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May 15, 2013

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

File Reference Nos. 2013-220 and 2013-221

Re: Proposed Accounting Standards Update, *Recognition and Measurement of Financial Assets and Financial Liabilities*

Dear Ms. Cospers:

Deloitte & Touche LLP appreciates the opportunity to provide feedback on the FASB's proposed Accounting Standards Update (ASU) *Recognition and Measurement of Financial Assets and Financial Liabilities*. We support the Board's objectives of (1) converging the guidance on classification and measurement of financial instruments under U.S. GAAP with that under IFRSs, (2) reducing unnecessary complexity in the accounting for financial instruments, and (3) requiring entities to provide more decision-useful information about their involvement with those instruments. However, we have several significant concerns related to how those objectives have been reflected in the proposed ASU that we believe should be addressed before the guidance is finalized.

Convergence

We continue to encourage the FASB and IASB to work together to eliminate remaining areas of divergence between (1) the FASB's proposed ASU and (2) IFRS 9 (2010)¹ as it would be amended by ED/2012/4² ("IFRS 9"). To support well-functioning global capital markets, a single converged financial reporting model for financial instruments should be a top priority. We are concerned that presenting both proposed models to the public as substantially converged may mislead investors and other financial statement users and dissuade them from performing appropriate comparative analysis when differences exist.

While certain principles in the proposed ASU and IFRS 9 may appear to be converged, some of the detailed application guidance differs in important respects. Such differences could sometimes result in very different accounting outcomes. For example, the FASB's guidance on sales from the amortized cost category differs from the IASB's. Regarding the assessment of whether sales activities from an amortized cost portfolio would be consistent with the "hold-to-collect" business model objective, the FASB provides a list of "permissible sales" while the IASB requires entities

¹ IFRS 9 (2010), *Financial Instruments*.

² IASB Exposure Draft ED/2012/4, *Classification and Measurement: Limited Amendments to IFRS 9*.

to evaluate the frequency and volume of sales. We support the FASB's proposal to provide a list of "permissible sales" in addition to indicating that other sales should be very infrequent.

In addition, we recommend that the FASB and IASB jointly redeliberate the remaining areas of divergence to eliminate significant differences, including those related to initial measurement of financial assets, initial and subsequent measurement of equity investments, and others. We discuss key areas of significant differences in Appendix A.

Complexity

We recommend that certain elements of the proposed ASU be improved to reduce unnecessary complexity and to clarify for preparers and users how to apply the proposed guidance and interpret the results.

We generally support the FASB's proposal to simplify current U.S. GAAP by replacing the existing embedded derivative requirements for hybrid financial assets. However, we are concerned that the requirement to use a narrowly defined contractual class flow characteristics assessment to classify and measure hybrid financial assets in their entirety could force hybrid financial assets into being classified as fair value through net income (FV-NI) even if the effect that an embedded derivative has on contractual cash flows is insignificant or the likelihood of a change in cash flows is remote. Further, we are concerned that the detailed application guidance on the proposed cash flow characteristics criterion is internally inconsistent and excessively complex. For example, depending on the type of feature, entities would use different types of assessments, such as the following, to determine whether an instrument meets the contractual cash flow characteristics criterion:

- A rules-based approach for assessing prepayment or extension options (paragraphs 825-10-55-21 and 55-22).
- A significance test for leverage features (paragraph 825-10-55-17).
- A benchmark instrument comparison approach for interest mismatch features under which an entity would ignore scenarios that are not reasonably possible (paragraphs 825-10-55-19 and 55-20).
- An evaluation that disregards nongenuine features (i.e., contingent terms that would affect the cash flows only upon the occurrence of an event that is extremely rare, highly abnormal, and very unlikely to occur) but otherwise would not take into account the probability of occurrence related to the assessment of other contingent features that may change the timing or amount of contractual cash flows (paragraphs 825-10-55-23 through 55-25).

Conceptually, it is unclear why different application guidance should apply to different types of features rather than a consistent set of principles. We recommend that the boards develop convergent, coherent, and consistent guidance that embodies similar criteria for evaluating

different types of features. More specifically, we recommend that the boards provide guidance that:

- Clarifies that any nongenuine feature affecting an instrument's contractual cash flows only on the occurrence of an event that is highly unlikely to occur should be disregarded in the assessment of an instrument's contractual cash flows, irrespective of the type of feature that is being evaluated.
- Eliminates the differences in proposed guidance that (a) requires entities to only consider reasonably possible scenarios when evaluating modifying terms, (b) requires entities to evaluate significance in assessing leverage features, (c) in the case of contingent features, prohibits entities from considering the probability of a contingent event occurring if such an event would result in cash flows that are not solely payments of principal and interest yet requires entities to disregard nongenuine features, and (d) permits prepayment or extension options that are contingent upon the occurrence of some event if such contingency provides the holder or issuer with certain protections from unfavorable changes in cash flows.
- Requires entities to "look through" to the underlying assets both for beneficial interests in securitized assets and other nonrecourse assets contractually linked to the performance of related assets.
- Requires entities to disregard terms that permit, but do not require, an investor to settle in a manner that would cause it not to receive all unpaid amounts of principal and interest (i.e., the investor could not be forced to accept such a settlement outcome).
- Requires entities to disregard terms that permit the issuer or borrower to settle in a manner that would cause the investor to receive an amount in excess of an unpaid amount of principal and interest.
- Clearly links the assessment of different types of features to the "payments of principal and interest" principle.

Further, the boards should provide guidance that clearly defines and addresses both nonrecourse debt and debt that is indexed or otherwise contractually linked to the performance of underlying assets. We believe the guidance should be the same or similar in the evaluation of economically similar instruments. In the case of nonrecourse debt, the guidance should also clarify when asset-specific risk becomes so significant that the originating entity does not provide lending but is de facto purchasing the risk or rewards inherent in an asset.

Another source of complexity in the proposed ASU is the allocation of debt instruments. Under the proposed ASU, an entity that acquires or originates a pool of instruments anticipating that a portion of the pool will be held to collect contractual cash flows and another portion sold, but has not identified which instruments will be held and which will be sold, must allocate a percentage of the instruments to appropriate classification categories. However, this guidance appears to be inconsistent with the proposed ASU's fair value through other comprehensive income (FV-OCI) business model objective, which states, in part, that if an "entity has not yet determined whether it will hold the individual asset to collect contractual cash flows or sell the asset," the entity's business model is consistent with the FV-OCI category. In addition, if the Board proceeds with the guidance on pools of similar financial instruments, we request that it clarify:

- Whether an entity would allocate a percentage of the pool with the resultant portion composed of whole loans or percentages of individual loans.

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- How impairment, reclassifications, write-downs, or subsequent sales should be assessed for the portions allocated to different categories and how the resultant adjustments or allowances should be allocated.
- Whether hedge accounting would be allowed and, if so, how it would be applied to individual assets (or portions of assets) within the pool. For example, if an asset in the pool is ultimately sold, how the entity would know whether the asset sold was a hedged item in whole or in part.

Decision-Useful Information

We encourage the Board to conduct appropriate outreach to financial statement users to assess whether the expected results of applying the proposed ASU will provide those users with more relevant, decision-useful information. We observe that the additional disclosures proposed may represent an incremental burden for preparers to gather and disclose the information that would be required but may not provide users with decision-useful information.

As noted above, we support the Board's proposed ASU with some significant modifications. The appendixes below contain additional comments as well as our detailed responses to the questions in the proposed ASU. They include recommendations that we believe should be followed before a final ASU is issued.

Deloitte & Touche LLP appreciates your consideration of our comments on the proposed ASU. If you have any questions, please contact Magnus Orrell at (203) 761-3402.

Yours truly,
Deloitte & Touche LLP

CC: Robert Uhl

Appendix A
Deloitte & Touche LLP
Key Areas of Difference Between the FASB's Proposed ASU and IFRS 9

Below we discuss differences we have observed between the proposed ASU and IFRS 9. We recommend that the FASB and IASB jointly redeliberate remaining areas of divergence to eliminate significant differences and reach agreement on converged requirements.

- *Initial measurement of financial instruments* — While the initial measurement amounts that would result from applying the FASB's proposed ASU and IFRS 9 may be similar in many cases, each contain different guidance on how to determine the initial measurement of financial assets and financial liabilities that are not subsequently measured at FV-NI. We generally support the principle underlying the FASB's proposed requirement to assess whether differences between transaction price and fair value at initial recognition are attributable to something other than the instrument and accounting for the other element appropriately. We note that questions have been raised related to the initial measurement of loans by development banks and transactions that contain multiple elements (e.g., a combination of a swap and a loan). We recommend that the boards converge their respective initial measurement guidance.
- *Ability to account for equity investments that would otherwise qualify for the equity method of accounting at FV-NI* — Under the FASB's proposed ASU, equity investments that are held for sale when they initially qualify for the equity method of accounting would be accounted for at FV-NI (unless they qualify for a practicability exception proposed in paragraph 323-10-15-4(e)). The IASB does not include this requirement in IFRSs. We generally support accounting for equity investments at FV-NI and the FASB's proposed practicability exception, which should also apply to equity investments held for sale that would otherwise qualify for the equity method of accounting.
- *Ability to account for equity investments at FV-OCI* — The FASB's proposed ASU would not permit an entity to account for equity investments at FV-OCI. Paragraph 5.7.5 of IFRS 9 permits an entity to make an irrevocable election to account for equity investments that are not held for trading at FV-OCI. We generally support accounting for equity investments at FV-NI and the FASB's proposed practicability exception. However, if the boards were to converge their models by permitting entities to make an election to account for equity investments at FV-OCI, we believe that until the joint project on the concept of other comprehensive income is completed, unrealized gains and losses in accumulated other comprehensive income should not be permanently deferred within equity as specified under IFRS 9 but rather reclassified to net income at an appropriate time, such as on derecognition of the instrument. We also acknowledge that permitting equity investments to be accounted for at FV-OCI necessitates a related impairment model. We generally do not support the one-step impairment model that the FASB proposes to apply to equity method investments and equity investments accounted for under the practicability exception. We would recommend retaining the other-than-temporary-impairment guidance but with clearer guidelines to reduce complexity and diversity in practice.
- *Business model description for FV-OCI* — Paragraph 825-10-25-25(b)(2) of the FASB's proposed ASU indicates that if an "entity has not yet determined whether it will hold the individual asset to collect contractual cash flows or sell the asset," the entity's business

- model is consistent with the FV-OCI category. Currently, IFRS 9 does not provide similar guidance. We believe that a business model definition of the FV-OCI category is unnecessary and that this category should be treated as a residual category. In addition, we believe that the business model definitions and related guidance should be strengthened to clearly identify instruments that should be accounted for at amortized cost or FV-NI.
- *Practicability exception from fair value measurement for equity investments without readily determinable fair values* — Paragraph 825-10-35-17 of the FASB's proposed ASU permits entities to account for certain equity investments without readily determinable fair values at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical investment or a similar investment of the same issuer. A similar practicability exception is not provided in IFRS 9. The proposed practicability exception will reduce the cost and complexity of applying the proposed ASU, and we support providing one.
 - *Fair value option* — The conditions under which an entity may elect to account for certain instruments at FV-NI are not the same in the FASB's proposed ASU and IFRS 9. Incorporating conditions adds complexity to the model, and the conditions may need to be revised in the future as financial markets and products change over time. We thus support an unrestricted irrevocable option, permitting entities to elect at initial recognition to account for financial instruments at FV-NI. While we acknowledge that some believe that an unconditional fair value option reduces comparability, there are many different sources of potential diversity in practice under the proposed ASU. If the FASB proceeds with a conditional fair value option, we believe that the boards should converge the conditions under which an entity may elect the fair value option. In all cases, entities should be required to disclose the reasons why they chose to use the fair value option.
 - *Reclassification date for financial assets* — Paragraph 825-10-35-23 of the FASB's proposed ASU requires an entity to recognize a reclassification of financial assets as of the last day of the reporting period in which the change in business model occurs; however, IFRS 9 requires an entity to recognize a reclassification as of the first day of the next reporting period as specified in Appendix A of IFRS 9. We believe that reclassifications should be recognized and disclosed in the period in which the change in business model occurs, as proposed by the FASB.
 - *Loan commitments, revolving lines of credit, and commercial letters of credit* — The proposed ASU would require an entity to account for a loan commitment, revolving line of credit, or commercial letter of credit (collectively, loan commitments) at FV-NI, fair value with all qualifying changes in fair value recognized in other comprehensive income, or amortized cost, depending on the classification of the loan that may result from the exercise of the commitment if such exercise is not remote. IFRS 9 excludes most loan commitments from its scope. We would support converged guidance that is based on the FASB's proposed accounting for loan commitments.
 - *Method for computing foreign currency gains and losses on monetary items in the FV-OCI category* — The proposed ASU would require an entity to use a fair-value based method to measure foreign currency gains and losses on financial assets accounted for at FV-OCI. Such gains or losses would be recognized in net income. IFRS 9 would require an entity to use an amortized cost method of computing such foreign currency gains and losses as described in paragraphs B5.7.2 and IG E.3.4 of IFRS 9. We believe that the

IASB's method for calculating such gains and losses is conceptually superior to the FASB's proposed method. Calculating foreign currency gains and losses on an amortized cost basis ensures comparability with the calculation of foreign currency gains and losses on financial assets and financial liabilities accounted for at amortized cost. Further, a calculation of foreign currency gains and losses that is based on the period change in the foreign exchange rate and a current-period fair value is not necessarily additive over time. To illustrate, if the foreign currency component is computed as the product of the period change in exchange rates and the current-period fair value in each period, the accumulated amount of calculated foreign currency gains and losses over time will not reflect the accumulated amount of foreign currency gains and losses on the basis of the original cost and the current-period fair value.

Appendix B
Deloitte & Touche LLP
Responses to Proposed ASU's Questions for Respondents (File Reference No. 2013-220)

Question 1: Do you agree with the scope of financial instruments included in this proposed Update? If not, which other financial instruments should be included or excluded from the guidance in this proposed Update and why?

We generally agree with the proposed ASU's scope. However, we note that since it applies to all financial instruments except those specifically exempted, there will be an increased focus on whether a contract meets the definition of a financial instrument. We encourage the Board to consider whether to provide additional implementation guidance on the application of the definition of a financial instrument. Further, we recommend that the Board clarify the application of the following proposed scope exemptions:

Derivatives

- Unless otherwise exempted, freestanding financial instruments that do not meet the definition of a derivative in ASC 815 are included in the scope of the proposed ASU because they do not have one or more of the required characteristics of a derivative. Therefore, entities will account for certain financial instruments not currently accounted for as derivatives (e.g., a physically settled option to purchase or sell a private equity share) at FV-NI (or under the practicability exception for equity investments without a readily determinable fair value). This represents a significant change in practice for such contracts. We recommend that the Board explain its reasoning for this change in the Basis for Conclusions of the final ASU.

Certain Financial Instruments Within the Scope of ASC 944

- Paragraph 825-10-15-8(d) of the proposed ASU provides scope exemptions for financial instruments within the scope of ASC 944 except for (1) a mortgage loan subject to ASC 944-310 (although the presentation requirements for mortgage loans therein remain in effect), (2) an investment in debt or equity securities subject to ASC 944-320, and (3) an investment subject to ASC 944-325. The consequential amendments to the *FASB Accounting Standards Codification* resulting from the proposed ASU would eliminate mortgage loans from the scope of ASC 944-310 and supersede ASC 944-320 and ASC 944-325 (see File Reference No. 2013-221). Because this guidance would be removed, it could no longer be applied to mortgage loans and other investments, which could result in confusion about what the scope of the proposed ASU includes. We recommend providing language in the proposed Subtopic 825-10 explicitly describing the instruments that are not within its scope.

Question 2: Do you agree with the industry-specific specialized guidance scope exceptions in paragraph 825-10-15-9? If not, why? What would you propose instead?

We generally agree with the industry-specific specialized guidance scope exceptions in the proposed ASU. However, we believe that the FASB should give investment companies subject to ASC 946 an option to apply the practicability exception described in paragraph 825-10-35-17,

which permits an entity to measure equity investments without readily determinable fair values that are not subject to the practical expedient in paragraph 820-10-35-59 at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical investment or a similar investment of the same issuer.

We acknowledge that certain entities that are subject to ASC 946 may not be permitted to apply such an option under regulatory guidance, such as those that are required to value securities at market or fair value under Regulation S-X, Article 6. However, we believe that the cost-based measurement permitted by the practicability exception in paragraph 825-10-35-17 is more closely linked to the way (1) certain investment companies expect to benefit from the cash flows of private-entity equity investments (i.e., not through a sale in the near term but as conditions develop under which an initial public offering may occur or the frequency of trades in the secondary market increases) and (2) they manage these investments (i.e., as a longer-term investment). For investment companies subject to ASC 946 that would be permitted to apply such an option, the practicability exception would also reduce the cost and complexity of measuring the fair value of equity investments without readily determinable fair values.

Question 4: Do the proposed amendments appropriately convey the principle associated with the contractual cash flow characteristics assessment? If not, why? What would you propose instead?

The proposed principle associated with the contractual cash flow characteristics assessment is that a “financial asset is classified at something other than fair value with all changes in **fair value** recognized in net income if . . . the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.” We believe the objective of this principle is to identify “normal lending arrangements” with “basic loan features” that should qualify for a classification at something other than fair value with all changes in fair value recognized in net income. We recommend that the FASB explicitly refer to this objective in describing the principle of “solely payments of principal and interest.”

We note that the use of the term “solely” may be misleading. For example, cash flows resulting from a contractual term that creates leverage or an interest rate reset mismatch would not cause an instrument to fail the contractual cash flow characteristics assessment if such terms do not result in cash flows that are more than insignificantly different from the cash flows of a benchmark instrument. That is, an insignificant amount of cash flows for something other than principal and interest would be permitted. “Solely” may not be an appropriate term to use.

Further, we believe that the definition of interest should be modified. The proposed ASU defines interest as “consideration for the time value of money and for the credit risk associated with the principal amount outstanding during a particular period of time, which may include a premium for liquidity risk.” The definition should clearly indicate that other components could form part of interest, such as profit margins, that do not contradict the objective of identifying instruments with contractual cash flows that are payments of principal and interest. In practice, entities use pricing methods, particularly for loan arrangements that use a building-block approach (which also reflects the refinancing cost of the entity). We further believe that additional clarification of the concept of “time value of money” is necessary, in particular whether that concept should reflect the way pricing mechanisms work in the economy where the financial instrument is originated.

In addition, it is unclear whether this definition of interest would preclude amortized cost accounting (or FV-OCI) for loans indexed to bank capital requirements. While we acknowledge that the illustrative example in paragraph 825-10-55-50 indicates that a loan indexed to a lender's published rate would pass the contractual cash flow characteristics assessment, we believe that this indicates elements other than time value of money, credit risk, liquidity risk, or profit margins may be incorporated into the definition of interest because a bank's published rate may be adjusted not only for these elements but also in response to changes in regulatory requirements. We recommend that the boards develop guidance that reflects this fact.

We have other concerns about some of the detailed guidance related to this principle, which we discuss in our cover letter and in our responses to Questions 5 through 9 below.

Question 5: The proposed amendments define principal as the amount transferred by the holder at initial recognition. Should the definition of principal be expanded to include repayment of the principal amount at maturity or other settlement? If so, what instruments would fail (or pass) the contractual cash flow characteristics criterion as a result of this change?

The proposed definition of "principal" may prohibit amortized-cost accounting for instruments that we believe should qualify for accounting at amortized cost; however, we do not believe expanding the definition to include repayment of the principal amount at maturity or other settlement will resolve this issue.

Specifically, the proposed definition of principal may cause certain debt instruments to fail the contractual cash flow characteristics assessment even though it may be more appropriate to permit entities to account for such instruments at amortized cost or FV-OCI. For example, a debt security acquired at a significant discount that is callable by the issuer at par may fail the contractual cash flow characteristics assessment because the par amount differs from the amount transferred at initial recognition, and the difference would not represent consideration for the time value of money or credit risk at the time the option is exercised. For the same reason, a loan asset acquired in the secondary market at a significant discount and that is prepayable by the borrower at par (e.g., a prepayable purchased credit impaired loan) may fail the contractual cash flow characteristics assessment. Similar issues apply to financial assets that are acquired at par but callable by the issuer at a significant premium to par and financial assets that are acquired at par but puttable at a significant discount to par. We do not believe that entities should be automatically precluded from accounting for such instruments at something other than FV-NI.

The IASB does not define "principal" in IFRS 9 (2010) or ED/2012/4 but indicates in the Basis for Conclusions for IFRS 9 that principal would be considered the funded amount (rather than the amount transferred by the holder). In addition, paragraph 825-10-55-14 of the FASB's proposed ASU states, "Cash flows that are interest always have a close relation to the amount advanced to the debtor (that is, the *funded amount*)" (emphasis added). This may suggest that the principal amount should be defined as the amount originally funded rather than the amount transferred by the holder.

We recommend that in addition to amending the definition of principal to refer to the funded amount rather than the amount transferred by the holder, the FASB require entities to disregard

the following types of features in assessing the contractual cash flow characteristics of a financial asset:

- Terms that permit, but do not require, an investor to settle in a manner that would cause it not to receive all unpaid amounts of principal and interest (i.e., the investor could not be forced to accept such a settlement outcome).
- Terms that permit the issuer (or borrower) to settle in a manner that would cause the investor to receive an amount in excess of unpaid amounts of principal and interest.

We believe that floating interest rate-only strips generally should fail the contractual cash flow characteristics test as their exposure to changes in market factors is leveraged because of the lack of a principal repayment at maturity. This issue could potentially be resolved by amending the definition of principal to require a principal repayment at maturity. We recommend that the Board clarify how to apply the contractual cash flow characteristics test to floating-rate interest-only strips, prepayable fixed interest-only strips, and prepayable principal-only strips.

If the Board were to require a repayment at maturity or other settlement in the definition of principal, it should consider consequential amendments to the application guidance related to perpetual instruments proposed in paragraphs 825-10-55-60 through 55-63. Under such guidance, repayment at maturity is not required.

Question 6: Do the proposed amendments contain sufficient application guidance and illustrations on implementing the cash flow characteristics assessment? If not, why?

We are concerned that the application guidance does not address common contractual terms or features often included in debt agreements other than prepayment and extension options, terms that create leverage, or terms that create an interest rate reset mismatch. We recommend that the Board provide guidance to illustrate the application of the cash flow characteristics assessment to interest rate features indexed to averages of published historical borrowing rates or to creditor-specific loan funding costs.

Paragraph 825-10-55-24 suggests that an entity would not consider the probability of a contingent event that would change the timing or amount of contractual cash flows if it results in cash flows that are not solely payments of principal and interest on the principal amount outstanding. Yet, an entity would disregard contractual terms that would change the timing or amount of contractual cash flows on the basis of the occurrence of a contingent event that is extremely rare, highly abnormal, and very unlikely to occur. This guidance is logically inconsistent (i.e., an entity would not consider the probability of an event but would consider whether the event is very unlikely to occur). Further, it is not clear how an entity would assess whether the contingent cash flows are or are not solely payments of principal and interest on the principal amount outstanding. We believe the FASB can address this by developing a consistent set of coherent principles for assessing common features, as described in our cover letter.

The application guidance related to the contractual cash flow characteristics assessment for an instrument that includes a prepayment option may require FV-NI accounting for debt instruments that are (1) prepayable by the borrower or issuer at par if they are acquired at a significant discount, (2) callable by the borrower or issuer at a significant premium to par if they are acquired

at par, (3) puttable by the investor at a significant discount if they are acquired at par, and (4) puttable by the investor at par if they are acquired at a significant premium. We do not believe that this is an appropriate accounting outcome. We recommend that the boards indicate that a prepayment term that gives the debtor a right to accelerate the payment of the debt, on terms that would give the investor more than adequate compensation for the time value of money, does not disqualify the feature from meeting the “solely payment of principal and interest” principle provided the prepayment feature is exercisable only by the debtor (and not by the investor). Similarly, we believe that a prepayment term that gives the investor a right to accelerate the payment of the debt on terms that would not give the investor adequate compensation for the time value of money should not disqualify the feature from meeting the principle provided the feature is only exercisable by the investor (and not by the debtor) since the investor cannot be forced to accept that low return.

In addition, we believe the application guidance in paragraph 825-10-55-22 related to extension options could be further clarified to describe how an entity would assess whether the terms of the extension option result in contractual cash flows during the extension period that are solely payments of principal and interest on the principal amount outstanding. Because extension options can often be exercised at any point during a wide window of time (e.g., during the period beginning immediately after origination and ending upon expiration of the option or maturity of the instrument if the option is not exercised), the assessment of what represents consideration for time value of money and credit risk during the extension period may be operationally difficult at initial recognition of the instrument.

We also recommend that the guidance on evaluating contingent features be consistent irrespective of whether such features result from a contingent prepayment option, contingent extension option, or other contingent feature. The evaluation of contingent features would not include an assessment of nonsubstantive or nongenuine features.

Finally, we suggest making the following changes to clarify application guidance on the contractual cash flow characteristics assessment:

- Paragraph 825-10-55-25 should provide guidance clarifying the meaning of punitive rate.
- Paragraph 825-10-55-45 provides an example of a bond for which the payments of principal and interest are linked to an inflation index of the currency in which the instrument is denominated to illustrate the contractual cash flows assessment. We suggest providing an example of a bond that is linked to an inflation index of a foreign currency (i.e., currency that differs from that in which the instrument is denominated).
- The application guidance in paragraph 825-10-55-47 appears to clarify the principle underlying the contractual cash flows assessment. We recommend that this guidance be included prominently in the standard or application guidance presented in the section on assessing contractual cash flows that begins in paragraph 825-10-55-14 to clarify that it broadly applies to various instruments.
- Paragraph 825-10-55-60 should explain how an entity would determine what a market rate would be for a perpetual instrument.

In addition, we request guidance clarifying whether the following instruments would meet the contractual cash flow characteristics criterion:

- Credit cards or adjustable-rate mortgages with below-market introductory rates.
- Loans indexed to a bank's prime rate, which may not have a specified tenor.
- Auction rate securities for which the applicable interest rate also does not have a specified tenor.
- Instruments indexed to underlyings related to physical variables (e.g., weather), a specified volume or sales or service revenue, or to nonfinancial assets or liabilities of one party to the contract.
- Debt-like equity instruments, such as an investment in mandatorily redeemable preferred securities. The proposed definitions of "debt instrument" and "equity investment" and the application guidance related to the contractual cash flows assessment provide insufficient guidance on whether such investments must be carried at FV-NI as equity investments or whether such instruments could be accounted for as debt instruments subject to the proposed classification model for financial assets.

Question 7: Should a financial asset with a contractual term that modifies the economic relationship (see paragraphs 825-10-55-17 through 55-20) between principal and interest be considered to contain cash flows that are solely payments of principal and interest? Should this be the case if, and only if, the contractual cash flows could or could not be more than insignificantly different from the benchmark cash flows as discussed in paragraph 825-10-55-19? If not, why? What would you propose instead?

Conceptually, we do not object to the view that financial assets with minor interest rate mismatch features or leverage should be available for a classification other than FV-NI. However, we are concerned that the proposed guidance is not sufficiently clear, is difficult to operationalize, and will potentially lead to divergence in practice. Our concerns are discussed in our response to Question 8 below.

Question 8: Do the proposed amendments contain sufficient application guidance in paragraphs 825-10-55-17 through 55-20 on assessing a modified economic relationship? If not, why?

We are concerned that the guidance on assessing a modified economic relationship is not sufficiently clear and adds to the complexity of the model. Specifically, we believe there is a lack of clarity about how the “benchmark test” should be performed. It is not clear, for example, whether the test should be performed on the basis of undiscounted cash flows, changes in the effective interest rate, or present value. We also note that preparers may find it practically difficult to identify a benchmark instrument or to develop a hypothetical benchmark instrument. It is unclear how to identify a benchmark instrument when there are multiple modifiers to an instrument’s economic relationship (e.g., whether a clean-host approach should be taken under which the modifiers are examined in the aggregate). Finally, it is not clear whether the assessment would only be quantitative in nature or whether a qualitative assessment is also required.

We believe that the evaluation of contingent features and of terms that modify the relationship should be governed by a consistent and coherent set of principles and should concentrate on the objective behind the principle of “solely principal and interest.” Further, we recommend reconsidering whether “more than insignificant” is an appropriate threshold, clarifying the meaning of “more than insignificant” if retained, and providing examples of terms that would result in more than insignificant leverage. Similarly, we recommend providing examples of more than an insignificant interest rate reset mismatch (or an alternative threshold).

We also believe that the related application guidance, if retained, should:

- In paragraph 820-10-55-19, clarify how an entity should analyze an instrument with multiple terms that modify the relationship between principal and interest.
- Also in paragraph 820-10-55-19, clarify the last sentence to state that a detailed assessment is not needed if it is clear with little or no analysis that *it is reasonably possible* that the cash flows of the financial asset under assessment could or could not be more than insignificantly different from the cash flows the benchmark instrument. This would achieve consistency with paragraph 825-10-55-20, which states an entity is required to only consider reasonably possible scenarios.
- In paragraph 825-10-55-51, address how an entity would determine the rate for a benchmark instrument used to evaluate the terms of a choose-your-rate instrument when there are several rate choices.

Question 9: For beneficial interests in securitized financial assets, the proposed amendments would require an entity to look through to the underlying pool of instruments in determining whether the tranche contains payments of solely principal and interest. Do you agree with this look-through approach? If not, why? What would you propose instead?

We generally support of the proposed guidance requiring entities to assess the contractual cash flow characteristics of beneficial interests in securitized financial assets and generally agree with the objective of the look-through approach prescribed. However, we note that the criterion in paragraph 825-10-55-26(c) could result in counterintuitive classifications for investments of differing credit quality. Paragraph 825-10-55-26(c) requires that the exposure to credit risk in the underlying pool of financial instruments that are inherent in the tranche of beneficial interest is

equal to or lower than the exposure to credit risk of the underlying pool for the investment to qualify for amortized cost or FV-OCI. As a result, investments in subordinated tranches of securitized financial assets composed entirely of high-quality debt instruments would not pass the cash flow characteristics assessment and would not qualify for the amortized cost or FV-OCI classification. However, an investment in the senior tranche of securitized financial assets composed entirely of junk bonds might meet the condition in paragraph 825-10-55-26(c). Provided the other conditions in paragraph 825-10-55-26 are met, the investment would be eligible for the amortized cost or FV-OCI classifications even though the credit risk and cash-flow variability inherent in the tranche is much higher than that of the subordinated tranche linked to Treasury securities. An alternative approach might be to require an evaluation of (1) credit risk in absolute terms (i.e., relative to prevailing market conditions instead of to the average credit risk of the underlying pool) or (2) the cash flow variability inherent in the tranche (although this would be inconsistent with the assessment of direct investments in loans and debt securities).

We are also concerned that the proposed ASU does not provide “look through” guidance for instruments that may be economically similar to a beneficial interest in securitized financial assets but for which the issuer is not a securitization vehicle. For example, an entity that holds nonrecourse financial assets for which payment of principal and interest is linked to (and may only come from) the performance of underlying receivables must assess the contractual cash flows of the nonrecourse financial asset to determine whether it could qualify for the amortized cost or FV-OCI classification. However, it is not clear whether the entity would look through to the underlying assets to determine whether the nonrecourse financial assets meet the cash flow characteristics assessment. IFRS 9 suggests that entities in certain circumstances should look through to the underlying assets or cash flows to determine whether a nonrecourse financial asset provides contractual cash flows that are payments of principal and interest (see paragraph B4.1.17 of IFRS 9 (2010)).

Finally, we suggest clarifying related application guidance as follows:

- Paragraph 825-10-55-26(b)(ii) should indicate whether an entity must look through to a single securitization trust or to a hypothetical pool of all instruments that create the cash flows passed to beneficial interest holders, regardless of which vehicle holds the underlying assets (e.g., in a resecuritization).
- Paragraph 825-10-55-26(c) should state whether this condition would not be met if a tranche would lose 51 percent or more of its cash flows if the underlying pool of instruments were to lose 50 percent, and it should more clearly state whether the 50 percent threshold used in this example is meant to be a bright line when the condition in this paragraph is interpreted.
- Paragraphs 825-10-55-65 through 55-67 should provide a more detailed qualitative assessment and include a quantification of the average credit risk of the individual tranches and the underlying pool such that the example provides a conclusion about whether the subordinated tranche meets the contractual cash flow characteristics assessment.
- Paragraph 825-10-55-68 should state that the assets are sufficient to fund any losses on the credit default swap as long as the assets’ fair values do not decline significantly.
- The first sentence of paragraph 825-10-55-69 should be deleted and the paragraph should conclude that it is not necessary to assess each individual tranche when other conditions

indicate that the beneficial interest will not pass the contractual cash flow characteristics assessment (e.g., because the contractual terms of the beneficial interest do not give rise to cash flows that are solely payments of principal and interest or because the underlying pool includes instruments that increase the cash flow variability of instruments in the underlying pool that otherwise provide cash flows that are solely payments of principal and interest).

- The boards should clarify whether the actual seizure of collateral in the pool leads to measurement at fair value through profit or loss. In our view, seizing collateral to protect the lender with the intent of monetizing the collateral as soon as practically possible should not preclude amortized cost treatment.

Question 10: Do the proposed amendments appropriately convey the principle associated with the business model assessment? If not, why? What would you propose instead?

We generally believe that the proposed principle associated with the business model assessment is appropriately conveyed, and we support the introduction of the business model assessment in addition to the contractual cash flow characteristics assessment as a model for identifying instruments that would be classified in a category other than FV-NI. In addition, we generally agree that instruments held within a business model for which the objective is to hold financial assets to collect contractual cash flows should be accounted for at amortized cost. Further, pending further work by the FASB and the IASB to determine what is the conceptual basis and purpose of other comprehensive income and how this information should be presented in a set of financial statements, we support the FASB's proposal to include FV-OCI as one of the three primary classification categories in the proposed ASU. However, we believe that the objective underlying this business model is not clear, and we suggest defining the FV-OCI category as the residual category since this would better reflect the intermediate nature of this category relative to assets that are held with the objective of collecting their contractual cash flows and assets that are held with the express objective of selling or trading them.

Further, the level at which the business model should be assessed is not clear. We recommend that the boards clarify whether an entity could identify multiple distinct business models with the same objective and similar assets (e.g., multiple amortized cost business models for various segments of a loan portfolio). Such clarification will also help entities assess (1) whether sales activities from a given business model are consistent with the hold-to-collect objective for that specific business model (or portfolio, or throughout the entity) and (2) the level at which an entity should assess changes in business models to recognize reclassifications.

Question 11: Do the proposed amendments provide sufficient application guidance and illustrations on how to distinguish among the three business models, including determining whether the business model is to manage assets both to collect contractual cash flows and to sell? Do you agree with the proposed guidance provided to describe those business models? If not, why?

We believe that the distinction between the business models is difficult, even under the proposed application guidance. The dividing lines between the models are not sufficiently clear, which may lead to significant divergence in practice. As discussed in our response to Question 10, we believe that the FV-OCI category should be defined as the residual category to better reflect its intermediate character between assets that are held to collect their contractual cash flows and

assets that are held for sale. We believe this would help mitigate some of the uncertainty related to what goes into the FV-OCI category and what it represents.

We are concerned that differences in the application guidance on the business model assessment between the proposed ASU and the IASB's model will lead to different classifications of similar instruments held in business models with similar objectives depending on whether the holder is applying U.S. GAAP or IFRSs. For example, the proposed ASU provides a list of "permissible sales" or sales activities for reasons other than significant credit deterioration that would still be consistent with the hold-to-collect business model. These include sales in response to a change in tax law, major business combinations or dispositions, and changes in statutory or regulatory requirements. IFRS 9 does not include a similar list. While we support providing a list of "permissible sales," we suggest that the list be expanded to also note that the following would be consistent with the hold-to-collect objective:

- Instances in which a regulator requires the reporting entity to sell instruments from its amortized cost portfolio regardless of whether the regulator requires all other entities under its jurisdiction to make similar sales.
- Instances in which an entity sells instruments from its amortized cost portfolio to address unanticipated imbalances in exposures to credit, industry, or geographical risk, or other concentrations of risk.
- Sales of insignificant volume.

In addition, the proposed application guidance in the IASB's ED/2012/4 on determining whether sales out of an amortized cost business model are inconsistent with the hold-to-collect objective suggests that entities should consider the frequency and volume of sales. Specifically, paragraph B4.1.3 in ED/2012/4 states that "[s]ales that occur for [reasons other than deterioration in the assets' credit quality] may also be consistent with a business model whose objective is to hold financial assets in order to collect contractual cash flows if such sales are *infrequent (even if significant) or insignificant both individually and in aggregate (even if frequent)*" (emphasis added). The FASB does not suggest a similar approach to analyzing sales activity in its proposed ASU.

Finally, we believe that the FASB should clarify what kind of documentation is needed to support an entity's business model assessment. For example, the proposed application guidance in paragraph 825-10-55-28 could be modified to clarify that the objective evidence described would be included in supporting documentation and would include the entity's business model objectives, related activities (sales and activities related to its documented investment strategy), the level at which the business model is assessed, the financial instruments that are included in each of the entity's business model, and other relevant information.

Question 12: Should the classification and measurement model for financial instruments contain an explicit tainting notion or should it rely on the principle and exercise of professional judgment? Why?

We believe a tainting notion is not necessary in the application of a classification and measurement model based on objectively determinable business models. However, we recommend that the Board provide guidance on sales from an amortized cost portfolio that occur

more than infrequently or for reasons other than those contemplated in the proposed application guidance. The guidance should clarify whether these should be treated as an indicator that the business model may have changed or is in the process of changing. Alternatively, it should clarify when, if ever, such sales would indicate that the original classification was an error. The guidance should also address subsequent sales of instruments originally issued or acquired as part of a pool of instruments that was allocated to multiple categories because the entity had not specifically identified which instrument would be held and which would be sold at initial recognition.

Question 13: The proposed amendments would require loan commitments, a revolving line of credit, or a commercial letter of credit (the potential creditor) to be measured on the basis of the likelihood of exercise of the commitment and the classification of the underlying loan that would be made upon exercise of the commitment. Do you agree with the proposed classification of loan commitments? If not, why? What would you propose instead?

We generally agree with the proposed classification of loan commitments, revolving lines of credit, and commercial letters of credit. However, we recommend that the Board consider whether loan commitments related to loans that will be classified as FV-NI should be measured at fair value regardless of the likelihood that the loan commitment will be exercised because a fair value measurement will incorporate market participant assumptions about the likelihood of exercise.

In addition, we note that the language in paragraph 825-10-25-28 may be confusing. The last sentence states, “Thus, an entity would classify a loan commitment consistent with the classification categories in paragraph 825-10-25-25 only if the underlying loan that would be made upon exercise of the commitment meets the contractual cash flow characteristics criterion in paragraph 825-10-25-17 and is managed in a business model consistent with paragraph 825-10-25-25.” All loans that meet the contractual cash flow characteristics criterion would be managed in a business model in accordance with paragraph 825-10-25-25 because one category is a default FV-NI. Thus, it is unnecessary to explicitly state that this is a condition for aligning classification of loan commitments with classification of the underlying loan.

Finally, the subsequent measurement guidance in paragraph 825-10-35-20 is not clear. The guidance states, “[I]f the underlying loan, when originated, is measured at fair value, the loan commitment also would be measured at fair value.” It is not clear whether the loan commitment should be subsequently measured at FV-NI or at FV-OCI if the underlying loan would also be classified in this category under paragraph 825-10-25-25. We recommend that the FASB consistently differentiate between the fair value categories to avoid confusion.

Question 14: Do you agree with the initial measurement principles for financial instruments? If not, why?

We generally agree with the proposed principles for the initial measurement of financial instruments. We recommend that the Board provide examples that illustrate the application of the initial measurement principles for financial instruments, including for transactions with multiple elements such as those in which an investor enters into an interest rate swap and originates a loan that would qualify for accounting at amortized cost.

In addition, we question whether it is necessary to refer to “a lending or other transaction” in paragraph 825-10-30-6 and recommend that the FASB instead refer only to “transactions.”

Question 16: Should financial liabilities subsequently be measured at amortized cost, unless certain exceptions are met? If not, why?

We agree that financial liabilities should be subsequently measured at amortized cost unless certain exceptions are met.

Question 17: The proposed amendments would require a nonrecourse financial liability that is settled with only the cash flows from the related financial assets (see paragraph 825-10-35-11) to be measured on the same basis as those assets. Do you agree with the proposed amendments? If not, why? What would you propose instead?

We generally agree with the proposed approach for aligning the measurement of nonrecourse financial liabilities and related assets, although we recommend that the FASB define “nonrecourse.”

Further, we recommend that the Board consider providing special measurement guidance on nonrecourse financial assets that contractually permit payments of solely principal and interest on the principal amount outstanding but for which the creditor’s claim is limited to specified assets or cash flows (e.g., the value of specified equity securities or sales or service revenue) and the contractual cash flows from the asset are likely to vary because of such risk rather than because of credit risk. Finally, we believe that the FASB should provide similar accounting for assets for which contractual cash flows depend on the performance of underlying assets in an economically similar manner, whether that is due to nonrecourse features or a contractually specified indexation of the cash flows.

Question 18: The proposed amendments would require financial assets measured at amortized cost that are subsequently identified for sale to continue to be classified and measured at amortized cost less impairment and would prohibit recognition of the gain, until the sale is complete. Do you agree with the proposed classification and measurement requirements? If not, why?

As discussed in our response to Question 12, we believe the Board should clarify the circumstances in which subsequent sales from an amortized cost classification indicate that the business model has changed or is in the process of changing.

In addition, we suggest that the Board clarify the conditions that must be met for an amortized-cost financial asset to be considered “subsequently identified for sale” and that such guidance clarify the period in which the entity expects to sell the asset and the documentation and sales activities that would support such assertions. Without such guidance, we would expect questions about the level of documentation or activities that should accompany the “subsequently identified for sale” classification if, for example, instruments are identified for sale but not sold for extended periods of time (e.g., greater than one year).

Question 19: The proposed amendments would provide a practicability exception for measuring equity investments without readily determinable fair values that do not qualify for the practical

expedient in paragraph 820-10-35-59 (that is, the net asset value per share expedient) and a one-step impairment model for all equity investments subject to the practicability exception. Do you agree with the proposed amendments? If not, why?

We generally agree with the Board's decision to provide a practicability exception to fair value for equity investments that do not have readily determinable fair values on the basis of cost minus impairment, if any, plus or minus changes resulting from observable price changes in observable transactions in orderly transactions for the identical investment or a similar investment of the same issuer. We recommend, however, that the Board explore whether it needs to clarify that an entity should disregard transactions that are clearly not on arm's-length terms (e.g., if the investor or its agent purchases a small number of additional equity shares at an excessive price to increase the carrying amount of the related investment). Further, we observe that the qualitative assessment to determine whether such investments are more likely than not impaired will be challenging when applied to certain private-company equity investments (e.g., early-stage companies backed by venture capital funds). We observe that this could be a source of complexity.

We also recommend giving investment companies subject to ASC 946 an option to apply this practicability exception, as discussed in our response to Question 2.

Finally, we recommend that the FASB retain the reference to restricted stock in the definition of "readily determinable fair value" under ASC 320. That is, the Board should add the sentence "Restricted stock meets that definition if the restriction terminates within one year." to paragraph (a) of the proposed definition of "readily determinable fair value" in the proposed ASU.

Question 20: Should an entity evaluate the need for a valuation allowance on a deferred tax asset related to a debt instrument measured at fair value with qualifying changes in fair value recognized in other comprehensive income separately from the other deferred tax assets of the entity (rather than combined and analyzed together)? If not, why?

We would not object to the proposal's requirement that an entity consider its deferred tax assets related to debt instruments for which qualifying changes in fair value are recognized in other comprehensive income separately from the other deferred tax assets of the entity in evaluating the need for a valuation allowance (rather than being combined and analyzed together). If an entity has the intent and ability to hold the debt instrument until the recovery of its amortized cost basis (which may be at maturity), increases and decreases in the debt instrument's fair value will reverse out of other comprehensive income over the contractual life of the investment, resulting in no cumulative change in the entity's comprehensive income or future taxable income over that contractual life. In this respect, the temporary differences associated with unrealized gains and losses on debt instruments are unlike other types of temporary differences because they do not affect either the income statement or the tax return if held until recovery of the debt securities' amortized cost.

We are concerned, however, that the FASB is providing additional, but limited, guidance on how an entity should assess one specific deductible tax difference in this project. The Board has already indicated its belief that application of the more likely than not criteria is appropriate for all forms of negative evidence. We believe that assessing the realizability of deferred tax assets requires the use of much judgment, particularly in determining whether (1) the future realization

of a tax benefit attributable to a tax loss carryforward or deductible difference will be expected for a portion, but not all, of the asset or (2) a group of assets should be evaluated collectively. ASC 740-10-30-18 states, "Future realization of the tax benefit of an existing deductible temporary difference or carryforward ultimately depends on the existence of sufficient taxable income of the appropriate character (for example, ordinary income or capital gain) within the carryback, carryforward period available under the tax law." That paragraph also includes numerous examples of the types of information that entities should consider when assessing realizability. We believe that since this aspect of the proposed ASU is only tangentially related to the broader accounting changes being proposed for financial instruments, the FASB may be better served addressing the diversity in practice related to this issue as part of a more comprehensive income tax accounting project.

Question 21: Under the amendments in this proposed Update, hybrid financial assets would not be required to be analyzed for bifurcation under Subtopic 815-15 and would be assessed in their entirety on the basis of the proposed classification requirements. In contrast, hybrid financial liabilities would be assessed for bifurcation and separate accounting under Subtopic 815-15, and the financial liability host contract would be subject to the proposed amendments. Do you agree with this proposal? If not, why? What would you propose instead?

We agree with the proposed approach to classifying and measuring hybrid financial assets and hybrid financial liabilities. However, we believe that the conditions for applying the fair value option to hybrid financial liabilities should be clarified. We suggest that the Board clarify how an entity would determine whether an embedded derivative significantly modifies the related cash flows. For example, the Board should clarify whether an entity should consider whether such modifications are possible or reasonably possible or whether the entity should develop a best estimate of the modification to the cash flows. The Board should also indicate whether a financial liability with multiple embedded derivatives should be evaluated in the determination of whether all of the features significantly modify the cash flows in the aggregate or whether individual features should be evaluated separately. We recommend that the Board retain the existing unrestricted fair value option under U.S. GAAP.

Question 22: The proposed amendments would require reclassification of financial assets when a change in business model occurs and prescribes how those changes should be subsequently accounted for. Do you agree with the proposed amendment on reclassifications? If not, why?

We support the proposed requirement to reclassify financial assets when a change in business model occurs. This helps ensure that the classification of financial assets reflects the entity's current business model rather than a past business model. However, we request that the Board provide additional application guidance, including examples that illustrate the application of this guidance, and identify instances in which a business model has changed. The application guidance should discuss whether subsequent sales from an amortized cost portfolio indicate a change in a business model that has occurred or may occur. The guidance should also list other factors that should be considered in the determination of whether a business model has changed. Finally, the application guidance should indicate whether entities must assess whether a subsequent reclassification is appropriate after the initial reclassification is made (i.e., whether the activities related to the new business model are consistent with the new business model's objective).

Question 26: The proposed amendments would require an entity to separately recognize in net income changes in fair value attributable to foreign currency gain or loss on foreign-currency-denominated debt securities³ measured at fair value through other comprehensive income (see paragraphs 825-10-45-14 through 45-15). Is the proposed fair-value-based method provided for computing the foreign currency gain or loss component operable? If not, why? What would you propose instead?

While we agree in principle with the proposal to separately recognize in net income changes in fair value attributable to foreign currency gain or loss on foreign-currency-denominated debt investments measured at FV-OCI, we disagree with the proposed fair-value based method. We note that IFRS 9 would require an entity to use an amortized cost method of computing such foreign currency gains and losses as indicated in paragraphs B5.7.2 and IG E.3.4 of IFRS 9. We believe that the IASB's method for calculating such gains and losses is conceptually superior to the FASB's proposed method. Calculating foreign currency gains and losses on an amortized cost basis ensures comparability with the calculation of foreign currency gains and losses on financial assets and financial liabilities accounted for at amortized cost. Further, a calculation of foreign currency gains and losses that is based on the period change in foreign exchange rate and the current-period fair value is not necessarily additive over time.

Question 29: Do you agree with the proposed disclosure requirements? If not, which disclosure requirement would you change and why?

It is unclear how the addition of several new disclosure requirements is consistent with the objectives of the FASB's disclosure framework project to increase the usefulness of relevant disclosures. We recommend that the Board seek and consider the input of preparers and users of financial statements in determining whether to proceed with the proposed disclosure requirements.

In addition, we have the following observations related to specific presentation and disclosure requirements:

- It is unclear whether an entity would be required to provide a classified statement of financial position to comply with the presentation requirements in paragraph 825-10-45-5, under which an entity would parenthetically present on the face of the statement of financial position (1) the fair value of financial assets and financial liabilities that are measured at amortized cost, except for receivables or payables due in less than a year, and (2) demand deposit liabilities. Certain entities (e.g., certain financial institutions) do not present a classified statement of financial position.
- The proposed ASU does not explicitly state whether an entity would be required to present or disclose fair value for equity investments that are measured under the practicability exception or under the equity method of accounting. We recommend that the FASB clarify that such disclosures are not required for equity investments measured under the practicability exception. We would support a requirement to disclose fair value for equity method investments unless it is impracticable to measure such value.

³ We believe that a requirement to separately recognize in net income changes in fair value attributable to foreign currency gain or loss should apply not just to debt securities but also to loans and receivables measured at FV-OCI.

- Paragraph 825-10-45-12 would not require an entity to disclose gains or losses on foreign-currency-denominated financial assets accounted for at amortized cost attributable to changes in foreign currency exchange rates. This may lead some to question whether foreign-currency-denominated debt instruments would fail the contractual cash flows assessment. We recommend that the Board require, along with the other disclosure requirements in paragraph 825-10-45-12, disclosure of foreign currency gains and losses, as applicable.
- Paragraph 825-10-50-42(c) should be amended to be consistent with the measurement approach described in paragraph 825-10-35-17 for equity investments without readily determinable fair values measured under the practicability exception to fair value. The following words should be added to the end of paragraph 825-10-50-42(c): “. . . in orderly transactions for the identical investment or a similar investment of the same issuer.”
- The proposed disclosure requirements for core deposit liabilities may introduce unnecessary complexity and potential inconsistencies between what is disclosed and what is required by applicable regulators.

Question 30: Should an entity be permitted to early adopt only the proposed presentation requirements related to changes in instrument-specific credit risk for hybrid financial liabilities that would qualify for the fair value option under the proposed requirements? If not, why?

While we support an ability to adopt the proposed presentation guidance early, limiting this early adoption option to hybrid financial liabilities that would qualify under the new conditions for the fair value option in proposed paragraphs 825-30-15-2 and 15-3 creates operational complexities and could confuse users of financial statements because only some financial liabilities elected under the fair value option would be subject to the proposed presentation guidance during the period between early adoption and the effective date of the other requirements in the proposed ASU. We recommend that the Board permit the new presentation guidance to be early adopted for all financial liabilities that have been elected under the fair value option irrespective of whether they would qualify under the proposed requirements.

Question 31: Should the effective date be the same for both public entities and nonpublic entities?

We believe that nonpublic entities should be given an additional year beyond the public-company effective date unless that date is set far enough into the future that both public and nonpublic entities would have more than adequate time to implement the new requirements.

Question 32: How much time is needed to implement the proposed guidance?

We believe that two and a half years are appropriate to allow information systems to be updated and implementation issues to be considered. We believe that at a minimum, one and a half years are needed to implement the proposed guidance from the date that the final guidance is released. We also believe that the transition and effective date for this proposed ASU should be coordinated with the transition and effective dates for the credit loss and insurance contracts projects unless doing so would unduly delay the issuance of final classification and measurement guidance.

Question 33: Are the transition provisions in this proposed Update operable? If not, why?

The transition provisions, which require entities to use the cumulative-effect method to apply the guidance in the proposed ASU, appear generally appropriate.

As discussed in our response to Question 30, we have concerns about the proposed transition for the presentation guidance related to the fair value option proposed in paragraph 825-10-65-2(d).

Question 34: The proposed amendments would require investments that qualify for the equity method of accounting in Subtopic 323-10, Investments—Equity Method and Joint Ventures—Overall, to be subsequently measured at fair value with changes in fair value recognized in net income if the investment is held for sale at initial recognition. Are the proposed indicators/conditions operable? If not, why? What would you propose instead?

To reduce complexity associated with evaluating the proposed conditions, we favor an unrestricted fair value option for equity method investments. We note that some have interpreted the proposed “held for sale” conditions as effectively providing an option to account for equity investments that otherwise qualify for the equity method of accounting at FV-NI. It may not be difficult to assert that an entity has identified an exit strategy or a time at which it expects to exit the investment. In fact, we are aware of concerns that the ease of triggering this held-for-sale conclusion could force many, if not most, equity investments that otherwise qualify for the equity method of accounting to instead be accounted for at FV-NI. If the Board proceeds with the proposed approach, it should consider requiring some level of documentation or clarifying whether the determination that such investments are held for sale should be supported by a demonstration of current or historical activities.

Question 35: The proposed amendments would change the current two-step impairment model for equity method investments to a one-step impairment model for all equity investments. Do you agree with the proposed one-step equity impairment model? If not, why? What would you propose instead?

No, we do not support the proposed one-step impairment model for equity method investments. We note that as a result of this impairment model, equity method investments would effectively be carried at the lower of (1) an amount resulting from the application of the equity method (adjusted for prior impairment losses) or (2) fair value. While a qualitative assessment to determine whether an investment is more likely than not impaired may be complex for certain private-company equity investments, when fair value is readily determinable, an entity would effectively mark the investment to its fair value in every period that fair value is less than the

carrying value. Conceptually, it is unclear what is represented by the resulting measurement, which is a hybrid of equity method and fair value information.

Further, the Board should clarify when and how an equity method investment that is written down to its fair value would be subsequently adjusted (especially, written up) for the investor's proportionate share of earnings or losses. In addition, we do not see conceptual merit to prohibiting impairment reversals.

Question 36: Do you agree that the current portfolio-wide option for not-for-profit entities, other than health care entities, to account for their equity method investments at fair value should be retained? If not, why? Should that option also be made available to not-for-profit health care entities that are within the scope of Topic 954, Health Care Entities?

Yes, we support retaining the fair value option for not-for-profit entities in part because of the conceptual and practical issues and complexities surrounding the equity method of accounting. We recommend extending the scope of the fair value option not only to health care entities but to all entities irrespective of industry. Conceptually, there is no reason to limit the option to certain industries only. For these investments, we also recommend that the Board permit entities to apply the practicability exception for equity investments without a readily determinable fair value as an alternative to applying the equity method of accounting.

Question 37: The proposed amendments would eliminate the fair value option for hybrid nonfinancial instruments in current U.S. GAAP and would provide a new fair value option for hybrid nonfinancial liabilities. For a hybrid nonfinancial liability, an entity would apply the bifurcation and separate accounting requirements in Subtopic 815-15 and account for the embedded derivative in accordance with Topic 815. The financial liability host that results from separation of the nonfinancial embedded derivative would be subject to the proposed amendments. However, an entity would be permitted to initially and subsequently measure the entire hybrid nonfinancial liability at fair value (with changes in fair value recognized in net income) if after applying Subtopic 815-15 the entity determines that an embedded derivative that requires bifurcation and separate accounting exists. In contrast, for a hybrid nonfinancial asset the proposed amendments would require the hybrid contract to be measured at fair value (with changes in fair value recognized in net income) if the hybrid nonfinancial asset contains an embedded derivative that would have required bifurcation and separate accounting under Subtopic 815-15. Do you agree with the proposed amendments? If not, why? What would you propose instead?

We do not object to the proposed approach.

Appendix C
Deloitte & Touche LLP
Responses to Questions Related to Consequential Amendments Resulting From the
Proposed ASU (File Reference No. 2013-221)

Question 1: Do you believe that the proposed consequential amendments that would result from the proposals in the proposed Update on financial instruments have been appropriately reflected? If not, what alternative amendment(s) do you recommend and why?

Below, we list additional consequential amendments that we believe should be made to reflect the proposals in the proposed ASU. We also recommend providing a Basis for Conclusions that describes the Board's rationale for the more significant consequential amendments proposed and for the elimination of the fair value option in Topic 825 for financial instruments outside the scope of the proposed ASU.

- Amend Topic 323 to require entities to disclose the amount of impairment recognized on investments accounted for under the equity method of accounting and to disclose the qualitative factors that led management to conclude that the investment was more likely than not impaired. Include such disclosures in the list of minimum interim disclosures specified in paragraph 270-10-50-1.
- Define "major categories" in the context of loans and trade receivables that should be separately disclosed in accordance with paragraph 310-10-45-2. The term major categories is also used in other paragraphs in the *FASB Accounting Standards Codification*, and a definition of the term, or guidance clarifying how to identify major categories, would increase comparability.
- Provide a scope exception in paragraph 323-10-15-4 for equity investments that do not give investors the ability to exercise significant influence over operating and financial policies of an investee in accordance with paragraph 323-10-15-6. Clearly excluding such investments from the scope of Topic 323 will avoid confusion.
- Discuss, in paragraph 323-10-15-12, the scope implications for an equity investment that previously required consolidation but for which the investor loses its controlling interest yet retains significant influence in accordance with paragraph 323-10-15-6.
- Amend paragraph 323-10-15-21 to address circumstances in which an investment that is held for sale in accordance with paragraph 323-10-15-20 may subsequently require consolidation if the investor obtains a controlling interest, and clarify whether such an investment would still be considered held for sale.
- Discuss, in the suggested Basis for Conclusions above, why ASC 340-30 is superseded and why all instruments or transactions currently in the scope of ASC 340-30 would be more appropriately accounted for under the proposed ASU.
- Retain and modify the guidance in paragraphs 815-10-55-99 through 55-110 and 55-156 through 55-165 to clarify that it can only be applied to financial liabilities.
- Delete paragraph 815-15-15-9A since this guidance is not needed in ASC 815-15. Financial assets are classified in their entirety under the proposed Subtopic 825-10.
- Consider whether the scope of paragraphs 815-15-30-1(c) and 815-15-35-1A is too broad since they seem to apply to all nonfinancial hybrid assets and liabilities.

- Eliminate the proposed prohibition in paragraphs 815-20-25-43(c)(2) and 815-20-25-43(d)(2) against hedge accounting for the risk of changes in fair value or cash flows attributable to the interest rate risk exposure of a debt security accounted for at amortized cost. Such prohibition may have been appropriate under an intent-based classification model, but it appears to be inconsistent with a model that requires a consideration of contractual cash flows and an objectively determinable business model assessment.
- Retain and modify the example in paragraphs 815-20-55-187 through 55-192 to clarify that such guidance would be applied to financial assets accounted for at fair value with qualifying changes recognized in net income.
- Retain and modify paragraphs 815-25-55-18 through 55-22 since this guidance is still relevant (e.g., for hedge accounting applied to commodity contracts).
- Consider an appropriate alternative location for the proposed guidance in paragraph 825-30-15-5 because nonfinancial liabilities are not within the scope of ASC 825-30.
- Consider retaining the guidance in paragraphs 825-10-25-4 through 25-6 and 25-13 because the guidance on election dates, elections to apply the fair value option to assets and liabilities in a consolidation, and unit-of-account for liabilities issued with an inseparable third-party credit enhancement is still relevant. Such guidance should be included in the proposed Subtopic 825-30.
- Consider amending paragraph 835-30-35-2 to address potential confusion between this guidance and the initial measurement guidance in the proposed ASU, particularly paragraphs 825-10-30-4 through 30-6.

Question 2: Do you believe that all guidance related to financial instruments in various Topics in the FASB Accounting Standards Codification® (for example, Topics 310 and 470) should be consolidated into a single Topic?

We support the Board's objective of consolidating guidance related to financial instruments into a single ASC Topic. However, we recommend a new Topic reference number, such as Topic 826. Differentiating between old and new guidance in ASC 825-10 will create unnecessary complexity in preparers' documentation related to accounting policies and procedures and in auditors' working papers.

Question 3: The proposed amendments also would eliminate the fair value option (for financial instruments not within the scope of the proposed Update on financial instruments) in current U.S. GAAP (see paragraph 825-10-15-4), related to guarantees, contingencies, rights and obligations of insurance contracts and warranties, written loan commitments, and firm commitments. Do you agree with the proposed elimination and the effective date and transition guidance? If not, why? What would you propose instead?

We do not support the proposed elimination of the fair value option in paragraph 825-10-15-4 for guarantees, contingencies, rights and obligations of insurance contracts and warranties, written loan commitments, and firm commitments. We support an unrestricted irrevocable option, permitting entities to elect at initial recognition to account for financial instruments at FV-NI. We support such an option for all financial instruments, including those listed above.