrument basis.

Question 14: The proposed guidance would require that interest income or expense, credit impairments and reversals (for financial assets), and realized gains and losses be recognized in net income for financial instruments that meet the criteria for qualifying changes in fair value to be recognized in other comprehensive income. Do you believe that any other fair value changes should be recognized in net income for these financial instruments? If yes, which changes in fair value should be separately recognized in net income? Why?

We concur with the proposed items to be recognized in net income.

Question 15: Do you believe that the subsequent measurement principles should be the same for financial assets and financial liabilities? If not, why?

As previously stated, we believe that the subsequent measurement should be based on management's business practices by instrument, regardless of whether the instrument is an asset or a liability. For most entities, financial liabilities are the funding source for financial assets so it is logical for the subsequent measurement to be consistent.

Question 16: The proposed guidance would require an entity to decide whether to measure a financial instrument at fair value with all changes in fair value recognized in net income, at fair value with qualifying changes in fair value recognized in other comprehensive income, or at amortized cost (for certain financial liabilities) at initial recognition. The proposed guidance would prohibit an entity from subsequently changing that decision. Do you agree that reclassifications should be prohibited? If not, in which circumstances do you believe that reclassifications should be permitted or required? Why?

We commend the Board for recognizing the long standing issue of tainting, as described in paragraph BC97, and agree the issue should be addressed. However, we do not believe that the proposed guidance solves the issue of tainting for several reasons. First, the issue of tainting will still exist in the initial classification of an instrument. For example, if an entity had a large volume of sales from the proposed fair value through OCI category, that fact pattern will become a consideration for future classifications. Secondly, paragraph IC37 of the Implementation Guidance states that an occasional sale may occur without ramifications; however, "a large number of sales" may indicate the strategy has changed, which suggests that the tainting notion has not been eliminated.

We believe that disallowing reclassifications will exacerbate the problem because future classifications may be called into question. As such, we recommend that reclassifications be permitted as an entity's business strategy changes and that all reclassifications should be robustly disclosed in order to inform readers of the change in business strategy. This will allow readers to independently evaluate changes in management's intent.

Entities, particularly financial institutions, use their investment portfolios to manage liquidity. As loan demand and customer deposit behavior shifts, the management of the investment portfolio shifts. We believe it is important to permit entities to manage the liquidity of their portfolios. By permitting reclassifications, we believe this will permit financial institutions to appropriately manage their portfolios.

Question 17: The proposed guidance would require an entity to measure its core deposit liabilities at the present value of the average core deposit amount discounted at the difference between the alternative funds rate and the all-in-cost-to-service rate over the implied maturity of the deposits. Do you believe that this remeasurement approach is appropriate? If not, why? Do you believe that the remeasurement amount should be disclosed in the notes to the financial statements rather than presented on the face of the financial statements? Why or why not?

We do not agree with the proposed measurement guidance (the remeasurement approach) for core deposit liabilities. We believe it adds complexity to single out a measurement approach for this particular instrument. Rather, we believe all deposits, including core deposits, should be carried at amortized cost if management's intent is to hold those liabilities for payment, because the amount recorded should reflect the amount contractually owed to the customer. As proposed, the amount recorded would likely be less than the amount owed to the customer which is an understatement of liabilities, which would result in gain recognition, albeit through OCI, when the customer withdraws their funds at amortized cost.

We are concerned with the lack of market data available for core deposits because the exit price information is overwhelmingly at amortized cost. As a reference point, according to 2009 data from Automated Clearing House (ACH), there were over 18 billion transactions which occurred, all at amortized cost. Marketplace data is available from observing whole bank acquisitions, branch acquisitions and FDIC-assisted transactions – which totaled 314 transactions for 2009. The vast majority of the transactions are occurring at amortized cost.

If the Board chooses fair value for deposits, we recommend that core deposits not be singled out with the re-measurement approach; rather, all deposits should be measured at fair value – either through OCI or earnings, depending upon management's intent. We believe that the measurement approach proposed is a valid approach to measuring the fair value of core deposits because the valuation methodology in the proposal is designed for a financial instrument (and is not supposed to mirror a core deposit intangible which is based on valuation methodology for an intangible rather than a financial instrument). However, we believe this is not well understood in practice and is not representative of how fair value is determined in a business combination. In our experience, a core deposit intangible is established and the resulting core deposits are recorded at par. As such, we suggest the Board clarify the different methodologies. In addition, it would be helpful for the Board to articulate the interaction with intangibles recorded in a business combination. In the interest of providing implementation guidance, the Board may wish to provide the re-measurement approach as one example of how to measure the fair value of core deposits. Please see our response to Question 31 for additional commentary.

Question 18: Do you agree that a financial liability should be permitted to be measured at amortized cost if it meets the criteria for recognizing qualifying changes in fair value in other comprehensive income and if measuring the liability at fair value would create or exacerbate a measurement attribute mismatch? If not, why?

We believe most entities (other than those that account for most of their financial instruments at fair value, such as investment companies and broker dealers) should be allowed to measure financial liabilities at amortized cost based on management's business practices. Consistent with our response on financial assets (when management's business practices is to hold the instrument for contractual payments), if an entity intends to make contractual payments on its financial liabilities, amortized cost is the most relevant basis to measure these instruments, rather than fair value. The criteria included in the proposal would limit the amortized cost option and adds unnecessary complexity. We also understand that users do not consider fair value a relevant measure for valuing liabilities that the entity plans to discharge through repayment.

If the Board does not agree with our comments above, we believe the following matters should be considered:

- The 50% test appears very prescriptive. For example, an entity may have financial assets measured at fair value that fluctuate between 45 – 55%. In this situation, the measurement of new financial liabilities could change from amortized cost to fair value or vice versa, depending on the level of their financial assets the preceding quarter. Providing a bright line test that can easily be managed would allow an entity to adjust the levels of financial assets at the end of a given period in order to receive a desired outcome of a planned borrowing.
- How are debt re-financings considered for purposes of the measurement test? Are they considered a continuation of the old debt and therefore not subject to a new measurement test date, or are they considered a new financing and therefore subject to a new measurement test date? The same questions also could apply to a debt modification and whether the modification is in substance a new borrowing.

- Paragraph 30 refers to the preceding reporting period for purposes of the measurement test. Would a non-public entity potentially use information that could be almost one year old for purposes of making this test?

Question 19: Do you believe that the correct financial instruments are captured by the criteria in the proposed guidance to qualify for measurement at the redemption amount for certain investments that can be redeemed only for a specified amount (such as an investment in the stock of the Federal Home Loan Bank or an investment in the Federal Reserve Bank)? If not, are there any financial instruments that should qualify but do not meet the criteria? Why?

We are concerned with the guidance in paragraph 34 in three areas: (1) the evaluation of impairment for Federal Home Loan Bank (FHLB) stock, (2) the possible unintended scope consequences and (3) the changes resulting from application to the National Credit Union Share Insurance Fund (NCUSIF).

FHLB stock has long been evaluated using an ultimate recoverability threshold (ASC 942-325-35-3). When this guidance was first developed as part of the AICPA Audit and Accounting Guide for Banks & Savings Institutions, and later included in SOP 01-6, the AICPA Accounting Standards Executive Committee's (AcSEC) conclusion was that the evaluation should be performed based on ultimate recoverability given the uniqueness of this asset, particularly as a government sponsored entity (GSE). The criteria included a methodology to assess ultimate recoverability. Because FHLB stock is an investment in a GSE, we believe FHLB stock impairment should be measured based on ultimate recoverability (using existing U.S. generally accepted accounting principles (GAAP)) rather than using the impairment guidance as proposed in paragraph 37(c) which would apply the credit impairment guidance for financial assets. In addition, we believe that Federal Reserve stock should also be based on ultimate recoverability, consistent with existing GAAP.

The broad scope in paragraph 34 may have unintended consequences. FHLB and Federal Reserve stock are unique investments with ties directly to the U.S. Government. There are many types of cooperative type arrangements for which this guidance may not be appropriate. In this paragraph, one example mentioned is agricultural cooperatives. In the Basis for Conclusions (BC148), another example is the NCUSIF which is not an investment with the same characteristics as discussed in the following paragraph. Other examples, not included in the proposal, are the membership capital shares and paid in capital, which are held by natural person credit unions in corporate credit unions. It is unclear whether the Board intends to include these types of investments in the scope. Because these instruments do not have the same unique characteristics as the FHLB stock and Federal Reserve stock, we believe inclusion may result in an unintended consequence and encourage careful consideration to the possible scope implications.

We are also concerned with the reference in the Basis for Conclusions that the National Credit Union Share Insurance Fund (NCUSIF) qualifies under paragraph 34. These assets do not represent certificates or equity ownership. Rather, these are funds that are on deposit with the National Credit Union Administration (NCUA) for insurance purposes, similar to Federal Deposit Insurance Corporation (FDIC) deposit insurance. For banks and savings institutions, premiums paid to the FDIC are not capitalized but rather are expensed. However, unlike the FDIC, the NCUA, through the NCUSIF, holds these funds on deposit. The amounts are refundable to credit unions, subject to certain restrictions. When this guidance was first developed as part of the AICPA Audit and Accounting Guide for Credit Unions, and later included in SOP 01-6, AcSEC acknowledged the uniqueness of the asset and established criteria for recognition and measurement. That guidance is contained in ASC 942-325-25-3 which states: "For credit unions and corporate credit unions, amounts deposited with the National Credit Union Share Insurance Fund shall be accounted for and reported as assets as long as such amounts are fully

refundable.” We believe ASC 942-325-35-4 provides the appropriate guidance for subsequent measurement. As such, we recommend the NCUSIF reference be removed from the Basis for Conclusion and explicitly scoped out of paragraph 34.

Question 28: Do you believe that the proposed criteria for recognizing qualifying changes in fair value in other comprehensive income are operational? If not, why?

Although we disagree with using OCI for all financial instruments held for collection or repayment, other than debt and equity securities, we believe the criteria are operational.

Question 29: Do you believe that measuring financial liabilities at fair value is operational? If not, why?

We believe measuring financial liabilities is operational, but disagree with measuring these instruments at fair value because it is not consistent with management’s intent and practice where liabilities will be relieved through repayment.

Question 30: Do you believe that the proposed criteria are operational to qualify for measuring a financial liability at amortized cost? If not, why?

Our response to question 18 includes operational matters that should be considered.

Question 31: The proposed guidance would require an entity to measure its core deposit liabilities at the present value of the average core deposit amount discounted at the difference between the alternative funds rate and the all-in-cost-to-service rate over the implied maturity of the deposits. Do you believe that this remeasurement approach is operational? Do you believe that the remeasurement approach is clearly defined? If not, what, if any, additional guidance is needed?

Although we believe the guidance could be operational, we do not agree with the proposal as discussed in our response to Question 17. If the Board retains the re-measurement approach, we recommend the following clarifications.

We recommend that more specific guidance beyond the information currently in IG 24 be provided, perhaps using the categories from the Federal Reserve’s Functional Cost and Profit Analysis (FCA). For example, we believe additional guidance is needed for insurance premiums (e.g. FDIC), data processing costs, indirect personnel costs, indirect branch costs, and back office function costs would be helpful. Without specific guidance, we are concerned there may not be consistency in practice.

We also recommend expanded guidance in paragraph IG24 on the definition of alternative funds rate. It would be helpful to provide examples to address expectations on duration and balances as well as guidance on determining the next available source of funds.

Presentation

Question 32: For financial liabilities measured at fair value with all changes in fair value recognized in net income, do you agree that separate presentation of changes in an entity’s credit standing (excluding changes in the price of credit) is appropriate, or do you believe that it is more appropriate to recognize the changes in an entity’s credit standing (with or without changes in the price of credit) in other comprehensive income, which would be consistent with the IASB’s tentative decisions on financial liabilities measured at fair value under the fair value option? Why?

Conceptually, we believe all changes in fair value should be recognized in earnings for financial liabilities carried at fair value. However, we are concerned with the counterintuitive result of

recognizing income in earnings due to an entity's deterioration in creditworthiness. Given the seemingly wide spread level of concern from all groups of constituents, we believe presentation in OCI is appropriate.

Question 33: Appendix B describes two possible methods for determining the change in fair value of a financial liability attributable to a change in the entity's credit standing (excluding the changes in the price of credit). What are the strengths and weaknesses of each method? Would it be appropriate to use either method as long as it was done consistently, or would it be better to use Method 2 for all entities given that some entities are not rated? Alternatively, are there better methods for determining the change in fair value attributable to a change in the entity's credit standing, excluding the price of credit? If so, please explain why those methods would better measure that change.

Between the two possible methods, we believe Method 2 is preferable given that many entities are not rated. However, for entities that are rated, Method 1 is the appropriate approach. As such, we recommend using either approach as long as application is consistent.

Credit Impairment

Question 37: Do you believe that the objective of the credit impairment model in this proposed Update is clear? If not, what objective would you propose and why?

Yes, we believe the overall objective is clear, however, we disagree with parts of the description of application of the proposed objective, in particular the last sentence in paragraph 36 which states:

“An entity's expectations about collectibility of cash flows shall include all available information relating to past events and existing conditions but shall not consider potential future events beyond the reporting date.”

We believe it is counterintuitive not to consider cash flows from future events. The result, as proposed, would result in a fair value adjustment which offsets the credit impairment to compensate for the fact that the credit impairment does not consider future events. Further, we believe this model would result in disproportionate amounts of credit impairment depending on the current economic cycle. We understand the concern with including future events and perceived “cookie jar reserving” but believe there are alternatives to address that concern.

There are unique characteristics between loans and debt securities, particularly in the resolution of the asset upon impairment. We believe those differences warrant different accounting and therefore recommend the following models.

For loans evaluated individually, typically the resolution is addressed over a short time horizon, through the disposition of the underlying collateral, so there are not long periods of cash flow estimation. We believe the triggering events, in paragraph 43, are sufficient in identifying when the asset is impaired. For measurement, we agree with the proposed model because the cash flow estimation would typically involve short time horizons and would not be significantly impacted by disregarding future events such as economic changes. We concur with removing the probable threshold because it has added unnecessary complexity to the model.

For loans evaluated on a pool basis, the existing GAAP model is largely workable. As with loans individually impaired, we concur with removing the probable threshold. We agree with the Board's proposal with two exceptions.

First, we disagree with the notion of including losses over the life of the loan for pools because this would include future events which have not yet occurred. In paragraph 59, the proposal states: "Historical loss rates shall reflect cash flows that the entity does not expect to collect over the life of the financial assets in the pool." In paragraph BC189, the proposal states: "The Board recognizes the established practice of using a formula approach for estimating losses related to these types of loans and the proposed guidance would not change that approach." However, we believe this would be a significant change in practice. We believe that the proposed model, which requires the use of a life of the loan concept coupled with cash flow information based solely on past and current conditions, will create real pro-cyclicality. In periods of high credit impairment, the recorded loss amounts will be exaggerated, because entities will have to consider that high loss rates will continue indefinitely. Conversely, during periods of lower losses of credit impairment, entities will have to assume that the low loss rates will not reverse.

Further, such a model would be counter to the long-standing view that the act of lending is not in and of itself a credit event (unless there is faulty underwriting). Rather, we believe that applying adjusted historical annualized loss rates to pools appropriately captures losses within the portfolio which exist but have not yet been identified.

Secondly, and related to our prior point, we believe the Board should address the concept of a loss emergence period. One of the most challenging and controversial points in current practice is determining how much "coverage" should be provided for pools, after determining the annualized loss rate. In other words, at issue is the amount by which the annualized loss rate should be multiplied, or for short term loans, divided. These techniques are attempts to identify losses which have been incurred, but have not yet surfaced for more precise measurement, similar to the measurement of incurred but not reported losses in the insurance industry. In the absence of addressing this issue, the default, if using an annualized loss rate, results in one year of coverage. As such, we recommend the Board address this issue and consider introducing a loss emergence period to the model as described in our response to Question 40.

For debt securities, the disposition typically occurs over a much longer time horizon than for loans, particularly for non-single issuer debt. For example, the cash flow estimates span many years for investments in securitized assets (e.g., pools of trust preferred securities). It does not appear to be reasonable to assume that economic changes will not have an impact on cash flows. For example, it would not have been reasonable to assume in 2008 that there were not going to be defaults in pooled trust preferred securities from failed financial institutions at the same time the number of banks expected to fail was rising as projected by the FDIC. Using the cash flows, as currently proposed, would have disregarded that forward-looking information which in turn would have resulted in understating losses. On the other hand, assuming that financial institution failures will continue at the same pace is also not a reasonable assumption.

For purposes of estimating these cash flows, we believe it is important to consider those cash flows that a market participant would use. As such, we recommend cash flows reflect events beyond past and current conditions, consistent with the cash flows that a market participant would use.

Question 38: The proposed guidance would require an entity to recognize a credit impairment immediately in net income when the entity does not expect to collect all contractual amounts due for originated financial asset(s) and all amounts originally expected to be collected for purchased financial asset(s).

The IASB Exposure Draft, Financial Instruments: Amortised Cost and Impairment (Exposure Draft on impairment), would require an entity to forecast credit losses upon acquisition and allocate a portion of the initially expected credit losses to each reporting period as a reduction in interest income by using the effective interest rate method. Thus, initially expected credit losses would be recorded over the life of the financial asset as a reduction in interest income. If an entity revises its estimate of cash flows, the entity would adjust the carrying amount (amortized cost) of the financial asset and immediately recognize the amount of the adjustment in net income as an impairment gain or loss.

Do you believe that an entity should immediately recognize a credit impairment in net income when an entity does not expect to collect all contractual amounts due for originated financial asset(s) and all amounts originally expected to be collected for purchased financial asset(s) as proposed in this Update, or do you believe that an entity should recognize initially expected credit losses over the life of the financial instrument as a reduction in interest income, as proposed in the IASB Exposure Draft on impairment?

We believe that credit impairment should be recognized at the point when an entity does not expect to collect all contractual cash flows rather than forecasting losses over the life through a reduction in interest income.

Question 39: Do you agree that a credit impairment should not result from a decline in cash flows expected to be collected due to changes in foreign exchange rates, changes in expected prepayments, or changes in a variable interest rate? If not, why?

We agree that credit impairment should not result from a change in foreign exchange rates.

With respect to debt structures, we agree that changes in expected prepayments and variable interest rates should not, in and of themselves, result in credit impairment. However, we disagree with the proposed guidance in paragraphs 48-49. We believe it is important to consider prepayments and variable rates with respect to debt structures, in particular certain securitized instruments as these structures are often much more complex. Expected prepayments and use of the forward curve for variable rate instruments are essential for developing the best estimated future cash flows as both will impact the timing and amount of cash flows allocated to the individual securities of a securitization and therefore directly impact the timing and amount of credit impairment recognized. For example:

- Prepayments – Certain securitizations include excess interest (i.e., the rate of interest being paid into the securitization by the collateral is in excess of the weighted average rate being paid out to the individual securities). Therefore, the longer the collateral in the securitization is outstanding, the more cash flow available to pay both interest and principal of the individual securities. Said differently, some security classes rely on excess interest within a securitization for the repayment of their principal. If the collateral were to prepay, less cash flow will be available for the individual securities and a loss of principal to that security may occur. We believe paragraph 48 should be amended to require including prepayments expectations when forecasting cash flows of securitized debt instruments.
- Variable rates – Certain securitizations involve a mixture of fixed rates, variable rates or hybrids such that over time, changes in rates being paid into the securitization will not be the same as the changes in rates being paid out on the individual securities. Perhaps overly

simplistic, but consider for example a securitization with collateral paying a variable rate into the securitization, while the interest rate being paid out to the individual securities is fixed. Thus, it is necessary to consider rate changes in arriving at the best estimate of future cash flows for these types of structures. Using this example, if the variable rate index was lower than the originally expected index, the cash flows of the collateral coming into the securitization may not be enough to pay the principal and interest of the some security classes of the securitization. The industry is already considering rates currently, not by “forecasting”, but by using the forward curve of that index. Further, when the forward curve is included in the forecast, it is then also used as a component of the accounting yield used when discounting cash flows to compute the credit impairment. Thus with respect to the variable rate index, the same rate was used to both forecast and discount the cash flows. We believe the guidance in paragraph 49 should be amended to require using the applicable forward curve for purposes of estimating cash flows expected to be collected for variable rate securitized instruments.

Additionally, excluding the prepayment assumptions and the forward curve from credit impairment computation will additionally result in two separate cash flows being generated – one for credit impairment and the other for computing fair value. We believe prepayment assumptions and the forward curve are necessary to determine the best estimate of future cash flows and thus a change in these assumptions may result in credit impairment. Further, if these items are excluded from determination of credit impairment, we believe there will be circumstances for which a loss within a current period that is otherwise probable will not be recorded until that event occurs.

We would be pleased to provide the Board with examples of the above if requested.

Question 40: For a financial asset evaluated in a pool, the proposed guidance does not specify a particular methodology to be applied by individual entities for determining historical loss rates. Should a specific method be prescribed for determining historical loss rates? If yes, what specific method would you recommend and why?

We agree that a particular methodology should not be specified for determining the historical loss rates. Given the judgment required in determining this estimate, we believe the proposed guidance is appropriate for determining the historical loss rates. As previously mentioned in our response to Question 37, we support applying a loss emergence period concept to pools of loans. The loss emergence period, also referred to as a loss confirmation period, would represent the time horizon from incurrence of a credit loss (i.e., deterioration in the borrower’s financial condition) to the confirmation of that loss (i.e., identification of the individual loan as impaired). We believe that addressing this component of the methodology would be helpful in practice as the question of coverage is simply not addressed. Without providing additional guidance in this area and using an annualized loss rate, the default answer is one year.

Given inherent subjectivity in evaluating pools and based on concerns with using cash flows which do not consider future events, we believe the Board should reconsider the guidance in paragraph 60 which states (underlining added):

The amount of credit impairment recognized for a particular pool of financial assets shall be based on a historical loss rate for that pool adjusted for existing economic factors and conditions.

We believe that considering the current trends is meaningful and that including such guidance would be consistent with a market participant view of expected cash flows without forecasting economic cycles. As such, we recommend including the guidance from the December 13, 2006, *Interagency Policy Statement on the Allowance for Loan and Lease Losses*, which states (underlining added):

When estimating credit losses on each group of loans with similar risk characteristics, an institution should consider its historical loss experience on the group, adjusted for changes in trends, conditions, and other relevant factors that affect repayment of the loans as of the evaluation date.

Question 41: Do you agree that if an entity subsequently expects to collect more cash flows than originally expected to be collected for a purchased financial asset, the entity should recognize no immediate gain in net income but should adjust the effective interest rate so that the additional cash flows are recognized as an increase in interest income over the remaining life of the financial asset? If not, why?

Although the proposed model is consistent with existing GAAP, we believe that increases in cash flows on purchased assets should result in gain recognition rather than an adjustment to the yield because this provides symmetry in the accounting for both increases and decreases in expected cash flows.

Question 42: If a financial asset that is evaluated for impairment on an individual basis has no indicators of being individually impaired, the proposed guidance would require an entity to determine whether assessing the financial asset together with other financial assets that have similar characteristics indicates that a credit impairment exists. The amount of the credit impairment, if any, would be measured by applying the historical loss rate (adjusted for existing economic factors and conditions) applicable to the group of similar financial assets to the individual financial asset. Do you agree with this requirement? If not, why?

We believe this approach would expand current GAAP as described in the ASC 310-10-35-36 (below) and in the diagram at ASC 310-10-55-1.

310-10-35-36 If a creditor concludes that an individual loan specifically identified for evaluation is not impaired under this Subsection, that loan may be included in the assessment of the allowance for loan losses under Subtopic 450-20, [EITF D-080, paragraph 10, sequence 85] but only if specific characteristics of the loan indicate that it is probable that there would be an incurred loss in a group of loans with those characteristics.

Current GAAP suggests that individually reviewed loans which are not impaired may be aggregated for purposes of determining impairment. We believe current GAAP is appropriate and therefore it does not appear to be operational to require aggregation since the loan may not have a sufficient amount of similar characteristics to be aggregated with similar loans (for example, a financial institution may have only one loan to a manufacturer). Further, forced aggregation may not result in the desired outcome if the pools are not sufficiently robust.

Question 46: The proposed guidance would require that in determining whether a credit impairment exists, an entity consider all available information relating to past events and existing conditions and their implications for the collectibility of the cash flows attributable to the financial asset(s) at the date of the financial statements. An entity would assume that the economic conditions existing at the end of the reporting period would remain unchanged for the remaining life of the financial asset(s) and would not forecast future events or economic conditions that did not exist at the reporting date. In contrast, the IASB Exposure Draft on Impairment proposes an expected loss approach and would require an entity to estimate credit losses on basis of probability-weighted possible outcomes.

Do you agree that an entity should assume that economic conditions existing at the reporting date would remain unchanged in determining whether a credit impairment exists, or do you believe that an expected loss approach that would include forecasting future events or economic conditions that did not exist at the end of the reporting period would be more appropriate? Are both methods operational? If not, why?

As described in our responses above, conceptually we believe the cash flow estimates should include future events because that is how a market participant assembles the cash flows. However, we do not agree with “forecasting” events and concur with the Board’s desire not to build allowances in good economic times. However, it does not seem reasonable to assume that in poor economic times, no recoveries will ever occur. As such, we believe the Board should provide more forward leaning language into the guidance not by “forecasting” but rather incorporating verifiable trends into the analysis.

We believe for most loans, the disposition of the individually evaluated loan is relatively short term so not forecasting economic changes will not have a significant impact. For loans evaluated in pools, we believe the appropriate adjustments can be made to the historical loss rates to encompass existing economic conditions and near term changes. We also refer to our response to Question 40. However, we believe cash flows should include future changes for debt securities because the time horizon for resolution is longer as described in our response to Question 37.

Question 47: The proposed guidance would require that an appropriate historical loss rate (adjusted for existing economic factors and conditions) be determined for each individual pool of similar financial assets. Historical loss rates would reflect cash flows that the entity does not expect to collect over the life of the financial assets in the pool. Would such an approach result in a significant change in practice (that is, do historical loss rates typically reflect cash flows that the entity does not expect to collect over the life of the financial assets in the pool or some shorter period)?

As mentioned in our response to Question 40, we believe this would be a significant change in practice. Historical loss rates are typically determined using several periods of loss history but are then reduced to a one year time horizon by calculating an annualized loss rate. From there, an additional multiplier may or may not be used, depending on whether the entity believes the loss coverage should be more or less than one year. As such, pools do not have life of the loan allowances but rather a much shorter time horizon.

Interest Income

Question 48: The proposed guidance would require interest income to be calculated for financial assets measured at fair value with qualifying changes in fair value recognized in other comprehensive income by applying the effective interest rate to the amortized cost balance net of any allowance for credit losses. Do you believe that the recognition of interest income should be affected by the recognition or reversal of credit impairments? If not, why?

We do not believe interest income should be impacted by credit impairments; rather, interest income should continue to be calculated based on amortized cost rather than amortized cost less any allowance for credit losses. We believe interest income should be based on the contractual amount owed which is well understood by users of financial statements. We also envision operational challenges with the proposed methodology for two reasons. First, the allowance for credit losses is typically calculated as a process separate from the loan subsidiary ledger which calculates interest income. Subtracting the allowance for credit losses from the amortized cost would typically be a manual exercise that would have to be performed for each loan. Secondly, we believe it would be very difficult to apply the methodology to smaller balance homogenous loans because those loans are typically evaluated for credit losses on a pool basis whereas interest income is calculated, by the subsidiary system, at the loan level. Lastly, we believe that users are accustomed to associating high bad debt expense and high allowances with the overall risk of the portfolio. Because the excess interest is credited against the allowance, this will result in lower allowances which in turn will require more effort by users to understand the underlying credit quality.

Question 49: Do you agree that the difference in the amount of interest contractually due that exceeds interest accrued on the basis of an entity's current estimate of cash flows expected to be collected for financial assets should be recognized as an increase to the allowance for credit losses? If not, why?

In addition to the reasons listed to our response to Question 48, we do not believe increasing the allowance for credit losses for contractual interest in excess of expected interest will obscure the allowance for credit losses. We believe that increases to the allowance for credit losses are understood to be either bad debt expense or recoveries and that introducing the concept of contractual interest amounts due in excess of interest expected to be collected into the allowance for credit losses will not be meaningful.

Hedge Accounting

Question 56: Do you believe that modifying the effectiveness threshold from highly effective to reasonably effective is appropriate? Why or why not?

In general, changing the threshold from highly effective to reasonably effective will only impact sophisticated hedging operations and for many entities this will have no impact as their goal has been, and will likely continue to be, to achieve as close to 100% effectiveness as possible. While we acknowledge the Board's desire to not provide a bright line definition to this new term, not doing so will contribute to challenges (including restatements) until the industry as a whole informally determines a threshold.

Question 57: Should no effectiveness evaluation be required under any circumstances after inception of a hedging relationship if it was determined at inception that the hedging relationship was expected to be reasonably effective over the expected hedge term? Why or why not?

We agree with the proposed guidance that initial and ongoing quantitative effectiveness assessment should be required only when circumstances warrant. For many hedges, a qualitative assessment will be sufficient to determining if a hedge is reasonably effective or if a quantitative assessment is necessary. Further, we believe that lowering the effectiveness threshold from highly effective to reasonably effective may increase the use of a qualitative assessment concept, which we believe will be helpful in practice.

Question 58: Do you believe that requiring an effectiveness evaluation after inception only if circumstances suggest that the hedging relationship may no longer be reasonably effective would result in a reduction in the number of times hedging relationships would be discontinued? Why or why not?

We do not believe requiring effectiveness evaluations only if circumstances warrant will reduce the number of hedges that are discontinued because they are no longer reasonably effective. Hedges that are not obviously effective will be monitored, even if only informally. Reducing the effectiveness threshold to reasonably effective will have a more significant impact in this regard.

If the goal is to reduce the number of hedges discontinued because they are no longer effective due to form rather than substance, we suggest the Board consider removing the requirement that the method of assessing the pass / fail effectiveness test be identified at inception in the formal documentation requirement or allow multiple methods to be specified. In our experience, we find that companies feel compelled to choose the method upon inception that is most likely to succeed the pass/fail effectiveness test over the life of the hedge. Typically, the method chosen is regression which is also the most onerous in terms of labor and expense. We believe that entities should not be required to specify, or be bound by, a particular quantitative method of assessing effectiveness, particularly since there is proscriptive measurement guidance in place for recording ineffectiveness which is separate from the pass / fail effectiveness test. As such, we believe entities should be able to use any acceptable method desired over the course the hedge.

Question 61: Do you foresee any significant operational concerns or constraints in calculating ineffectiveness for cash flow hedging relationships? If yes, what constraints do you foresee and how would you alleviate them?

We do not anticipate any operational concerns in calculating ineffectiveness for cash flow hedges using the proposed guidance.

Question 62: Do you foresee any significant operational concerns or constraints in creating processes that will determine when changes in circumstances suggest that a hedging relationship may no longer be reasonably effective without requiring reassessment of the hedge effectiveness at each reporting period? If yes, what constraints do you foresee and how would you alleviate them?

We believe most entities will be able to create appropriate policies and procedures to monitor and determine if changes in circumstances warrant additional evaluation of hedge effectiveness without quantitatively reassessing each reporting period.

Question 63: Do you foresee any significant operational concerns or constraints arising from the inability to discontinue fair value hedge accounting or cash flow hedge accounting by simply dedesignating the hedging relationship? If yes, what constraints do you foresee and how would you alleviate them?

We believe removing the ability to electively de-designate hedge accounting will only increase administrative costs. If an entity desires to maintain the derivative position and the hedged item while terminating existing hedge accounting, this can still be achieved by settling the existing derivative position for cash and entering a new position at the current market with all other terms remaining unchanged. This same situation currently exists with cash flow hedge re-designations in which a new hedging relationship is not possible because the existing swap now has a value. This has not stopped de-designations and re-designations in this regard, but instead has simply resulted in a few more steps to achieve the same outcome.

In addition, we do not agree with the proposed changes described in paragraph 121 which would permit the addition of new derivatives to an existing hedging relationship as we believe this is inconsistent with the principles of the standard and constitutes a de-designation and re-designation event.

Question 64: Do you foresee any significant operational concerns or constraints arising from the required concurrent documentation of the effective termination of a hedging derivative attributable to the entity's entering into an offsetting derivative instrument? If yes, what constraints do you foresee and how would you alleviate them?

We do not anticipate any significant operational concerns with requiring concurrent documentation for effective termination by entering an offsetting derivative.

Disclosures

Question 65: Do you agree with the proposed disclosure requirements? If not, which disclosure requirement do you believe should not be required and why?

Because we do not support fair value as a subsequent measurement for financial instruments held for collection or payment, other than debt and equity securities, we recommend fair value for these instruments be disclosed.

As discussed in our response to Question 16, we recommend all reclassifications should be robustly disclosed in order to inform readers of the change in business strategy. As such, we concur with the proposed disclosures in paragraph 100.

We understand that these proposed disclosures were developed based on the proposed changes to recognition and measurement. Because we do not agree with many of those changes, particularly for subsequent measurement, credit impairment and interest income recognition, it is difficult to comment on the proposed disclosures. For example, as discussed in our response to Questions 48 and 49, we do not support the proposed interest income model. As such, we do not believe the disclosures in paragraph 102 are necessary. As another example, we do not believe that core deposits should be subject to the re-measurement method. Accordingly, we believe the disclosures in paragraph 106 are unnecessary.

If the Board makes significant changes to the current proposal, we recommend the disclosures also be re-evaluated to determine what is most useful to readers based on any revisions to the recognition and measurement provisions of the proposal. Depending upon the outcome of that process, the Board may wish to re-expose the disclosures for comment.

Effective Date and Transition

Question 68: Do you agree with the transition provision in this proposed Update? If not, why?

We concur with the proposed transition provisions.

Question 69: Do you agree with the proposed delayed effective date for certain aspects of the proposed guidance for nonpublic entities with less than \$1 billion in total consolidated assets? If not, why?

We support the proposed delay in effective date for nonpublic entities with less than \$1 billion in consolidated assets. However, we believe this delay should apply to the entire proposal, rather than only for measuring loans, loan commitments, and core deposit liabilities. We understand the Board intends to perform a post-implementation review two or three years after the initial effective date but before the requirements become effective for all entities. By delaying the proposal entirely for those entities, they would not be subject to provisions that may eventually be changed after the Board's comprehensive review of the standard. Further, a full delay will allow additional time for smaller entities, which are already resource constrained, to implement the changes rather than a piecemeal type of adoption.

We are also concerned with the proposed re-evaluation annually during the deferral period to determine whether a nonpublic entity still qualifies for the deferral. Given the depth and breadth of this proposal, we believe it is unfair to have an unknown effective date for those entities. As such, we recommend the Board drop the required re-evaluation during the deferral period.

Question 70: How much time do you believe is needed to implement the proposed guidance?

From the auditor perspective, we do not envision that a significant amount of time will be needed in order for auditors to be appropriately prepared.

From our experience with entities most impacted by this proposal, we believe that a minimum of four years is needed for smaller entities which will allow time for systems and methodologies to be built and for these entities to benefit from the implementation of larger entities. As previously mentioned, we believe it is important for the Board to complete its comprehensive review of the implementation, and address any identified issues, prior to requiring adoption for all entities.

Question 71: Do you believe the proposed transition provision is operational? If not, why?

As described in our responses to question 69, we believe there are operational issues related to annual re-evaluation to determine if an entity continues to qualify for the deferral. We are not aware of operational issues from an auditor's perspective.

Other comments

The following are additional comments on the proposal.

Measurement of Impairment

Currently, GAAP measures impairment based on recorded investment which includes accrued interest receivable as described in ASC 310-10-35-34 as follows (underlining added):

If the present value of expected future cash flows (or, alternatively, the observable market price of the loan or the fair value of the collateral) is less than the recorded investment in the loan (including accrued interest, net deferred loan fees or costs, and unamortized premium or discount), a creditor shall recognize an impairment by creating a valuation allowance with a corresponding charge to bad-debt expense or by adjusting an existing valuation allowance for the impaired loan with a corresponding charge or credit to bad-debt expense.

In paragraph 62, it appears that the impairment is measured based on amortized cost which would be a change in practice because the amortized cost definition as proposed in paragraph 8 does not include accrued interest receivable. We recommend the Board use the existing ASC definition of recorded investment in receivable (provided below) to measure impairment or re-define amortized cost in paragraph 8 (the glossary) to include accrued interest receivable (underlining added).

Recorded Investment in the Receivable - The recorded investment in the receivable is the face amount increased or decreased by applicable accrued interest and unamortized premium, discount, finance charges, or acquisition costs and may also reflect a previous direct write-down of the investment.

Nonaccrual Guidance

We do not support the proposed nonaccrual guidance in paragraph 82. With the uncertainty in collection with a problem loan, it is typically difficult to determine the expected cash flows. The proposed guidance presupposes a level of precision that typically does not exist. As described elsewhere, we do not support the proposed interest income model. With the proposed changes to interest income coupled with this nonaccrual guidance, we believe the result will be misleading because loans with even the smallest interest accrual will not be recognized as nonaccrual which will understate the nonaccrual disclosures.

We believe determining nonaccrual status should have a level of judgment and support defining the term nonaccrual. One possible source is the guidance in ASC 310-30, *Loans and Debt Securities Acquired with Deteriorated Credit Quality* (formerly SOP 03-3) which states (underlining added):

310-30-35-3 Recognition of income under this Subtopic is dependent on having a reasonable expectation about the timing and amount of cash flows expected to be collected. Subsequent to acquisition, this Subtopic does not prohibit placing loans on nonaccrual status, including use of the cost recovery method or cash basis method of income recognition, when appropriate. For example, if the timing of either a sale of the loan into the secondary market or a sale of loan collateral in essentially the same condition as received upon foreclosure is indeterminate, the investor likely does not have the information necessary to reasonably estimate cash flows expected to be collected to compute its yield and shall cease recognizing income on the loan.

Another source is the guidance from the federal banking regulators in the glossary to the regulatory (Call) reporting instructions.

Banks shall not accrue interest, amortize deferred net loan fees or costs, or accrete discount on any asset (1) which is maintained on a cash basis because of deterioration in the financial condition of the borrower, (2) for which payment in full of principal or interest is not expected, or (3) upon which principal or interest has been in default for a period of 90 days or more unless the asset is both well secured and in the process of collection.

If the Board chooses to retain this guidance, we believe the example in paragraph 82 should be changed from “less than the original principal amount” to “less than the remaining principal amount.”

Writeoffs of Financial Assets

We support defining “write-off” in GAAP. We believe as currently proposed, the timing of write-offs will be delayed compared to current practice which is when management deems the loan as uncollectible.

Credit Impairment

The last sentence in paragraph 36 states “An entity’s expectations about collectability of cash flows shall include all available information relating to past events and existing conditions but shall not consider potential future events beyond the reporting date.” Assuming the reporting date is the same as the balance sheet date, this sentence does not appear consistent with ASC 855-10-25-1, which states “An entity shall recognize in the financial statements the effects of all subsequent events that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements.” We believe it is important that the objective in this paragraph not confuse this important concept since subsequent event information is commonly used in impairment assessments and recommend clarification to the paragraph to specifically address subsequent information.

Determination of the effective interest rate

Paragraph 66 of the proposal indicates that “In measuring the amount of credit impairment for fixed-rate assets, generally, an entity shall discount the cash flows expected to be collected at the financial asset’s original effective interest rate.” This sentence uses the term “generally”. We recommend the wording should be clear whether there is an alternative to using the asset’s original effective interest rate.

Practical expedient for measurement of impairment

We concur with the Board’s proposed changes to the definition of collateral dependent by removing the term “solely” and adding “primarily or substantially.”

Paragraph 71 of the proposal indicates that the fair value of the collateral can be used as a practical expedient if the financial asset in question is collateral-dependent. We agree with the Board’s decision; however we have observed in practice that it is not always clear whether the collateral value represents the “as is” value or the “as complete” value. For example, upon foreclosure, the as is value of an undeveloped piece of real estate would be significantly less than the value upon completion of the construction of a hotel or other structure. We recommend clarifying that the collateral value should be based on the “as is” fair value, versus the “as complete” value.

Allowance for Credit Losses

The last sentence of paragraph 104.a. refers to disclosing any change to a creditor's accounting policies or methodology from the prior period and management's rationale for the change. We recognize that entities change policies and methodologies from time to time, however, in the context of the allowance there is significant judgment required to determine whether a change of this nature is a change in estimate or a change in principle. We recommend adding the need to consider ASC 250, *Accounting Changes and Errors*, to the extent an entity changes its policy or methodology regarding the allowance for credit losses.