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September 26, 2012

Ms. Leslie Seidman
Chairman
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-05116

Re: FASB File Reference No. 2012-200, Proposed Accounting Standards Update, Financial Instruments (Topic 825): Disclosures about Liquidity Risk and Interest Rate Risk

Dear Ms. Seidman:

The Financial Reporting Committee (FRC) of the Institute of Management Accountants (IMA) is writing to provide its views on the Proposed Accounting Standards Update, Financial Instruments (Topic 825): Disclosures about Liquidity Risk and Interest Rate Risk (Proposal).

The FRC is the financial reporting technical committee of the IMA. The FRC includes preparers of financial statements for some of the largest companies in the world, representatives from the world's largest public accounting firms, valuation experts, accounting consultants, academics and analysts¹. The FRC reviews and responds to research studies, statements, pronouncements, pending legislation, proposals and other documents issued by the domestic and international agencies and organizations.

The IMA supports the efforts of the Financial Accounting Standards Board (FASB or Board) to provide users of financial statements with decision-useful information about an entity's liquidity risk and interest rate risk. However, we have the following principal concerns in the application, implementation, and timing of the Proposal.

- The tables, primarily the liquidity gap maturity and repricing gap analysis tables, have too many limitations that will result in users having to make highly subjective assumptions, or not applying proper assumptions, that will hinder their decision-making abilities or mislead the user.
- The inconsistencies between the Proposal and the way an entity manages its liquidity and the way a financial institution manages interest rate risk are too severe. Due to the dynamic nature of managing these risks and the type of management discussion regarding these risks that is required for a user to properly understand the risks and management thereof, the disclosures are better suited for inclusion in Management's Discussion and Analysis (MD&A).
- The Proposal significantly expands the boundaries of the notes to the financial statements and, therefore, should be considered subsequent to FASB's projects on the Disclosure Framework and Private Company Decision-Making Framework to ensure the Proposal aligns with the goals of these projects.

¹ Additional information about the IMA Financial Reporting Committee can be found at www.imafrc.org



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- The Proposal is being considered at the same time that the banking regulators and the Financial Stability Board are developing projects related to disclosure of the same risks which could result in additional interpretative issues with the disclosures. If there is no consistency among the various disclosure requirements, users will need to interpret the differences which will simply confuse users and hinder the usefulness of all of the disclosures.

Due to the large amount of implementation and usefulness concerns with the Proposal, we recommend the FASB defer issuing the Proposal in final form until the projects on the Disclosure Framework and Private Company Decision-Making Framework have been completed. This delay would allow the FASB time to ensure the Proposal aligns with the directives of these projects. Additionally, a deferral would allow the FASB to time to reconsider whether the liquidity and interest rate risk disclosures are ultimately best suited for MD&A or to dialogue with the Securities and Exchange Commission (SEC) to ensure there is an alignment between the financial statement disclosures and MD&A.

More specific to our concerns, the standardized approach detailed in the Proposal could have the unintended consequence of providing users with incomplete, and potentially misleading, information. At a minimum, the amount of interpretation required by the users will be vast. Each entity has different types and levels of liquidity and interest rate risks, and, accordingly, manages these risks in dynamic ways that are unique to each entity. We believe that trying to identify these risks by inputting information into standardized tables, which have inherent limitations, will be counterproductive to the Board's intended purpose of the Proposal to provide decision-useful information about an entity's exposure to liquidity and interest rate risk.

The Proposal requires management to add narrative disclosures to certain tables so that a user will understand its liquidity and interest rate risk. To properly discuss these risks, we believe the qualitative disclosures will have to be written in a manner similar to discussion currently included in MD&A. We believe this exceeds the boundaries of the notes to the financial statements. Because this discussion will require management to describe its view as to what is critical to understanding the entity's liquidity and interest rate risks and how they have and are prepared to manage these risks in the past and the future, we believe this discussion is most appropriately included in MD&A. Accordingly, we recommend that the FASB reconsider the Proposal and, instead, actively dialogue with the SEC staff to ensure that the liquidity and interest rate risk concerns raised by financial statement users during the FASB outreach projects can be sufficiently addressed in MD&A.

We are also concerned with the amount of data that will be required to be included in the notes to the financial statements to comply with the Proposal (quarterly and annually). We believe the data will be overwhelming and difficult to interpret for many users. The FASB recently issued an invitation to comment on a Discussion Paper on the Disclosure Framework (Disclosure Framework). Chapter 2 of the Discussion Paper discusses how to identify information that should be disclosed in notes to the financial statements through a decision process. One hope is that this decision process will limit the information that is included in the notes to the financial statements and assist in reducing the volume of notes to the financial statements. Additionally, the FASB's technical projects include determining a Private Company Decision-Making Framework. Due to the significant impact the Disclosure Framework and the Private Company Decision-Making Framework may have on the notes to the financial statements, we recommend that the Proposal be



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considered subsequent to these projects to ensure that it is consistent with their objectives and ultimate results.

An important component in liquidity and interest rate risk management is analyzing the potential impacts to the entity from expected and unexpected changes in the environment (i.e., economic factors, competitive conditions, etc.) and then developing a contingency plan to respond to these changes. While a thorough understanding of the entity's balance sheet is needed to manage liquidity, an equal understanding of the dynamics of the entity, (i.e., pricing strategies, customer behavior, market conditions, etc.) is also needed. This management process occurs daily and results in constant monitoring and reallocating of portfolios as economic conditions change.

The Proposal attempts to identify an entity's liquidity and interest rate risks by utilizing a standardized point in time view of the entity's balance sheet without any consideration of an entity's dynamics or risk strategies. While we agree that providing users with information to help understand each entity's liquidity and interest rate risks is important, we are concerned that trying to provide a snapshot of these risks in audited financial statements imposes limitations that will greatly reduce the usefulness of the disclosures. The management of liquidity and interest rate risks is inherently forward looking as compared to the period end(ing) recognition, measurement, and disclosure of an entity's financial position, performance and changes in financial position. Further, as the Proposal requires companies to narrow its cash flow estimates to one expectation, users will not be able to comprehend the volatility or variables in the cash flow estimates that are necessary in analyzing liquidity and interest rate risks.

We believe that it is also important for the Board to recognize that the timing of the Proposal will coincide with the additional regulatory reporting expected by the Federal Reserve for the implementation of the Basel III framework (including the Liquidity Coverage Ratio, which is intended to portray an entity's resilience to potential liquidity disruptions over a thirty-day horizon). We also understand that the Financial Stability Board is planning to develop its own set of required liquidity and interest rate risk disclosures. Along with the burden that will be placed on preparers to update their systems and processes to compile this information, having multiple different liquidity and interest rate disclosures has the potential to result in confusion for users making the disclosures less useful. We recommend that, if the Board proceeds with the Proposal, it considers these other initiatives in relation to the Proposal to ensure there is consistency between these requirements.

We have provided additional comments, below, for the Board's consideration should it elect not to defer the Proposal, including the details of our concerns on why the standardized tables could be misleading to users.

Scope

We believe additional clarity is needed for defining a financial institution as it would significantly impact the extent of disclosures required under the Proposal. The Proposal narrowly defines a financial institution an entity or a reportable segment for which the primary business activity is either to: (1) earn, as a primary source of income, the difference between interest income generated by earning assets and interest paid on borrowed funds; or (2) provide insurance. It is unclear as to whether a financial institution whose primary source of income is fee based (such as companies in the credit card industry) is intended to be scoped into the definition of a financial institution. Also,



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in determining which segment is considered a financial institution or not, additional clarity is needed on how to define the “primary” source of income for an entity or a segment.

We also recommend that the scope exclude non-publicly traded companies. A large portion of the financial institutions that would be scoped into the Proposal will not have the complexities and risks of larger publicly traded financial institutions and the burden placed on them to prepare the disclosures may be significant. We do believe that most private investors of financial institutions have the ability to obtain information from and have more access to an entity’s management team. If the Board proceeds with the Proposal, we recommend that it defer the Proposal for non-publicly traded companies until it can be evaluated using the Private Company Decision-Making Framework.

The Liquidity Gap Maturity Table

There are inherent shortcomings in any gap analysis, which is the primary reason that financial institutions have deviated from managing liquidity risk via a gap analysis. For example, the Board has chosen to utilize “expected maturities”, versus contractual maturities, to address the various embedded options (e.g., calls, puts) in financial instruments. While contractual maturities would be a poor representation of forecasted cash flows, the utilization of “expected maturities” in the Proposal is also problematic as it requires an entity to display one set of expected cash inflows and outflows. Proper liquidity management requires an entity to consider multiple scenarios that could occur and the varying cash flow obligations that could result from those scenarios. As an entity will plan for multiple scenarios, an entity will maintain cash and liquid funds to ensure it has the ability to meet its cash obligations under the multiple scenarios. The liquidity gap maturity table required in the Proposal would not capture these scenarios or an entity’s managed liquidity position to cover these multiple scenarios. Additionally, as the “expected maturities” of many instruments (e.g., mortgage loans, securitized interests) can change dramatically as economic factors (e.g., interest rates) change, the volatility of these “expected maturities” will not be conveyed through a single display of “expected maturities”. Overall, by displaying a single “expected maturity” without considering the volatility of the displayed cash flows or associating the entity’s availability of funds with the cash flow obligations, an entity’s liquidity position will not be properly represented. The effect of this presentation will either reduce the usefulness of the table or result in users being misled as to the entity’s liquidity risk and position. Additionally, we do not believe that users will readily understand the term “expected” as described in the Proposal. Instead, they will use the term in the more commonly understood definition that would capture all scenarios (e.g., sales).

Another general shortcoming with gap analysis is the display of balances without contractual maturities. While the Proposal requires an entity to spread the balances over time, others would argue the best approach is to display them into a single “non-maturity” category. Obviously, there are benefits and shortcomings to either approach. However, the biggest shortcoming to either approach is that neither represents the actual liquidity risk of these accounts, such as the risks related to seasonal balance fluctuations. The table in the Proposal also does not properly capture the rollover nature of deposit accounts. The Proposal displays to an investor that a certain amount of a financial institution’s deposit accounts are expected to mature at certain time intervals; however, it ignores the simultaneous expectation of new deposits. While the entity’s expectation could be a zero net cash flow for a certain time interval, the table could be incorrectly interpreted to mean that the entity has an expected cash outflow.



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The concept of expected rollovers also applies to other less volatile balances (e.g., loans, short-term borrowings), which is another reason that companies have reduced their reliance on a gap analysis to manage liquidity risk. The table would also indicate that liquidity is considered on a granular basis over an extended period of time whereas anything greater than two years is not useful for a user's decision-making.

We are also concerned that the table may not result in an apples-to-apples comparison among companies. The table will require multiple subjective assumptions. Therefore, two companies with identical financial instruments may present different "expected maturities". If an investor were to compare the disclosures among these two companies, they would likely form a different view on the liquidity position when arguably their positions are not different. If the companies were to consider the cash flows of these financial instruments in stress scenarios, however, they likely would consider them in the same realm and manage their liquidity accordingly. The table in the Proposal would not display this commonality between the two companies.

Overall, due to the shortcomings and limitations of the proposed liquidity gap maturity table, we do not believe it will provide an accurate picture of an entity's liquidity gap position or provide a useful format for comparison among companies. We do not believe that users could compensate for the above shortcomings to allow them to make a useful decision based on the table's data.

Available Liquid Funds

While we are generally supportive of the available liquid funds table, we are not sure of the need as the information is already presented within entity's balance sheet and footnotes. The balance sheet will list an entity's cash and cash equivalents and investment securities available for sale. The investment securities and fair value footnote will also provide a good description of the types of investments that are available for sale, any potential credit risk associated with disposing of the investments, and the marketability of the instruments. Also, regulatory risk-based capital ratios and leverage ratios already provide much of the information that this information is intended to convey. However, if the Board pursues the disclosure of this table, the Board may want to consider updating this table to include an entity's known and potential short-term cash flow obligations (assuming the elimination of the liquidity gap maturity table).

Repricing Gap Analysis

Similar to the liquidity gap maturity table, we believe there are shortcomings in presenting this type of table. These shortcomings will result in an entity's repricing risk being misrepresented for the following reasons.

- The use of contractual reset rate is an inaccurate depiction of the repricing risk for instruments with a high degree of prepayments. For example, a large portion of a bank's loans and debt securities may prepay prior to maturity, and the amount of projected prepayments will fluctuate as interest rates change. The table would require the reset date to be included in the contractual date column which would be inconsistent with the true repricing risk of those instruments.
- The table does not show the relationship of variable rate instruments whose repricing risk has been hedged with the derivatives or forecasted transactions that serve as a hedge. Using the table, a user could interpret an instrument as being susceptible to short-term interest rate



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movement. If the entity has hedged this risk through, for example, an interest rate swap, the user's interpretation would be wrong.

- Further, the contractual yield will not always be representative of an entity's expected or earned yield. For example, the yield on debt securities will change as prepayments occur and any associated premium accretion or discount amortization is accelerated. The contractual yield, which does not include the impact of premiums and discounts amortized over the contractual life of the instruments, will differ from the actual yield. Because of the frequency of prepayments, we are concerned as to what an investor would infer from the stated contractual yield. One concern is that a user could interpret that a low yield is being earned over a long period of time but in reality a higher yield is being earned because of repricing in the shorter term.
- The liquidity of the assets subject to repricing will not be considered. For example, as interest rates change and an entity determines that it needs to reallocate its portfolio, assets and liabilities that are available will be exchanged solely for interest rate reallocation or instruments may be hedged out of their contractual rate. While instruments may portray a longer repricing period, there are many scenarios where they are not planned to be or will not be held to the contractual date. Because of this, the time intervals outside of two years are not useful.

Overall, we believe that financial institutions are generally directionally weighted for their interest rate risk (i.e., short or long-term weighted for assets, short or long-term weighted for liabilities). We recommend the Board focus more attention on disclosures that would provide a user with an indication of the direction that an entity has weighted its interest rate risk. This would allow a user to understand whether an entity would face positive or negative consequences as interest rates change.

Interest Rate Sensitivity Table

We do believe use of an interest rate sensitivity table is a good tool to identify interest rate risk for a bank. However, we are concerned with the ability to show the effect on net income and shareholders' equity. Generally, financial institutions now show the effect on their core net interest income. If the Board went ahead with the sensitivity table as proposed, we believe the time that would be needed to implement this requirement would be significant. Additionally, we are concerned with the potential liability of including this information in the footnotes. Because the information cannot use any forward looking information, the proposed methodology would not represent the expected income effect of an interest rate change and certainly will not equal actual results. As a result, a user could interpret the analysis to mean more than it represents which could lead to litigation. If disclaimers were included around the table, the investor may not use the information at all. Overall, this information would be best displayed with related assumptions and narrative as part of MD&A.

Cash Flow Obligations

We recommend the Board clarify what should be included or excluded in the tabular disclosures and the use of the term "expected" in paragraph 825-10-50-23M. The Proposal has limited the term to contractual payments in other areas of the Proposal. If the Board is using the term "expected" to include both contractual and non-contractual cash flows expected to occur as of the end of the



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reporting period, this will result in an operational burden for many entities. For example, an entity would need systems and/or processes to gather all of its purchase orders to populate the cash flow obligations table. Other examples are uncertain tax benefit liabilities and asset retirement obligations. Additionally, an entity would need to make very subjective estimates for these types of obligations over the time intervals established for the table. These estimates would be highly volatile and difficult to audit. Additionally, if the future amounts are inconsistent with the previously reported amounts due to economic changes, we are unsure that users would understand the amount of subjectivity inherent in the table. Similar to the rest of the Proposal, we believe that the most appropriate place for an entity to explain these cash flow obligations is in MD&A

Operational Concerns

If the Board pursues the Proposal, we would request the Board provide an adequate amount of implementation time as preparers will need to make multiple changes to their systems and processes. A considerable amount of resources will be required to implement these changes and such resources are limited. Additionally, the Proposal must be aligned with the numerous other regulatory and accounting changes entities are implementing. Further, the processes will need to be auditable and thoroughly understandable by management to afford appropriate narrative disclosure and internal review. Accordingly, we recommend that the Board consider an implementation date for periods ending no earlier than December 15, 2015.

Overall, we are very concerned with the Proposal and the effect it will have on the audited financial statements. Instead of providing a user of the financial statements with decision-useful information, the Proposal would provide data that is incomplete, difficult to interpret and potentially misleading. We strongly believe that most of the information called for in the Proposal is best suited for MD&A.

We would be pleased to discuss these comments with you or the FASB Staff. I can be reached at (646) 256-3115.

Sincerely,

A handwritten signature in blue ink that reads "N. Schroeder".

Nancy J. Schroeder
Chair, Financial Reporting Committee
Institute of Management Accountants