

FASB Credit Losses

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Respondent information

Type of entity or individual:

Credit Union

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Questions and responses

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

We do not disagree with the limited scope of financial assets that are included in this proposed update. The complex nature involved in addressing methods for achieving successful and relevant accounting for credit losses is a significant task often made worse by attempts to force unnecessarily broad scope solutions. The board's decision to limit the scope to only address impaired financial assets or credit losses is the more realistic approach.

2. The proposed amendments would remove the initial recognition threshold that currently exists in U.S. GAAP and, instead, view credit losses as an issue of "measurement" as opposed to an issue of "recognition" because the credit losses relate to cash flows that are already recognized on the balance sheet. Do you believe that removing the initial recognition threshold that currently exists in U.S. GAAP so that credit losses are recognized earlier provides more decision-useful information?

The proposed transition from the "recognition" to "measurement" method of viewing credit losses would substantially reduce the reliability and effectiveness of decision critical information. Currently, credit unions utilize several factors to establish the initial credit rate for a transaction including but not limited to primarily credit risk and liquidity risk. Under our current GAAP compliant practices, added rate earnings for credit risk would be recognized over the life of the assets in accordance with the matching principle. The proposed ASU would necessitate changes requiring the whole current value of the cost of the credit risk to be recognized at the time of acquisition, resulting in apparent non-compliance with the matching principle. This proposed approach would accelerate the entire related cost of credit losses and negatively impact the revenue streams of credit unions.

3. As a result of the proposed amendments, the net amortized cost on the balance sheet (that is, net of the allowance for expected credit losses) would reflect the present value of future cash flows expected to be collected, discounted at the effective interest rate. Do you agree that the net amortized cost (which reflects the present value of cash flows expected to be collected) results in more decision-useful information than currently exists under U.S. GAAP?

An extremely unfortunate negative unintended consequence of this proposal if adopted as currently written would be to significantly impair the effectiveness of decision-useful information currently available under U.S. GAAP. This proposed acceleration of the entire cost of credit losses at the time of acquisition would deviate from historical practices as well as that required by the matching principle within U.S. GAAP.

4. The Board has twice considered credit loss models that would permit an entity not to recognize certain expected credit losses. In the January 2011 Supplementary Document, the Board considered a model that would permit an entity not to recognize some credit losses expected to occur beyond the foreseeable future. In the recent discussions on the three-bucket impairment model, the Board considered a model that would permit an entity only to recognize lifetime credit losses for loss events expected to occur beyond the 12-month horizon. Instead, the proposed amendments would require that at each reporting date an entity recognize an allowance for all expected credit losses. Do you believe that recognizing all expected credit losses provides more decision-useful information than recognizing only some of the expected credit losses? If not, how would you determine which expected credit losses should not be recognized (for example, 12 months or similar, foreseeable future horizon, initial recognition threshold, and so forth)?

We do not believe that recognizing all expected credit losses at each reporting period would provide more decision-useful information. Instead, we prefer a more consistent approach to the methodology of recognizing credit losses and currently our credit union and many others use an industry "best practices" approach of using a 12 month horizon method for loss events expected to occur. Extending loss event estimates too far into the future would serve to reduce the efficacy of the projections and as well reduces the reliability of financial statements. More recent data over the past year coupled within environmental factors serves to provide a more reliable and decision-useful credit loss methodology.

5. The proposed amendments would require that an estimate of expected credit losses be based on relevant information about past events, including historical loss experience with similar assets, current conditions, and reasonable and supportable forecasts that affect the expected collectibility of the financial assets' remaining contractual cash flows. Do you believe that expected credit losses based on this information provides decision-useful information?

As it is unrealistic to believe every event considered in accounting for estimates of expected credit losses can truly be predicted, we have serious concerns about the usefulness of information based on this method. Events, both expected, and unexpected, which in many cases impact the collectability of financial assets, are not both considered in their entirety within this methodology. Believing that every event can be accounted for when creating future forecasts is an unrealistic assumption.

6. For purchased credit impaired financial assets, the proposed amendments would require that the discount embedded in the purchase price that is attributable to expected credit losses at the date of acquisition not be amortized and recognized as interest income over the life of the asset. To achieve this result, upon acquisition the initial estimate of expected credit losses would be recognized as an adjustment that increases the cost basis of the asset. Apart from this requirement, purchased credit impairment assets would follow the same approach as non-purchased-credit-impaired assets. That is, the allowance for credit losses would always be based on management's current estimate of the contractual cash flows that the entity does not expect to collect. Changes in the allowance for expected credit losses (favorable or unfavorable) would be recognized immediately for both purchased credit-impaired and non-purchased-credit-impaired assets as bad-debt expense rather than yield. Do you believe that using the same approach to recognize changes in the credit impairment allowance for purchased credit-impaired assets and non-purchased-credit impaired assets provides decision-useful information? Do you believe that this is an improvement from the current model used for purchased credit-impaired assets?

We agree with this revision as it appears to simplify the method to be used for recognizing changes in credit impairment for both purchased and non-purchased credit impaired assets. Consistency across application of this rule requiring that purchased and non-purchased assets be treated the same in this instance will likely result in measurable improvement.

7. As a practical expedient, the proposed amendments would allow an entity not to recognize expected credit losses for financial assets measured at fair value with qualifying changes in fair value recognized in other comprehensive income when both (a) the fair value of the individual financial asset is greater than (or equal to) the amortized cost amount of the financial asset and (b) the expected credit losses on the individual financial asset are insignificant. The proposed amendments would require an entity to disclose the amortized cost basis of assets that apply this practical expedient each period. Do you believe that the practical expedient for some financial assets measured at fair value with qualifying changes in fair value recognized in other comprehensive income is reasonable? Why or why not?

We do not necessarily oppose this provision of the update; however, we do oppose the use of the term "insignificant", which can lead to misinterpretations if not clearly defined.

8. The proposed amendments would require that an entity place a financial asset on nonaccrual status when it is not probable that the entity will receive substantially all of the principal or substantially all of the interest. In such circumstances, the entity would be required to apply either the cost-recovery method or the cash-basis method, as described in paragraph 825-15-25-10. Do you believe that this approach provides decision-useful information?

As this is the approach credit unions currently use we agree with this particular paragraph of the proposed amendment. We are and have remained very aware that the expectation of collecting interest owed from a credit arrangement is logically reduced with the passage of time and this approach recognizes interest income in accordance with how we and other credit unions are currently handling its recognition per regulation and practice.

9. The proposed amendments would require that an estimate of expected credit losses be based on relevant information about past events, including historical loss experience with similar assets, current conditions, and reasonable and supportable forecasts that affect the expected collectability of the financial assets' remaining contractual cash flows. Do you foresee any significant operability or auditing concerns or constraints in basing the estimate of expected credit losses on such information?

We are quite concerned about the proposed use of historical loss experiences with "similar" assets, current conditions, and reasonable and supportable forecasts that affect the expected collectability of the financial assets' remaining contractual cash flows. A very relevant point in this case is that the many factors that contribute to an economic crisis change over time and corrective efforts in response differ, substantially, at times, as well.

10. The Board expects that many entities initially will base their estimates on historical loss data for particular types of assets and then will update that historical data to reflect current conditions and reasonable and supportable forecasts of the future. Do entities currently have access to historical loss data and to data to update that historical information to reflect current conditions and reasonable and supportable forecasts of the future? If so, how would this data be utilized in implementing the proposed amendments? If not, is another form of data currently available that may allow the entity to achieve the objective of the proposed amendments until it has access to historical loss data or to specific data that reflects current conditions and reasonable and supportable forecasts?

Many institutions such as ours have access to relevant historical data, but many do not have the resources to obtain and effectively use the data to forecast future performance (speculative) in a manner the current proposal would require. Again, though forecasting future performance using historical data can provide us with some level of confidence, it must still be recognized as speculation and the further out we look, the greater the possibility becomes for miscalculations and errors.

11. The proposed amendments would require that an estimate of expected credit losses always reflect both the possibility that a credit loss results and the possibility that no credit loss results. This proposal would prohibit an entity from estimating expected credit losses based solely on the most likely outcome (that is, the statistical mode). As described in the Implementation Guidance and Illustrations Section of Subtopic 825-15, the Board believes that many commonly used methods already implicitly satisfy this requirement. Do you foresee any significant operability or auditing concerns or constraints in having the estimate of expected credit losses always reflect both the possibility that a credit loss results and the possibility that no credit loss results?

We see no issues currently that would result in our opposing this requirement.

12. The proposed amendments would require that an estimate of expected credit losses reflect the time value of money either explicitly or implicitly. Methods implicitly reflect the time value of money by developing loss statistics on the basis of the ratio of the amortized cost amount written off because of credit loss and the amortized cost basis of the asset and by applying the loss statistic to the amortized cost balance as of the reporting date to estimate the portion of the recorded amortized cost basis that is not expected to be recovered because of credit loss. Such methods may include loss-rate methods, roll-rate methods, probability-of-default methods, and a provision matrix method using loss factors. Do you foresee any significant operability or auditing concerns or constraints with the proposal that an estimate of expected credit losses reflect the time value of money either explicitly or implicitly? If time value of money should not be contemplated, how would such an approach reconcile with the objective of the amortized cost framework?

The required operating expense outlay as a result of the new requirements present in this proposal would increase substantially at a time when profit margins continue to narrow for credit unions nationally. In the event these new requirements were adopted, time necessary for compliance given the complexity involved would most certainly add to the cost of additional training and required enhancements to internal systems. Additionally, satisfying audit related requirements in this regard would also result in heightened costs as a result of expanded audit procedures and time required to successfully comply with the new requirements.

13. For purchased credit-impaired financial assets, the proposed amendments would require that the discount embedded in the purchase price that is attributable to expected credit losses at the date of acquisition not be recognized as interest income. Apart from this proposal, purchased credit-impaired assets would follow the same approach as non-purchased-credit-impaired assets. That is, the allowance for credit losses would always be based on management's current estimate of the contractual cash flows that the entity does not expect to collect. Changes in the allowance for expected credit losses (favorable or unfavorable) would be recognized immediately for both purchased credit-impaired and non-purchased-credit-impaired assets as bad-debt expense rather than yield. Do you foresee any significant operability or auditing concerns or constraints in determining the discount embedded in the purchase price that is attributable to credit at the date of acquisition?

We have concerns with this proposal with regards to the treatment of the difference between the credit discount total and expected credit loss. At the time of purchase, the effects of factors impacting valuation, such as embedded options, and observations of risk free rates, estimated credit discounts can be identified and should incorporate an overstatement of anticipated credit losses at the time as well. As a result, further detailed guidance from the Board on the adequate and relevant treatment of the difference between the discount and loss totals is advisable.

14. As a practical expedient, the proposed amendments would allow an entity not to recognize expected credit losses for financial assets measured at fair value with qualifying changes in fair value recognized in other comprehensive income when both (a) the fair value of the individual financial asset is greater than (or equal to) the amortized cost basis of the financial asset and (b) the expected credit losses on the individual financial asset are insignificant. Do you foresee any significant operability or auditing concerns or constraints in determining whether an entity has met the criteria to apply the practical expedient or in applying it?

We do not have any objection nor concerns to express with regards to this expedient.

15. The proposed amendments would require that an entity place a financial asset on nonaccrual status when it is not probable that the entity will receive substantially all of the principal or substantially all of the principal or substantially all of the interest. In such circumstances, the entity would be required to apply either the cost-recovery method or the cash-basis method, as described in paragraph 825-15-25-10. Do you believe that this proposal will change current practice? Do you foresee any significant operability or auditing concerns with this proposed amendment?

We do not have any objections nor concerns to express with regards to this aspect of the proposal. It is our understanding that we are already currently required to comply with this requirement under industry regulation as a credit union.

16. Under existing U.S. GAAP, the accounting by a creditor for a modification to an existing debt instrument depends on whether the modification qualifies as a troubled debt restructuring. As described in paragraphs BC45–BC47 of the basis for conclusions, the Board continues to believe that the economic concession granted by a creditor in a troubled debt restructuring reflects the creditor’s effort to maximize its recovery of the original contractual cash flows in a debt instrument. As a result, unlike certain other modifications that do not qualify as troubled debt restructurings, the Board views the modified debt instrument that follows a troubled debt restructuring as a continuation of the original debt instrument. Do you believe that the distinction between troubled debt restructurings and nontroubled debt restructurings continues to be relevant? Why or why not?

We do believe the distinction between trouble debt restructurings and nontroubled debt restructurings (modifications not rising to the level of a TDR) continues to be relevant. In the case of modifications not rising to the level of a TDR, the debtor normally has other options for restructuring. These other options can include revised terms, agreements, concessions, obtaining financing via other credit institutions, and others. Flexibility in these situations is far greater in most cases than in the cases of those institutions holding troubled debt. In the cases of troubled debt restructurings, both the creditor and debtor are trying to avoid issues related to credit loss. Both scenarios include options that are unique with regards to future goals and opportunities. The differences between the two scenarios as well as the methods and options for handling them remain unique and relevant and should be considered going forward separately.

17. Do you believe the disclosure proposals in this proposed Update would provide decision-useful information? If not, what disclosures do you believe should (or should not) be required and why?

As a result of our review of the update, the disclosure proposals do not contribute to providing enhanced decision-useful information. Rather, as currently written, the disclosures only add to the overburdensome nature of requirements already in place in this regard.

18. Do you foresee any significant operability or auditing concerns or constraints in complying with the disclosure proposals in the proposed Update?

The most significant concern we would like to voice with regards to compliance with this proposed update involves the cost of compliance related to both implementation and continued adherence to the rules subsequent to the effective date. The changes required associated with this proposal will be cost prohibitive for many financial institutions and place an increased burden on all credit unions. In addition, these ever increasing compliance costs will serve to narrow already thin net income margins, thereby reducing capital and the ability to provide much needed services and products to our membership.

19. Do you believe that the implementation guidance and illustrative examples included in this proposed Update are sufficient? If not, what additional guidance or examples are needed?

As a result of our review, the implementation guidance and illustrative examples are insufficient in their present form. Based upon the expansive scope of the revisions proposed, the guidance provided must provide greater detail and relevance to those who will rely upon them for direction.

20. Do you agree with the transition provision in this proposed Update? If not, why?

We respectfully disagree with this provision as it is our belief that the adoption of the ASU is not in the best interest of our credit union nor of the financial institution industry as a whole.

21. Do you agree that early adoption should not be permitted? If not, why?

We do not support the adoption, early or otherwise, of the Accounting Standards Update.

22. Do you believe that the effective date should be the same for a public entity as it is for a nonpublic entity? If not, why?

We do not support the adoption of this ASE; however, in the event it is adopted, we agree with the delayed effective date for nonpublic entities. As credit unions are nonpublic entities, our financial statement end users are vastly different and require more industry specific decision-useful data such as is currently required via industry regulation. In addition, the performance of our credit union industry during this time of economic recession should be taken into consideration as our overall performance and required capital reserves far exceed that of other industries.

23. Do you believe that the transition provision in this proposed Update is operable? If not, why?

We do not support the transition provision of this update and do not believe it be feasible for operation as currently written for our industry. Financial instruments have unique and varied characteristics and not all will be amenable to the creation of decision useful loss estimates. This is certainly true when the characteristics that make them unique, such as longevity and volatility, impact predictions of future performance.

24. How much time would be needed to implement the proposed guidance? What type of system and process changes would be necessary to implement the proposed guidance?

We oppose the adoption of this proposal regardless of the time allocated to financial institutions for its implementation for all of the reasons previously stated. The evident weaknesses within the proposal with regard to validation, objectivity, and past cost principals will only serve to lessen confidence in future financial statements.

Additional comments-updt. Please provide any additional comments on the proposed Update:

Additional comments-process. Please provide any comments on the electronic feedback process:
