



Via Email

July 31, 2009

Mr. Russell Golden  
FASB Technical Director  
Financial Accounting Standards Board  
P.O. Box 5116  
Norwalk, Connecticut 06856-5116

Via e-mail: director@fasb.org

Re: File Reference No. 1700-100: *Exposure Draft of a Proposed Statement of Accounting Standards: Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses*

Dear Mr. Golden:

The Investors Technical Advisory Committee ("ITAC") appreciates the opportunity to express its views on the FASB's File Reference No. 1700-100: *Exposure Draft of a Proposed Statement of Accounting Standards: Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses* ("ED"). Our input is based upon our expertise and perceptions as users of financial statements and our goal is to improve the clarity, completeness, and usefulness of financial statements.<sup>1</sup>

**General Comments**

ITAC members believe that disclosures are critical for enhancing the quality, comparability and usefulness of financial results presented on the face of financial statements. We further believe that providing more meaningful disclosures about loans and other financing receivables is long overdue and we urge the Board to conclude this project and issue a final standard without further delay. The proposed disclosures, when combined with the additional recommendations we outlined herein would have great potential to meaningfully improve investors' understanding of credit quality and trends, credit risk exposures and accounting policies surrounding loans and other financing

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<sup>1</sup> This letter represents the views of the ITAC and does not necessarily represent the views of its individual members, or the organizations by which they are employed. ITAC views are developed by the members of the Committee independent of the views of the FASB and its staff. For more information about the ITAC, including a listing of the current members and the organizations in which they are employed, see [http://www.fasb.org/investors\\_technical\\_advisory\\_committee/itac\\_members.shtml](http://www.fasb.org/investors_technical_advisory_committee/itac_members.shtml)

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receivables. We commend the FASB members and staff for bringing forward this proposal for discussion and comment.

We applaud FASB's financial instrument project and are hopeful that loan fair values will soon be presented on the face of the balance sheet under US GAAP. Irrespective of the financial instruments project, we believe that the disclosures proposed in this ED will meaningfully benefit investors.<sup>2</sup> That said, we would add that FASB should monitor the timing of the financial instruments project relative to the timing of this ED, and determine whether the financial instruments standard or the credit quality disclosure standard would be the best standard in which to require (a) that the disaggregated loan fair value amounts disclosed in the loan footnote be reconciled to the total fair value amount presented on the balance sheet and (b) total changes in fair value disclosed in the footnotes be reconciled to the loan loss provision included in Net Income and flowing through Retained Earnings, plus changes in fair value included in Other Comprehensive Income and flowing through Shareholders Equity outside of Retained Earnings.

The following are our responses to specific questions raised in the ED:

### **Specific Questions**

#### **Scope (Paragraph 2)**

1. *This proposed Statement defines a financing receivable as both loans as defined by FASB Statement No. 114, Accounting by Creditors for Impairment of a Loan, and lessors' investment in leases other than operating leases that have been recorded as assets in accordance with FASB Statement No. 13, Accounting for Leases. Do you agree with the definition used to identify a financing receivable subject to the provisions of this proposed Statement? If not, why not?*

We agree that the proposed disclosures should be required for originated or acquired loans, credit card receivables, accounts receivables with terms exceeding one year, notes receivable and receivables relating to lessors' rights to payments from leveraged leases or direct financing leases or sales-type leases. However, it is not clear to us whether comparable credit quality disclosures are provided in other GAAP guidance for accounts receivables with contractual maturities of one year or less that arose from the sale of goods or services (except for credit card receivables), debt securities and retained interests. **We believe clarity,**

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<sup>2</sup> Note that the FASB's forthcoming financial instruments Exposure Draft is expected to present amortized cost measurement as well as the fair values, but to retain today's loan loss accounting in net income and retained earnings for most loans.

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**transparency, and comparability would be enhanced if all such instruments were to be disclosed using a consistent and comparable standard to this ED.**

We appreciate that the scope would have this ED apply to finance companies of industrial and retail companies, so that these companies provide comparable disclosures to their financial institution peers.

2. *This proposed Statement would apply to all creditors, including all public and nonpublic entities that prepare financial statements in accordance with generally accepted accounting principles. Do you agree with the scope of this proposed Statement? If not, why not?*

We agree with the scope in this regard. Applying the same disclosure requirements to all creditors is appropriate for achieving consistency and comparability across entities.

#### **Disclosures (Paragraphs 10-16)**

3. *This proposed Statement would require a **rollforward schedule of the total allowance for credit losses** in both interim and annual reporting periods by portfolio segment and in the aggregate. In addition, it also would require a **rollforward schedule of financing receivables** in both interim and annual reporting periods by portfolio segment and in the aggregate. Do you believe those disclosures will assist financial statement users in better understanding the financial information for the total allowance for credit losses as well as the associated financing receivables? If not, why not?*

It would be extremely useful to have a rollforward of the loan loss reserve account that includes the provisions, the losses and the recoveries for each [standardized] loan/financing-receivable category (see our response to Issue 4 for a suggested approach to standardized categories).<sup>3</sup> **However, a significant shortcoming of the ED is the omission of a requirement to separately disclose any general/residual reserve component of the total loan loss provision in the**

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<sup>3</sup> Letter from Mike Gyure, Member, Investors Technical Advisory Committee, to Mr. Robert Herz, Chairman, Financial Accounting Standards Board 2-3 (Dec. 11, 2007), <http://www.fasb.org/jsp/FASB/Page/ITACDisclosureProposal.pdf> (Advocating roll-forward disclosures as an element of a disclosure framework).

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**rollforward schedule.**<sup>4</sup> We are very supportive of the expanded disclosure requirements by category of receivable based on whether management assesses the credit risk in those credit instruments collectively or individually. However, we believe that a perspective in the measurement of loan losses is missing: disclosure of the movement among components of the allowance based on whether the provision and the allowance are specific, general, or unallocated. It is our understanding that banks continue to book unallocated reserves for environmental and other factors that may reduce the ability of investors to analyze credit quality and loan performance. FASB should require disclosure of this attribution of the loan loss reserve on a class of receivable basis (i.e., by [standardized] loan/financing-receivable category) in the rollforward, as opposed to the more aggregated portfolio segment basis.

Separately, we are pleased to see improved disclosure requirements surrounding nonaccrual loans (paragraph 16 of the ED). We would add that if a company defines nonaccrual loans differently from nonperforming assets (NPAs), then that difference should be disclosed and loan amounts quantified. We are aware that some banks appear to charge-off their expected losses after 90-120 days and at the same time keep the loan balance in the NPA category until the issue is “resolved;” other banks appear to wait to charge off loans until they have to do so, and in the meantime build a reserve in anticipation of that coming loss event. As a result, ratio and trend analyses get distorted. Therefore, **we recommend adding a disclosure requirement for the amount of loans by [standardized] category, that are classified as nonaccrual or NPA, and, importantly, disclosure of the related loan loss amounts included within the total loan loss reserves, as well as the amount of nonaccrual or NPA loans that have already been charged off.**

**Additionally, in the rollforward schedule of financing receivables, we recommend disclosure of sales of impaired loans with repayments on a gross basis and not netted together.** In economic terms, these are fundamentally different events with differential implications for the future risks and returns of the loan portfolios and should not be netted. For example, a sale may reflect managers’ decisions to enhance liquidity, while repayment provides an indicator of the improving health of the borrower. Similarly, the netting of transfers into and out of impaired loans obscures trends in improving or declining credit quality and such flows should be reported gross on the rollforward reconciliation.

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<sup>4</sup> We would add that this requirement for separate disclosure of any general or residual reserves should be expressed consistently throughout the ED, including on page v paragraph 1, paragraph 11c, and Appendix A.

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4. *This proposed Statement would require interim and annual credit quality disclosures about a portfolio by class of financing receivable, including quantitative and qualitative information about the credit quality of financing receivables. Do you believe those disclosures will assist financial statement users to better understand the credit quality for the associated financing receivables? If not, why not?*

We believe that these quantitative and qualitative disclosures will enhance investor understanding of the credit quality of loans and other financing receivables; however, there are some critical additional disclosures that we urge the FASB to consider.

As an initial matter, we believe that the proposal to require managers to disclose their policies for determining when loans/financing-receivables are assessed for impairment, when loans may be classified as nonaccrual and when they are charged off (paragraphs 11, 13 and 14) adds important information and will substantially improve the usefulness and transparency of the disclosures. **It would also be very helpful to add a requirement for a discussion of the key assumptions underlying asset-price decline projections and sensitivities** to these key assumptions in their models that help determine what loans may fall into nonaccrual or NPAs.

**Separately, we believe that in order to achieve comparability across reports, more standardization of loan/financing-receivable categories is needed than would be provided by paragraphs 5, 6 and 8 of the ED.** We are concerned that incomparability will result from having disclosures based on the approach used by each individual team of managers that varies across companies and through time. We recommend the following standardized categories for real estate loans specifically be used for disclosures in this ED:

Residential real estate loans:

1. First lien
2. Second lien or home equity

Commercial real estate loans:

1. Land development and construction
2. Owner-occupied
3. Residential/multi-family
4. Income-producing/retail

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**Loans in each of the above categories have different economic drivers and risk profiles. In requiring this disaggregation approach for loans/financing-receivables by asset type, investors could better assess the heightened credit risk inherent in certain types of loans and other financing receivables.**

Further to achieving comparability, it is our experience that companies change their reserve and charge-off policies over time for various reasons, as managers change, or as managers change their views after learning more or at various points in economic cycles. Every time a policy is changed, investors lose history. As a general rule, **companies should be required to provide disclosures that will allow investors to understand the effects of such a change on amounts presented in financial statements and rollforward and aging schedule disclosures over at least two years, and it should be presented in table format and by [standardized] loan/financing-receivable category.** The ED appears not to require reporting of such amounts to allow for comparability.

We appreciate the acknowledgment in paragraph 8 of the ED that too much aggregation of certain data can obscure important information that would be material to investors. We note that clearly presented and useful information actually does not overburden investors with excessive detail. We also realize that financial institutions have complex business activities, and extra disclosures are needed to explain the dynamics to investors. **We recommend that the standard include the following examples of disclosure disaggregation** that would not be intended to be all-inclusive:

- One example would be a discussion regarding the amounts of loans or financing receivables and the estimation of loss reserves for any **subset portfolio of [standardized] loan/financing-receivable categories that have notable trends or material delinquency levels**; for instance, specific categories where nonaccrual assets are accelerating at a rapid rate or for which delinquencies are at elevated levels. In the fourth quarter of 2008, this would have applied to construction loans, and in the fourth quarter of 2007 this would have applied to brokered home equity loans. Such indicators can be material to security prices of financial institutions even if the loans are a relatively small sub-category of overall loans.
- A second example we recommend is for **disclosure of important information required in Call Reports and therefore considered material to regulators, but not otherwise required under GAAP.** For

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instance, the FDIC has recently required that banks provide in their Call Reports the amount of interest that a bank has capitalized if the bank has significant exposures to construction and land development loans.<sup>5</sup> It would be very helpful to have such information provided in quarterly GAAP footnotes, in total for all subsidiaries that may otherwise report the information across various Call Reports under different company names.

- A third example would be **disclosure of the noncash portion of interest income** included in net income, such as negative amortization on residential loans and interest reserve draw downs on commercial real estate loans. Further, the interest reserve or capitalized interest amount for any commercial real estate loans on the balance sheet should be separately disclosed.
- Fourth, disclosure should be required of **SOP 03-3 loans in each [standardized] loan category, their fair value and par value amounts, and associated credit loss reserves and provisioning during the reporting period**, if any. Having these amounts lumped in with other loans and reserves distorts credit quality analysis for the rest of the loans and is very frustrating to analysts.

In addition to quantifying the general or environmental reserve amounts in the roll forward schedules, as discussed in our response to Issue 3 above, there should be a **qualitative discussion as to how managers determine the amount of general reserves needed for each category as applicable**.

We encourage adding a requirement for creditors to **disclose loan-to-value ratios for all collateralized loans** (i.e., residential, commercial and home equity line of credit (HELOC) loans), with ratios at origination disclosed separately from current ratios, and discussion as to how the values were measured.

Given the heightened significance and variations of economic environments by geographic location as a factor impacting credit quality, **required disclosure of the major categories of loans and the associated loan loss reserves by state, or, at a minimum, by region**, would be an important disclosure.

It has come to our attention that some companies are attempting to work around the requirement to disclose loans modified during a period by changing the

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<sup>5</sup> <http://www.fdic.gov/news/news/financial/2009/fil09007.html>

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definition of what they would technically consider to be a modification as opposed to a change in specified terms. Therefore, we suggest considering the following language for paragraph 13(f):

A modification of terms of a financing receivable includes any change in the class of the carrying amount, and fair value of the financing receivables due to modification, restructuring, impairment, or changes in internal reporting policies including but not limited to:

1. ~~Reduction~~ Change (absolute or contingent) in ~~of the stated~~ contractual interest rate for the remaining original life of the debt
  2. ~~Extension of~~ Change in the maturity date or dates with no compensation or at a ~~stated interest~~ rate lower than the ~~current~~ prevailing market rate for new debt with similar risks and term
  3. ~~Reduction~~ Change (absolute or contingent) in ~~of the face amount or maturity amount of the debt as stated in the instrument or other agreement~~
  4. ~~Reduction~~ Change (absolute or contingent) in ~~of~~ accrued interest.
5. *This proposed Statement would require an **analysis of the age of financing receivables that are past due, but not impaired**, at the end of the reporting period separately for each class of financial instruments. Do you believe those disclosures will assist financial statement users in better understanding the credit quality for the associated financing receivables? If not, why not?*

We believe that the proposed disclosures will assist investors; however, it would be extremely useful to have **the allowance amounts that correspond to each stage in the analysis of the age of financing receivables that are past due for each [standardized] category, including separate disclosure of the general versus the specific allowance amounts.** The proposal as it stands now would result in aggregation of this essential information.

Additionally, for each category of performing and nonperforming loans and financing receivables in the aging schedule, if managers believe that the expected losses are superior measures of the amounts that managers expect in losses over the expected lives of the loans/financing-receivables, then managers should be encouraged to disclose those measures. If measures of expected losses are provided, they should be provided for each specific [standardized] loan/financing-receivable category. We are aware that there is no conceptual basis for measuring and recognizing loans and financing receivables at other than net of their estimated-incurred losses or at their fair values. However, **if managers believe**

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**that the incurred-loss or fair-value measures do not reflect managers' expected losses as of the reporting date, then we believe that managers should be encouraged to disclose and explain why the expected losses are more relevant and why they differ from the incurred-loss and/or fair-value amounts reported on the face of the balance sheet.** Over time, managers should disclose how their expected losses, and, separately, how estimated-incurred losses, have tracked with actual losses on loans and financing receivables by [standardized] category.

6. *This proposed Statement would require the **fair value of loans** at the end of the reporting period by portfolio segment. Do you believe those disclosures will assist financial statement users in better understanding the credit quality for the associated financing receivables? If not, why not?*

We agree that the fair values and significant assumptions used to estimate the fair value by portfolio segment will assist users in better understanding the credit quality for financing receivables. However, having the significant assumptions would be far more useful if the **loan value sensitivities to the significant assumptions** were provided. Each reporting period, the change in fair values of loans in each category should be disclosed, and enhanced with a **discussion as to why the values changed and what may cause these values to meaningfully change from their current contractual and expected amounts in the future.**

7. *Do you believe it is **operational** for entities to disclose all of the proposed requirements for **interim and annual** reporting periods? Why or why not?*

It would be extremely useful to have the critical disclosures proposed in the ED and in our response to Issues 3, 4, 5 and 6, provided to investors on an annual and interim basis. We note that some of the information is already assembled and required on a quarterly basis in bank Call Reports and similar regulatory filings.

#### **Effective Date and Transition (Paragraph 17)**

8. *The final Statement is expected to be issued in the third quarter of 2009. The Board concluded that this proposed Statement would be effective for financial statements beginning with the **first interim or annual reporting period ending after December 15, 2009**. Do you agree with the Board's decision on the effective date? If not, what would be a reasonable period of time to implement the provisions of this proposed Statement? If you do not agree, please provide a*

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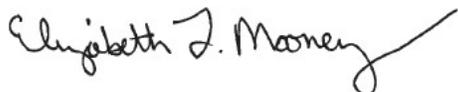
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*description of the process changes necessary to implement this proposed Statement that would require additional time.*

We urge the Board to move forward with the much needed proposed disclosures without further delay. We believe that this information is critical to investors and fully support the requirement to provide these disclosures to complement 2009 calendar year end financial results.

The ITAC appreciates the opportunity to respond to the *Exposure Draft of a Proposed Statement of Accounting Standards: Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses*. Should the Board or staff have questions about our views or wish to discuss these matters further, please contact the undersigned or any member of the ITAC.

Respectfully,



Elizabeth Mooney  
Member, ITAC

cc Gavin Francis, Director of Capital Markets, IASB  
Alan Teixeira, Director of Technical Activities, IASB