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Ms. Susan Cosper
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File Reference No. 2013-220- *Proposed Accounting Standards Update, Financial Instruments – Overall Recognition and Measurement of Financial Assets and Financial Liabilities (Subtopic 825-10)*

Dear Ms. Cosper:

The Financial Reporting Executive Committee (FinREC) appreciates the opportunity to comment on the Proposed Accounting Standards Update (ASU), "Recognition and Measurement of Financial Assets and Financial Liabilities." FinREC continues to support the efforts of both the FASB and the IASB to either converge or more closely align U.S. generally accepted accounting principles (U.S. GAAP) with the International Financial Reporting Standards (IFRS). However, as we have stated in previous letters, high quality accounting standards should not be sacrificed for the sake of convergence.

The FASB is to be commended for undertaking this important project. The proposal certainly has many positive aspects. For example, we agree that there should be one accounting model for all financial instruments. We also agree that entities should be required to report fluctuations in instrument-specific credit risk (own credit) in other comprehensive income (OCI) rather than net income for liabilities under the fair value option election. Likewise, we support the FASB's position on changes in fair value of equity securities being recorded through net income. We also support the elimination of the tainting provisions for sales from the hold-to-collect category.

We note that the FASB's stated objective in this proposed ASU is to establish an improved and more consistent financial reporting model for the recognition, measurement and presentation of financial instruments in an entity's financial statements. However, in some aspects, this proposal falls short of reaching its stated objective. We also find the proposal problematic for the following reasons:

- Complexities will be encountered with the solely payments of principal and interest (SPPI) model
- Amortized cost sales provisions are too restrictive
- Hedge accounting of interest rate risk for securities held at amortized cost is precluded while it is permitted for loans carried at amortized cost
- Bifurcation and the fair value option (FVO) of financial assets should be allowed to achieve parallel treatment to that permitted for financial liabilities
- Reclassification provisions are too restrictive and not clear enough
- Nonrecourse liabilities should have parallel treatment to the related financial assets
- Parenthetical disclosure on the balance sheet of amortized cost and fair value should instead be required in the footnotes
- Limiting the availability of the fair value option is not appropriate
- Disclosures place an undue financial reporting burden on smaller financial institutions and nonfinancial entities

Complexities will also be encountered with the SPPI model

For assets, the proposal seems to have exchanged the current complex model (i.e., "clearly and closely related" for identifying embedded derivatives in hybrid instruments) for another complex model that tries to accomplish the same objective of identifying instruments that should be classified in fair value through net income because of their cash flow characteristics. While the principle behind the current clearly and closely related model appears to be very simple, constituents discovered that it was not actually so simple when they tried to apply it in practice in adopting FAS 133. Over the years, those complexities were resolved as a result of the issuance of the implementation guidance by the FASB, as well as the accounting firms, and as industry practice developed around implementing the clearly and closely related model for hybrid instruments. Based on our experience, we believe that now, since the implementation guidance and industry practice for the clearly and closely related model already exists, it works in practice and should be retained.

The issue with the proposed SPPI model is that, although it also appears to be simple, it actually creates the same types of complexities as the clearly and closely related model experienced initially. Thus, we do not see the benefit of moving to this new SPPI model, which would cause a significant shift from current practice for classification of financial instruments, since it introduces significant new implementation and operational issues to address, with no doubt unintentional consequences, what the current clearly and closely related accounting model seems to handle well already. We also note that the SPPI model adds to complexity because the embedded derivative guidance would be retained for liabilities.

Amortized cost sales provisions are too restrictive

The amortized cost criteria are too restrictive, especially for loans. While at the time of issuance banks often intend to hold loans for collection of contractual cash flows, they may subsequently decide to sell some of the loans as part of a sale of a pool of loans or through securitization. Under the current practice such sales are allowed for loans even from the held-for-investment category. We ask the FASB to allow such sales from amortized cost under the proposed standard as well.

Furthermore, companies hold various instruments for different purposes and we agree that the general accounting framework should reflect the manner in which companies expect to realize cash flows from these instruments. However, in implementing this framework, the proposed ASU places significant restrictions on sales of debt instruments held at amortized cost. We believe that some of the restrictions are unnecessary and inconsistent with prudent risk management. For example, sales of debt instruments after an observable decline in borrower creditworthiness are allowed but sales to manage credit concentrations are not due to the ASU's claimed inconsistency of such sales with the concept of investing for the collection of cash flows. This produces a result where proactive risk management of a loan portfolio would not be viewed as appropriately maximizing cash flows of the portfolio, but sales of loans after credit has already deteriorated are permissible. We disagree, and believe that limiting credit concentrations is portfolio credit risk management and should not preclude the portfolio from being classified in amortized cost.

Also, in some cases, the entity's intention to hold the asset in the amortized cost category has not changed but a sale is required by an external party, such as a banking regulator. We believe that in such cases, entities should also be allowed to sell out of the amortized cost category without questioning the entity's initial intent for that asset or its objective to hold other instruments for collection of principal and interest on a prospective basis.

Hedge accounting of interest rate risk for securities held at amortized cost is precluded while it is permitted for loans carried at amortized cost

The proposal, by allowing hedge accounting of interest rate risk for loans but not securities held at amortized cost, effectively retains current guidance for hedge accounting of held-for-investment loans and held-to-maturity securities. Since we support the elimination of differences in accounting for financial instruments that are economically the same (i.e., loans and debt securities), we do not understand why current guidance that makes this distinction between the instrument types should be retained. We believe that hedge accounting for all instruments held at amortized cost should be allowed, including hedge accounting of interest rate risk. Entities may wish to do so to synthetically change the cash flow characteristics of the instrument (e.g., fixed to floating rate or vice versa). We do not understand why hedge accounting of interest rate risk should be prohibited, since allowing

hedge accounting for all instruments held at amortized cost would not violate the assertion that such instruments will be held to collect contractual cash flows.

Bifurcation and the fair value option of financial assets should be allowed to achieve parallel treatment to that permitted for financial liabilities

When it comes to bifurcation and fair value election, we fail to understand why the proposal treats hybrid financial assets and liabilities differently. We believe there should be symmetry. Therefore, we ask the FASB to retain the current embedded derivative bifurcation requirement for hybrid financial assets and an ability to elect fair value through net income accounting for the entire hybrid instrument, which is what the proposal already allows for hybrid liabilities.

Reclassification provisions too restrictive and not clear enough

We believe that reclassifications should be allowed for portfolios of assets if the business objective for the portfolios has changed. While allowing reclassifications, the FASB's proposal should be less restrictive for transfers from amortized cost to FV-OCI or to FV-NI since it would result in more assets carried at fair value. However, it would be appropriate to maintain greater restrictions for reclassifications from FV-NI or FV-OCI to amortized cost.

Should the FASB adopt the reclassification provisions as proposed, the ASU needs to clarify whether transfers are allowed at the portfolio level

Nonrecourse liabilities should have parallel treatment to the related financial assets

According to the proposal, "if the contractual terms of a nonrecourse financial liability require an entity to settle the entire liability with only the cash flows from the related financial assets, the entity shall … subsequently measure the nonrecourse financial liability on the same measurement basis as the related financial assets…." We ask the FASB for parallel treatment in the proposed standard by also allowing the assets to be measured on the same measurement basis as the liabilities if those non-recourse liabilities require settlement with cash flows from the related financial assets.

Consider the case where both the assets and liabilities of a pass-through entity are marked to market through net income but, as the liabilities trade on the market, only the fair value of the liabilities is observable based on quoted prices, whereas the asset fair value marks are not visible because of the lack of any market activity. In such cases, the fair value of the assets may be currently determined based on the fair value of the liabilities rather than the other way around.

We believe the FASB's objective of ensuring that there is no impact on the parent company's income statement from such financing entities can be achieved with either method. Moreover, if use of the fair value option is expanded in the proposed ASU as recommended below, the accounting could be simplified as described above.

Parenthetical disclosures on the balance sheet of amortized cost and fair value should instead be required in the footnotes

We are concerned that this disclosure requirement would result in very cluttered balance sheets and ask that the required information be disclosed in the footnotes instead, where management can display it in a clearer, more user-friendly way.

Limiting the availability of the fair value option is not appropriate

We do not think reduction of the use of the fair value option results in better financial reporting. It often creates asymmetry in the treatment of financial assets and liabilities. We are not aware of the current usage of the fair value option being abusive and believe that existing disclosures create sufficient transparency regarding which assets and liabilities are reported under the fair value election as well as providing a justification for making this election.

Disclosures place an undue burden on smaller financial institutions and nonfinancial entities

The proposed disclosure requirements that will be imposed on all entities warrant reconsideration, especially for smaller financial institutions and nonfinancial entities. These disclosures are a significant increase over what is currently required, particularly for debt securities and core deposit liabilities. Requiring such extensive disclosures is a contradiction to the FASB's current disclosure framework project, which seeks to streamline the information currently being reported for all entities. The FASB should reconsider the impact this proposal will have on this population in relation to the disclosure framework project's overarching goal before proceeding. Additionally, the FASB should consider the impact of requiring these disclosures in relation to the goal of its other ongoing projects aimed at reducing the reporting burden for small and mid-sized entities.

We believe that the proposed ASU places a greater burden on smaller financial institutions and entities outside of the financial services industry. Companies would be required to use complex calculations in areas where they may not currently be capturing this data. As a result, these entities will now be forced to incur significant and unwarranted implementation costs. Such costs include staff retraining, system reconfigurations and, in many cases, full system procurements. We believe that, especially for those companies, the

potential costs of compliance with this approach outweigh the likely benefits to financial statement users.

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We suggest that rather than completely overhauling the current model in order to meet the stated objective, the FASB make more focused changes in areas that have been deemed problematic. Overall, while there are some positive aspects in the proposal, the proposal seems to have exchanged one complex model for another equally complex model. Thus, we do not see how the few benefits of moving to this financial reporting model would justify such a significant shift from current practice. In fact, such a change would introduce significant and unnecessary implementation and operational issues into the current accounting model, which will take considerable time to fully understand and adopt. However, in the event that the FASB proceeds with the current proposal, the FASB should work together with the IASB to develop comparable implementation guidance before finalization of the ASU to achieve greater convergence in the actual adoption of the provisions of the ASU. Such collaboration would significantly benefit multinational preparers in the U.S. and overseas.

We have provided responses to many of the questions you posed in the attached appendix.

Representatives of FinREC and the Financial Instruments Task Force would be pleased to discuss our comments with you at your convenience.

Sincerely,

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Chairman, FinREC

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Appendix

General Observations

Definitions

Generally, we recommend that the definitions found in the proposed ASU generally remain consistent with the current definitions already found in the codification.

Core Deposits

The proposed definition of core deposits will create confusion by redefining that term. The commonly accepted definition of core deposits is currently based on regulatory guidance and describes the portion of a bank's deposit base that is expected to remain with the bank over a longer term. The ASU's proposed core deposit definition would include demand deposits, but could exclude certain other types of deposits that management would also consider core because of their nature as a stable source of funding, such as a portion of the time deposits or certificates of deposit (CDs). While time deposits and CDs may have a contractual maturity, many are expected to continually roll over. We do not believe all deposits with a contractual maturity should automatically be excluded if they also represent a stable source of funding for a bank.

Bank regulators define core deposits for the purposes of using it as an analytical and supervisory tool, intended to include the deposits that are generally more stable, lower cost and reprice more slowly in the rising interest rate environment than other deposits. For instance, the FDIC's definition of core deposits follows (this definition comes from the FDIC's July 2011 study of Core Deposits and Brokered Deposits that was submitted to Congress pursuant to requirements of the Dodd-Frank Act).

Core deposits are not defined by statute. Rather, they are defined for analytical and examination purposes in the Uniform Bank Performance Report (UBPR). Core deposits are currently defined as the sum of demand deposits, all negotiable order of withdrawal (NOW) and automatic transfer service (ATS) accounts, money market deposit accounts (MMDAs), other savings deposits and time deposits of $250,000 or less, minus all brokered deposits of $250,000 or less.

The $250,000 represents the amount of the FDIC's maximum deposit insurance coverage. NOW accounts are interest-bearing savings accounts on which limited check-writing privileges are permitted. ATS accounts are the types of accounts in which funds are automatically transferred from savings account to checking as checks are presented for payment.

Principal

Please see our response to question 5 below regarding defining "principal" as the repayment amount at maturity or other contractual prepayment dates.

All-in Cost-to-Service Rate

We are concerned that the inputs needed to compute this rate are highly complex and would require a great deal of subjectivity. As a result, there would be inconsistencies in the assumptions made by each reporting entity, thereby eliminating any comparability of the resulting disclosure. Furthermore, the usefulness of disclosing this information is highly questionable as the inputs that would be used to compute this rate could be inconsistent across institutions. Therefore, we ask that this disclosure requirement be eliminated.

If the FASB decides to retain the disclosure of the all-in cost-to-service rate for core deposits, examples are required to illustrate how the calculation would be accomplished, including how the components of the all-in-cost-to-service rate are to be determined.

Implied Weighted-Average Maturity

Similar to the all-in cost-to-service rate, we have concerns regarding the calculation of this maturity for deposits without a contractual maturity and question the usefulness of this information for all core deposit liabilities regardless of the definition. Therefore, we ask that this disclosure requirement also be eliminated.

Other Observations

Paragraph 825-10-55-41 provides an example of when an entity would not need to conduct a comparison of the fair value and transaction price at the inception of a lending or borrowing arrangement or other transactions in which a financial instrument is acquired. We ask the FASB to consider the example of a zero percent introductory rate credit card. Under this proposal, this type of loan could fail the SPPI test and, thus, the loan would be required to be classified at fair value through net income. This outcome seems inconsistent with the purpose of the proposed model to allow non-complex financial instruments, such as credit card loans, that are held for collection of contractual cash flows to be classified in amortized cost.

Question 1

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

Response

Short-term receivables (and payables) should be excluded from the scope and continue to be recorded at amortized cost. Otherwise, entities that sometimes factor their accounts receivable would be required to record them at fair value. The costs preparers would incur to determine fair value for such receivables would far exceed the benefits, if any, for users.

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?

Response

We agree with the industry-specific scope exceptions. For example, broker-dealers and investment companies should continue to follow their specialized industry guidance, because fair value as a general measurement principle is the most relevant attribute for these types of entities and their investors.

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?

Response

While the principle behind the contractual cash flow characteristics assessment is clear, the guidance in the proposal relating to the SPPI test would inappropriately exclude many plain vanilla financial instruments from the amortized cost and FV-OCI categories. Examples include adjustable rate mortgages that reset based on the prime rate (since the prime rate has no tenor), money market funds (since an implicit guarantee of the $1 NAV constitutes a contingency), credit cards with zero or low introductory rates (since the initial rate would not be a benchmark rate) or with non-cash rewards programs, and auction rate instruments (since a market rate has no tenor).

The existing guidance for bifurcation of embedded derivatives that are not clearly and closely related to the host in a hybrid instrument is designed to address similar concerns that complex financial instruments should not be recorded at amortized cost. We believe the current clearly and closely related guidance should be carried forward into the proposed guidance. We believe that otherwise the proposed ASU could ultimately need a multitude of additional implementation guidance which could easily be avoided by the use of the existing guidance.

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?

Response

We believe that the definition of principal should be expanded to include repayment of the principal amount at maturity as well as other possible or anticipated settlement dates according to the contractual prepayment clause. Without such amendment, any prepayable instrument that is purchased at a large premium or discount subsequent to the original issuance may fail the contractual cash flow characteristics test and would therefore have to be recorded at fair value through net income. Such an outcome seems counterintuitive given that the same instrument, if originated or purchased at issuance, would have no problem passing the contractual cash flow characteristics test and would be measured at amortized cost.

Question 6

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

Response

We appreciate the examples that you have provided. However we have some comments regarding them:

Example 1:

Instrument D- Collateralized Full Recourse Loan

Consider making the instrument just a collateralized loan. For illustrative purposes, whether or not the loan is full recourse should not matter.

Instrument G: Perpetual Instrument

Please explain how instrument G differs from a perpetual equity. We think this perpetual debt instrument should fail the SPPI test and should be marked to market through net income.

Example 4: Held-to-Collect Contractual Cash Flows

We believe the guidance in the proposal for consequential amendments carried forward from current ASC 815 on the prohibition of hedge accounting for securities measured at amortized cost for changes in the benchmark interest rate risk should be revised. Entities may want to manage the interest rate risk exposure by converting the fixed interest rates to floating or vice versa without violating the "hold to collect" business model assessment. Moreover, since one of the FASB's objectives is to have consistent treatment for loans and debt securities, we believe that all instruments measured at amortized cost (including loans and debt securities) should be able to get hedge accounting even where interest rate is the designated hedged risk.

Example 6: Held-to Collect Contractual Cash Flows

Paragraph 825-10-55-78 states that if the entity is required by its regulator to sell financial assets either to demonstrate that the assets are liquid or to comply with a regulatory requirement that affects the entity (and not the industry) consistent with paragraph 825-10-55-32(d), the business model for those financial assets is not to hold them to collect contractual cash flows.

We think that this requirement is too harsh and should be withdrawn. If a regulator directs the entity to sell financial assets in the amortized cost category, the entity should be able to do so. Such a sale did not occur because of the entity's violation of the intent to hold to collect contractual cash flows, but rather the sale was caused by outside circumstances not under the entity's control. While a sale due to a regulatory requirement is rare, as long as there is a theoretical possibility for such sale, a regulated financial institution may find it hard to include most instruments in amortized cost even if they would otherwise qualify for amortized cost measurement under the proposed standard.

We also believe that sales due to credit concentrations and legal lending limits should be permitted similar to selling an asset due to credit concerns. Over time, the composition and size of the financial asset portfolios may change as a result of business combinations or changes in the economic environment, resulting in greater concentrations of risk than were anticipated when the assets were classified in amortized cost. We believe management should be permitted to sell amortized cost assets in such circumstances. Additionally, when a non-troubled loan is modified, we believe the entity should be allowed to make a new designation of its business objective, given the changed risk profile.

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 for the benchmark cash flows as discussed in paragraph 825-10-55-19? If not, why? What would you propose instead?

Response

We are very concerned that this guidance would result in many common financial instruments held within a held-to-collect business being required to be accounted for at fair value through net income.

For example, consider a credit card loan. Credit card issuers commonly offer an initial zero-percent introductory rate, which subsequently resets based on a benchmark rate when the introductory period expires. We believe that according to the proposed guidance, such credit card loans could have to be recorded at fair value through net income, but we think the ASU should consider these introductory rate cash flows to be solely payments of principal and interest.

Another common example would be a variable rate mortgage loan which resets periodically to a current prime rate. Since the prime rate does not have a tenor (such as one-month prime or three-month prime), any mortgage loan that does not reset to prime daily would be in danger of being recorded in fair value through net income. Again, we think such instruments' cash flows should be considered solely payments of principal and interest. Moreover, cash flows that differ insignificantly from their benchmarks should be disregarded for purposes of applying this criterion.

Additionally, many loans have prepayment options that allow the borrower to prepay without penalty. However, the proposed guidance suggests that such prepayment options could disqualify an entity from passing the SPPI test, particularly, if an entity purchased the loan at a sizeable discount or a premium. In the case of a large premium, since the borrower has the ability to prepay the loan at par, the investor could be considered not to be able to recover substantially all of his investment. In the case of a large discount, the difference between the prepayment at par and the purchase price could be considered "unreasonable" compensation (since the proposed ASU defines the principal to be the purchase price) and not just principal and interest. Thus, these instruments in their entirety could be required to be recorded at FV-NI, rather than the prepayment options being bifurcated as required under the current literature.

We believe that this strict guidance violates what appears to be the principle of the proposal that simple instruments with cash flows that represent interest and principal and which are held to collect contractual cash flows should qualify for amortized cost measurement.

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?

Response

As discussed in our response to Question 7, we question the propriety of the proposed guidance as it applies to many simple financial instruments with cash flows representing interest and principal, which are held to collect contractual cash flows. We believe that by adopting today's clearly and closely related model for hybrids to replace the proposed SPPI cash flow test, most of these issues could be avoided.

Question 9

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

Response

We disagree with the look-through approach. If an investor holds the beneficial interest to collect principal and interest cash flows, the cash flows from the beneficial interest itself are only principal and interest, are consistent with a market rate of return and the beneficial interest should meet the SPPI test. Moreover, only the original investors in an asset-backed securitization could possibly have the information required to do the look-through assessment if they were involved in the structuring of the collateral pool requirements. However, as these securities frequently trade, the secondary investors would not be privy to the information needed to make the required assessment.

We are also concerned that the look-through approach introduces a credit test into what is for all other financial assets only a test of the characteristics of the cash flows. We believe this provision should be eliminated. Moreover, if this provision is retained, we believe it could encompass all asset-backed securities, including government-sponsored entities mortgage-backed securities, and this could result in all such securities being reported in the FV-NI category.

We also see significant operational problems with this approach particularly for smaller and less sophisticated entities, which may not have the system capabilities to do such an analysis.

Question 10

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

Response

The objectives of each of the business models are clear. However, we ask the FASB to be consistent in discussing that this test can be applied at a portfolio level and does not need to be applied only at a more aggregated segment or business level. Within a segment or business, entities may have many portfolios with differing business model objectives and it is inappropriate to require that all business models within a segment or business be considered jointly as one business when that aggregation does not reflect management's actual objective for each portfolio.

Also, because of the interaction of the SPPI test with the business model test, assets that fail the SPPI test would be classified in FV-NI regardless of the objectives for managing the assets in the portfolio.

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?

Response

As noted in our response to Question 10, we believe the objectives for amortized cost and FV-OCI are clear. However, as FV-NI is a residual category, it will contain financial assets managed under all three business models. Also please see our response to Question 6, Example 4 above.

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?

Response

The proposed ASU should not contain an explicit tainting provision and we generally agree with the proposed guidance in this area. However, clarity would also be helpful on the prospective consequences of selling too many times out of the amortized cost category for reasons that are not explicitly permitted.

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?

Response

We do not see a compelling reason to move to an entirely new model for accounting for loans and loan commitments. This model will introduce unnecessary implementation issues without any obvious benefits. For example, this model will introduce comparability issues as some entities might have loans carried at FV-OCI and others could have similar loans classified as FV –NI.

Additionally, please clarify whether standby letters of credit should also be in the scope. We do not understand why a distinction is being made between standbys and commercial letters of credit.

Question 14

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

Response

We generally do not object to the initial measurement principles for financial instruments in the proposed ASU. However, in some cases, the application of the initial measurement principles needs further clarification.

At the time of issuance of a loan, a bank may decide to participate out a portion of the loan. We ask the FASB to clarify whether a portion of a single financial asset could be included in amortized cost and another portion in a different category; or whether the assessment to classify a financial instrument in any of the categories would have to be made for the entire asset.

Furthermore, sometimes a decision to do a loan participation may take place after origination of the loan. Thus at issuance, management's objective may be to hold-to-collect the entire loan. Once management has decided to do the participation, however, some portion of the loan would then be held for sale. Initial classification of the loan at amortized cost should be acceptable for the entire loan.

Question 16

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

Response

Yes, financial liabilities initially recorded at amortized cost should continue to be measured at amortized cost.

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?

Response

We propose that you also allow related financial assets to be measured on the same basis as the financial liability. This would simplify amortized cost accounting as no allowance would be required and, for assets and liabilities classified as FV-NI, allow the use of the most transparent price. Entities should be permitted to conform the accounting for assets restricted to settle nonrecourse liabilities by electing to report the assets using the same accounting method as the liabilities as well as what is proposed (i.e., to report the liabilities using the same method as the assets). See our discussion of "Nonrecourse liabilities should have parallel treatment to asset accounting" in our cover letter.

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?

Response

No, we disagree. We believe that reclassifications of portfolios should be allowed when the business objective has changed. The proposed model introduces a fourth measurement category (LOCOM) which is unnecessary. Instead, the FV-NI category should be used.

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?

Response

Yes, we agree with the proposed amendment. Also see Question 35.

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?

Response

Yes, we agree with the proposal since it would result in consistent treatment across entities.

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?

Response

No, we disagree. We believe there should be symmetry in accounting for hybrid financial assets and liabilities, since it would make the accounting principle consistent for both financial assets and liabilities and when the FVO may be selected. We believe bifurcation or FVO for the entire instrument should be available for both financial assets and liabilities.

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?

Response

We agree with the methodology, but as noted in our response to Question 18, we think reclassification to FV-NI should be required when asset portfolios are identified for sale.

Question 23

The proposed amendments would require public entities to parenthetically present fair value for items measured at amortized cost on the face of the statement of financial position. Does that presentation requirement provide decision-useful information? If not, why? What would you propose instead?

Response

The proposed ASU requires FV disclosures on the face of the balance sheet. We believe this should not be the required place since the notes are an integral part of the financial statements. Requiring such disclosures on the face of the balance sheet could make the balance sheet cluttered and hard to read in some circumstances. It could also create tagging challenges with XBRL. We believe the FASB should permit entities to provide fair value disclosures either parenthetically on the balance sheet or in the footnotes.

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 securities measured at fair value through other comprehensive income (see paragraphs 825-10-45-14 through 45-15). Is the proposal fair-value-based method provided for computing the foreign currency gain or loss component operable? If not, why? What would you propose instead?

Response

We support separate recognition in net income for changes in fair value attributable to foreign currency gains and losses in debt securities denominated in foreign currency and measured at FV-OCI. However, under the proposed method, an entity could derive a different fair value attributable to foreign currency gain or loss from the method currently prescribed by the IASB. In this case, we believe the FASB should consider adopting the IASB's proposed method (amortized cost x currency spot exchange rate change during the period) to achieve greater convergence.

Question 29

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

Response

The FASB is significantly increasing the amount of required disclosures, particularly for debt securities and other financial assets. While financial institutions already disclose most of the information required for loans, most of the proposed disclosures are new for securities. As these are being proposed for both interim and annual reporting periods, the reporting burden will be excessive for preparers. We support providing disclosure of the circumstances leading to reclassifications of portfolios of assets. We also believe that fair value disclosures should not be required for private companies. Also, see our response to Question 23.

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?

Response

We support permitting early adoption for changes in instrument specific credit risk for hybrid financial liabilities under the fair value option. In the period prior to adopting the entire final ASU, we believe that the early adoption provision for own credit risk should be expanded to include all financial liabilities that had elected the fair value option under the current guidance. This would also be consistent with the IASB's proposal.

Question 31

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

Response

We believe nonpublic entities should be allowed more time to adopt the standard than public entities. The FASB should consult with its newly created Private Company Council to evaluate and make their recommendation on the appropriate effective dates for nonpublic entities.

Question 32

How much time is needed to implement the proposed guidance?

Response

We believe that three years would be sufficient to implement the proposed guidance for public entities. This would correspond to the timeline we recommend for implementing the credit loss model. We believe this proposed ASU should be implemented simultaneously with the proposed credit impairment model.

More time should be given for nonpublic entities. Again, we suggest that FASB work closely with the newly created Private Company Council to determine the appropriate time for this population.

Question 33

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

Response

The transition provisions are operable.

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?

Response

We believe the proposal is not operable. We believe the indicators proposed in 323-10-15-20 are overly broad. It is not clear to us how specific or probable a "potential exit strategy" must be in order to qualify. Similarly, "a range of dates" seems open to interpretation. The

FASB might consider language closer to that specified in ASC 360-10-45-9 that addresses when long-lived assets are considered held for sale. The conditions in that paragraph are more concrete and readily understood in terms of current practice. Additionally, periodic reconsideration should also be allowed for step transactions since a change in ownership may change a business objective.

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, what would you propose instead?

Response

We note that the proposed one-step impairment model includes indicators of impairment that are similar to the indicators of impairment under IAS 39 under which equity-method investees are assessed under IFRS. However, it appears that under the proposed ASU, impairment would be automatically recognized to the extent that fair value is calculated and determined to be below the carrying amount and there would be no consideration of how long the investment has been impaired or whether the fair value is expected to recover within a reasonable period of time. Based on the first sentence in 323-10-35-31A that indicates "an investment in an equity method investee is impaired if it is more likely than not that the fair value of the investment is less than its carrying value", fair value may be required to be calculated even when the triggers are not met if it is likely that fair value is below cost (such as in a general market downturn that still does not breach the more severe impairment triggers).

In contrast, under IFRS an impairment results only when the decline in fair value is significant or prolonged or when there is otherwise objective evidence of impairment. In addition, under the principles in IAS 36, *Impairment of Assets*, the measurement of the impairment is based on the higher of the fair value less cost to sell and value-in use. As a result, we believe that the proposed impairment model would result in increased volatility in earnings under US GAAP relative to the IFRS impairment model. This volatility may not be consistent with the longer-term nature of investments typically accounted for using the equity method.

Accordingly, a majority of FinREC members believes the FASB, in this case, should consider adopting the IFRS approach because it appears to be more conceptually aligned with the approach applicable to the FASB's standard for goodwill impairment. Therefore, convergence in this area would enhance the comparability of net income resulting from all consolidated investments and those accounted for using the equity method.

However, certain FinREC members support retaining the current model for equity method investments citing that switching to a LOCOM model may create a burden for smaller and nonfinancial entities as the cost would not outweigh benefits derived nor, in some cases, would it reflect the economics of the transactions. Additionally, some entities with shared power rather than significant influence would find it difficult to obtain sufficient information needed to apply LOCOM on a timely basis to meet reporting deadlines.

Furthermore, the proposal adds complexity to non-financial entities which engage in joint ventures under the equity method of accounting. Specifically, the operation of the equity method changes the carrying amount of the investment in ways that may not reflect changes in the fair value of the investment, potentially creating a book impairment that is not an economic impairment.

For example, if an entity acquires a 20 percent interest for $100, then records its share of earnings of $1 and OCI on cash flow hedges of $80 in the next period, the entity's basis in the investee becomes $181. Assuming no change in fair value, the entity would need to record an immediate impairment of $81 related to its new investment even though there has been no change in fair value.

Question 36

Do you agree with the current portfolio-wide option for not-for-profit entities, other than healthcare 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*?

Response

This is an opportunity for the FASB to create an overarching principle to permit the fair value option for all equity method investments. In that case, there would not be a need for exceptions.

We support retaining the portfolio-wide election for not-for-profit entities to account for their equity method investments at fair value in the proposed guidance. In many cases, due to legal or donor-related restrictions, not-for-profit entities are required to make operating decisions based on the fair value or rate of return of their investment portfolio. For example, a not-for-profit entity may have a spending policy based on a percentage of the fair value of the investment portfolio that limits program-related expenditures. The decision-usefulness of not-for-profit financial statements is improved by allowing these entities to measure and report these investments using the same criteria by which the operating decisions are made (e.g. fair value).

However, we do not see a need to extend the availability of this option to not-for-profit health care entities. Not-for-profit health care entities generally are business-oriented and

under current guidance, the financial statements of these entities are, to the furthest extent possible, made comparable to those of for-profit entities engaged in the same industry. We believe that continues to be a reasonable objective for not-for-profit health care financial reporting.

Question 37

The proposed amendments would eliminate the fair value option for hybrid nonfinancial instruments in current 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 assets the proposed amendments would require the hybrid contact 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?

Response:

We do not agree with the proposed elimination of the bifurcation and separate accounting requirements for hybrid assets. We fail to understand why the proposal treats hybrid financial assets and liabilities differently. We believe there should be symmetry. Therefore, we ask the FASB to retain the current embedded derivative bifurcation requirement for hybrid financial assets and the ability to elect fair value through net income for the entire hybrid asset, if it is otherwise required to be bifurcated, which is what the proposal already allows for hybrid liabilities. These provisions would also have greater consistency with the IASB's model.