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May 31, 2013

Via email: [director@fasb.org](mailto:director@fasb.org)

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

**Re: File Reference No. 2012-260 – Financial Instruments – Credit Losses (Subtopic 825-15)**

Dear Ms. Cospers:

U.S. Bancorp (USB) appreciates the opportunity to comment on the Proposed Accounting Standards Update – *Financial Instruments – Credit Losses (Subtopic 825-15)* (the “Exposure Draft” or “ED”). USB supports the FASB’s primary objective of providing financial statement users with more decision-useful information about expected credit losses on amortized cost financial assets and other commitments to extend credit at each reporting date. We appreciate the FASB’s dedication to developing a high quality credit impairment model and consideration of the challenges faced by preparers in estimating both the timing and amount of expected credit losses. We support a model that will be operational and meet the objective of providing users with transparent information about the current estimate of all expected credit losses in financial assets.

USB generally agrees with the FASB’s proposal to replace the existing impairment models, which reflect incurred credit events, with a model that recognizes current expected credit risks and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates (the “proposed model” or the “CECL Model”). While no model could have addressed the unforeseen credit events experienced during the recent economic crisis, we believe the CECL Model will address concerns about credit loss results lagging changes in credit cycles as well as delayed recognition of expected credit losses. It will also improve transparency to users about changes in expectations about losses during a reporting period by using a single measurement method for amortized cost financial assets (no transfers between “buckets” with different measurement methods) and removing the need to estimate the

expected timing of the loss events (no arbitrary cutoff for recognizing expected losses based on a 12 month or “foreseeable future” forecast horizon).

We generally support applying the FASB’s proposed model to financial assets accounted for at amortized cost. However, we encourage the FASB to consider the following comments which highlight topics needing further clarification or refinement. We believe it is important for these topics to be addressed for the proposal to be operational, provide transparent and decision-useful financial reporting, promote consistent application, and fully achieve the FASB’s objectives.

- Economic and credit event forecasts beyond a short period of time (for example, six months) are inherently inaccurate. The requirement to base the estimate of expected credit losses on relevant information including “reasonable and supportable *forecasts* that affect the expected collectability of the assets’ remaining contractual cash flows” may be misinterpreted as a requirement to prepare and incorporate longer-term economic and credit event forecasts into the determination of expected credit losses. We recommend this requirement be clarified to emphasize the CECL model is not intended to be a forecasted loss model, but rather is predominantly based on historical loss experience data for similar assets with appropriate adjustments. These adjustments would reflect known changes in underwriting policies and practices, differences in portfolio composition, and changes in borrower behavior and portfolio performance observed each reporting period. All of these factors inform management’s expectations about credit losses and how they may differ from historical credit loss experience.
- Incorporating expected contractual interest cash flows and the time value of money into the determination of expected credit losses adds unnecessary complexity and confusion. We recommend the determination of an allowance for expected credit losses include only principal losses and not require an implicit or explicit consideration of the time value of money. While we understand the theoretical purity of considering all cash flows and the timing of those cash flows, we believe an allowance focused on principal credit losses will be most transparent to users and will best meet their need for information about expected credit losses. Nonaccrual accounting policies and related disclosures about nonperforming assets and delinquency statistics provide users with transparent information about interest income recognition. The inclusion of expected contractual interest cash flows and present value concepts (which inherently require consideration of the timing of cash flows) in determining the allowance for expected credit losses does not fully decouple credit and interest income recognition and may result in double counting of credit losses. Additionally, if specific guidance for nonaccrual assets is included in the codification, we recommend it be consistent with current regulatory guidance.
- Credit losses on purchased financial assets are generally contemplated in the purchase price paid for these assets. We support the proposed accounting for purchased credit impaired assets which would eliminate the operational complexity of ASC 310-30 (“SOP 03-3”) accounting and require recognition of an allowance for expected credit losses at the purchase date through purchase accounting entries rather than credit loss

provision. However, we recommend application of this accounting to all purchased financial assets with embedded expected credit losses (other than individual or portfolios of loans purchased at or shortly after the origination date) regardless of the significance of the credit impairment at the purchase date. A single credit loss measurement model for all purchased financial assets will eliminate implementation complexity and provide users with consistent, transparent and decision-useful information including relevant credit loss provision metrics and interest income reflective of the rate of return implicit in the purchased asset.

- A separate designation and accounting model for Troubled Debt Restructurings is unnecessary. We believe the proposal to adjust the cost basis of a modified asset to enable the effective interest rate to continue to be the original effective rate would be operationally challenging and complex, and would not be cost beneficial. We believe enhanced disclosures for all modified loans would be more relevant to understanding the nature, type and significance of modifications. For example, we believe investors would prefer to see the impact of rate reductions in margin rather than as charge-offs.
- The CECL Model is appropriate for financial assets managed within a business model of holding for collection of cash flows (that is, amortized cost). Because the CECL Model is specifically an expected credit loss model, it does not contemplate the ability to sell an asset and, as a result, is fundamentally disconnected from the FV-OCI business model. We recommend the Board retain existing other-than-temporary-impairment (“OTTI”) guidance described in ASC 320-10-35 for all financial assets classified and measured at FV-OCI (including loans, where applicable). The existing OTTI model is well-understood, operational, and we are not aware of any user concerns.

We generally support the proposed CECL model because it has the following benefits and advantages over the current model and other proposed models:

### **Benefits of an Expected Loss Model**

USB supports a model that requires an entity to recognize management’s estimate of all expected credit losses and to consider all available information including both internal and external data. Estimates about credit losses expected to occur as a result of future credit events require significant use of judgment, and therefore, will always be imperfect. We believe the CECL model is not intended to be a “forecast” model and therefore does not require preparers to forecast economic conditions and credit events that will occur in future periods. Instead, an expected loss model is predominantly based on historical loss experience data but includes adjustments to reflect other factors that inform management’s expectations about credit losses and how they may differ from historical credit loss experience. For example, adjustments may reflect changes in portfolio composition, the Company’s underwriting policies and practices, and observed changes in borrower behavior and portfolio performance. Management’s analysis of actual portfolio performance each reporting period provides new information and insights

that may warrant an adjustment to historical data and therefore the current expected credit loss estimates.

Utilizing all available information, including historical credit loss experience, typical length of credit cycles, current economic conditions, and reasonable and supportable adjustments to historical data to reflect factors expected to result in loss experience that differs from historical credit loss experience will provide users with a complete picture of management's current estimate of expected credit losses. Increases and decreases in expected losses during a reporting period will reflect changes in the composition of the portfolio resulting from new originations or purchases and changes in management's expectations about all expected credit losses in the portfolio. This is preferable to a 12 month or "foreseeable future" forecast horizon where some changes in reserves would be based on credit losses entering or leaving the forecast horizon or a change in the horizon length an entity is able to forecast with no change to underlying expected credit loss.

We believe the CECL model would address pro-cyclicality issues in the incurred loss or other event driven models. Beginning with historical credit loss experience data, considering the average length of credit cycles for the relevant asset classes, and considering the full life of the loan based on the contractual maturity date and impact of estimated prepayments (all of which are consistent with how credit risk is managed) will allow preparer's to incorporate a broader spectrum of reasonable and supportable information to determine the allowance for credit losses. However, whether in a downturn or improving phase of the credit cycle, as long as an existing portfolio performed exactly as expected and no new information or insights were extracted from credit analysis conducted during a reporting period, the allowance would not change from one reporting period to the next except for changes related to portfolio balances and composition. Unlike methodologies with a specified forecast horizon, there is no need to consider the timing of the expected credit loss events which may exacerbate pro-cyclicality issues.

We recognize there may be concerns regarding immediate recognition of an entity's expected credit losses on "Day 1" for originated loans as well as aligning related revenues and expenses. Although an expected loss model may not fit perfectly within the existing GAAP conceptual framework, we believe the benefits of the model to both users and preparers outweigh any theoretical imperfections. The proposal would address concerns about credit loss results lagging changes in credit cycles as well as delayed recognition of credit losses. In addition, qualitative and quantitative information included in enhanced disclosures around assumptions, impacts due to portfolio growth, asset quality and methodologies used in loss estimates will promote transparency and comparability among entities. We believe the proposed model addresses the primary G20 and Financial Crisis Advisory Group concerns about delayed recognition and how to incorporate more forward-looking information and improve financial reporting to help enhance investors' confidence in financial markets. From an operational standpoint, we believe it is a reasonable and understandable approach that can be implemented. As a larger institution with robust tools and modeling ability, we believe we would be able to leverage existing processes, systems, and controls to prepare for a model which has characteristics of the CECL Model.

## **CECL Model Advantages Over Other Models Considered by the Boards**

### *Current Incurred Loss Model*

Credit losses under an incurred loss model will often lag changes in credit cycles and contribute to pro-cyclical impacts that can occur during declining or improving economic conditions. The incurred loss model also presents challenges and limitations in determining if, and when, a financial asset has “incurred” a loss, and therefore, can result in significantly different amounts of recognized credit losses. The proposed model removes the probable threshold and would not require an entity to differentiate whether losses have been incurred or if an individual asset is impaired. Both users and preparers would also benefit from a model that reflects management’s evaluation of a broader and more forward-looking set of information.

### *FASB/IASB’s Common Proposal and FASB’s Foreseeable Future Model*

The January 2011 Supplementary Document (“the SD”) included a FASB-only Foreseeable Future model. USB believes it will be difficult to define the foreseeable future period, and as a result, believes there would be significant inconsistencies in application among preparers and across different asset classes because the interpretation of when reasonable and supportable information exists to support specific projections of events and conditions may vary. We believe a model based on projecting losses over the foreseeable future is highly dependent on the ability to forecast the exact timing and amount of losses and therefore is problematic. This model would be subject to significant interpretation, preparer capability, knowledge and tools and result in different conclusions not solely based on expectations of inherent losses but also based on capability to forecast exact timing.

We believe using a minimum twelve month period may result in expected losses for certain asset classes similar to losses recorded in an incurred loss model for those entities unable to forecast beyond 12 months, whereas other entities with the ability to apply a longer foreseeable future period may record expected losses at a higher level perhaps comparable to the CECL Model. In many circumstances, an entity’s foreseeable future may capture a substantial portion of its full expected credit losses where assets have relatively short lives, and assets for which credit losses tend to be more concentrated in the earlier part of the portfolio life. To the extent convergence was achieved with a foreseeable future model, we are also concerned about how this would be interpreted, applied, and potentially mandated by regulators and auditors in different countries.

It also is unclear as to whether losses based on specific supportable projections could result in banks holding no reserves for certain performing loans in the good part of the credit cycle. Introducing a 12 month period minimum could lead institutions to record a minimum amount in several circumstances, and result in delayed recognition of losses and significant volatility in the allowance and provision because losses would only be recognized when they become supportable and predictable. This may be more confusing to users because the provision in a reporting period will not just reflect the impact of portfolio additions and changes in credit loss estimates but also changes related to expected timing of deterioration becoming predictable.

### *IASB Model*

We believe the CECL Model has advantages over the model proposed by the IASB<sup>1</sup>. The FASB's proposed model is a single measurement model and would not require interpretations of when assets should be transferred between stages of credit deterioration (except for determining whether purchased assets have experienced "significant" deterioration). The IASB's proposed dual measurement model is highly dependent on the determination of deterioration. The CECL Model attempts to decouple interest and credit loss recognition to address strong opposition to the FASB's May 2010 proposed accounting standards update<sup>2</sup> ("the May 2010 Update") as noted in paragraph BC 44 of the Exposure Draft. In the IASB proposal, interest income would be calculated on a coupled approach based on credit deterioration.

### **Topics Needing Further Clarification or Refinement**

We encourage the FASB to consider the following comments which highlight topics needing further clarification or refinement. We believe it is important for these topics to be addressed for the proposal to be operational, provide transparent and decision-useful financial reporting, promote consistent application, and to fully achieve the FASB's objectives.

#### ***Clarify the Proposed CECL Model to be an Expected Loss Model and Not a Forecast***

We believe the CECL model needs to be further clarified to be a model based on an entity's expected losses and not based on forecasted losses under a reasonable and supportable economic forecast. Specifically, we believe there needs to be revisions to the guidance to de-emphasize "reasonable and supportable forecasts" and instead focus on "reasonable and supportable adjustments to historical data" in determining expected credit losses. For example, historical credit loss data may need to be adjusted to consider the current economic conditions and how those may differ from the economic cycle(s) applicable to those historical loss periods, and therefore impact expectations about the collectability of future cash flows. Similarly, analysis of portfolio performance during a reporting period will often provide management with additional insights and inform the estimate of expected credit losses. Finally, historical data and/or current portfolio performance also may not fully capture the impact of other key factors such as recent changes in industry or firm underwriting, changes in portfolio composition, or changes in borrower behavior which may need to be considered to appropriately adjust historical credit loss data.

Based upon our initial modeling of potential outcomes, it appears there are key drivers and assumptions affecting the estimates of expected credit losses. These include: length of historical information used and nature/severity of the past cycles, current economic conditions,

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<sup>1</sup> IASB issued an exposure draft in March 2013, *Financial Instruments: Expected Credit Losses*, with comments to be received by July 5, 2013.

<sup>2</sup> FASB issued Proposed Accounting Standards Update, *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities*, which proposed that interest income should always be calculated on the basis of the amortized cost less any allowance for credit impairments of the financial asset.

nature and vintages of the assets, assumptions including prepayments and expected life of loans. One of the most important drivers is how to adjust historical data to reflect the factors discussed above.

In the May 2010 Update, the FASB proposed for purposes of measuring credit impairment a requirement that an entity assume the economic conditions existing at the reporting date would remain unchanged for the remaining life of the financial assets. Many stakeholders expressed concerns about the requirement to assume economic conditions as of the reporting date remain unchanged in the future. To do so could delay or even potentially overstate recognition of losses depending on the nature of current economic conditions in relation to the past cycles which contribute to pro-cyclical impacts. Therefore, our understanding is that the Board included in the proposed ASU the requirement to use “reasonable and supportable forecasts” to address the concerns raised initially by stakeholders to the May 2010 Update. We believe a focus on expected credit losses (based on historical data on credit cycles and related credit losses with reasonable and supportable adjustments) rather than credit loss forecasts would alleviate those stakeholder concerns and not introduce concerns about forecasting future economic conditions.

To address this concept and promote consistency among preparers, we believe paragraph 825-15-25-3 could be changed to include language similar to the following:

“An estimate of expected credit losses shall be based on internally and externally available information considered relevant in making the estimate. That information includes information about past events, including historical loss experience with similar assets, current conditions, and reasonable and supportable adjustments to historical data to consider factors which impact management’s expectations about forecasts and their implications for expected credit losses.”

This guidance could be further supported by the addition of guidance which further explains this change similar to the following:

“For example, historical credit loss data may need to be adjusted to consider the current point, severity, or direction of the economic cycle and how it may differ from the economic cycle(s) applicable to those historical loss periods, and therefore impact expectations about the collectability of future cash flows. Similarly, analysis of portfolio performance during a reporting period will often provide management with additional insights and inform the estimate of expected credit losses. Finally, historical data and/or current portfolio performance also may not fully capture the impact of other key factors such as recent changes in industry or firm underwriting, changes in portfolio composition, or changes in borrower behavior which may need to be considered to appropriately adjust historical credit loss data.”

### *Allowance for Principal only Versus Principal and Interest*

Incorporating expected contractual interest cash flows and the time value of money into the determination of expected credit losses adds unnecessary complexity and confusion. USB recommends the allowance for expected credit losses include only principal losses rather than focusing on estimating the explicit or implicit timing of all future cash flows not expected to be collected including interest. USB believes the requirement to recognize contractual cash flows not expected to be collected, inclusive of interest cash flows, does not fully decouple interest income recognition and credit losses, which users have expressed is important; and continues to introduce complexity into the accounting and reporting model. We believe to achieve transparency and provide relevant information to users, the allowance for credit loss should reflect contractual principal amounts not expected to be collected and nonaccrual accounting concepts can address collectability of expected contractual interest cash flows.

We understand the FASB has defined<sup>3</sup> 'expected credit losses' as an estimate of all contractual cash flows not expected to be collected from a recognized financial asset (or group of financial assets) or commitment to extend credit. The FASB's amortized cost objective is to reflect the present value of cash flows that an entity expects to collect. It believes this is achieved through the combined effect of measuring the amortized cost basis at a present value of contractual cash flows and the proposed model resulting in an allowance for credit losses at a present value based on contractual cash flows not expected to be collected. We believe the proposed allowance recognition guidance including all contractual cash flows (that is, recognition of expected losses of both principal and interest) in combination with the proposed guidance on nonaccrual of interest income is confusing, does not fully decouple credit losses from interest recognition, and may result in double counting of losses. If the allowance is intended to cover interest cash flows not expected to be collected, then guidance addressing nonaccrual of interest income is not necessary. It may result in double-counting the impact of the uncollectible interest first through provision for credit losses and then again by not recognizing interest income if the asset is placed on nonaccrual status.

Additionally, because investors generally prefer to evaluate interest recognition implications of contractual nonperformance through analysis of nonaccrual loan and net interest margin metrics, we further believe it is not necessary to provide an allowance based on both principal and interest. In fact it would be consistent with the investors' feedback to the FASB to not mix interest recognition and impairment evaluation, and would also provide users with information consistent with how institutions manage credit risk on loans and investment securities.

The current model for designating nonaccrual loans is well understood by users and consistently applied by preparers. The proposed changes for determining when to place assets on nonaccrual would represent an unnecessary change in industry practice as generally specified by bank regulatory reporting requirements. It changes a performance metric significantly relied upon and well understood by financial statement users. If specific guidance for nonaccrual assets is required to be included in the codification, we recommend it be consistent with current regulatory guidance.

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<sup>3</sup> See Questions 1 and 7 of the March 25, 2013 "Frequently Asked Questions" document published by FASB.

***Apply the Methodology for Purchased Credit Impaired Assets to All Purchased Assets (other than individual or portfolios of loans purchased at or shortly after the origination date)***

USB supports the methodology proposed for assets considered to be purchased credit impaired (“PCI”). This methodology would require recognition of an allowance for credit losses at acquisition with an offsetting cost basis adjustment equal to expected credit losses embedded in the acquisition purchase price. As a result, the expected credit losses embedded in the purchase price would not be accreted into interest income. Subsequent changes in expectations of credit losses would then be recorded similarly to originated assets.

The current PCI model is operationally complex for preparers and continues to be difficult for users to understand. Many preparers with significant PCI assets find it necessary to provide supplemental information to allow users to convert reported amounts to information reflective of originated loans metrics. We believe the proposed approach will be much more transparent and understandable for users. Specifically, this approach will provide users the allowance attributable to purchased assets on a basis comparable to originated loans and a clear view of the estimated credit losses for these assets.

We recommend the approach for PCI assets also apply to all purchased amortized cost financial assets (other than individual or portfolios of loans purchased at or shortly after the origination date) including those with embedded credit losses not considered to be “significant”. We believe it is important to investors to have relevant, transparent, and consistent accounting for all purchased loans so that there is not a mixed accounting model for assets acquired in a single acquisition transaction. A dual measurement accounting model for purchased assets also does not meet the Board’s objective of achieving a single impairment model. The purchase price of acquired loans in all circumstances includes an estimate of the expected credit losses, and we recommend the accounting reflect this. We believe introducing the concept of “significant” deterioration is unnecessary and in fact adds interpretational and operational complexities for purchased assets by accounting for them inconsistently.

Under the proposal, embedded credit losses included in the purchase price of assets with embedded credit losses not considered “significant” would be accreted into interest income. Because an allowance would need to be recorded immediately for expected credit losses, the proposal seems to result in recording provision expense for the embedded credit losses at acquisition when these were contemplated in the purchase price. This would also conflict with the Board’s objective of net amortized cost being reflected on the balance sheet. Given the requirement that all financial assets have an allowance for expected credit losses, the day 1 fair value on the non-PCI assets would be reduced by the allowance for credit losses and therefore not reflect the amortized cost basis objective.

Application of the proposed PCI methodology to all purchased financial assets will greatly improve transparency, consistency and comparability in financial statements, and remove unnecessary complexities and separate accounting treatments. We believe the proposed approach for PCI assets is operational and would utilize many of the existing operational

processes and controls around determination of and subsequent accounting for credit losses embedded in all purchased assets. It is operationally easier to account for all purchased assets similarly, and consistent with how the credit risk is managed. Users may also benefit from additional disclosures about credit quality and embedded credit losses recorded for purchased assets as of the acquisition date. For example, we believe users may benefit from information related to changes in allowance differentiated between originated and purchased loans to understand how these portfolios perform over time, and how acquired portfolios are performing in relation to original credit assumptions at acquisition.

We also believe the interaction of the proposed guidance on PCI assets included in paragraph 825-15-25-9 and the nonaccrual guidance in paragraph 825-15-25-10 is confusing. We recommend the Board clarify the application of the nonaccrual guidance to purchased assets.

Finally, we recommend the Board provide implementation guidance related to all purchased assets including transition guidance related to existing purchased assets designated as PCI versus not PCI, treatment of pools versus individual assets, treatment of nonaccretable differences, and how the change in definition of a PCI asset may impact the accounting both at adoption and in subsequent periods.

### ***Separate Model for Troubled Debt Restructurings is Unnecessary***

A separate designation and accounting model for troubled debt restructurings (TDRs) is unnecessary and does not provide readers with more decision-useful information about estimated credit losses. Under the CECL Model all loans require a credit loss estimate for all contractual cash flows not expected to be collected regardless of whether or not they are designated as TDRs. Previously, the designation of a modification as a TDR required the loan to be designated as impaired and an allowance evaluation to be recorded in accordance with ASC 310-10. This separate ongoing designation and allowance evaluation would no longer be necessary with a single measurement credit loss model.

USB believes the requirement to recognize an adjustment to the amortized cost basis to maintain the same effective yield on the loan should be removed because it does not fully decouple interest income recognition and credit losses which users have expressed is important. Removal of this separate accounting model for TDRs would also eliminate several application issues that exist today including interpretations about whether the borrower is experiencing *financial difficulty* and whether a *concession has been granted*. Instead, we believe users would be better served with a common impairment model for all loans (including all modified loans). As discussed above, this model includes a credit loss allowance for principal losses and nonaccrual policies to address uncollectible interest income. We also recommend enhanced qualitative and quantitative disclosures for a broader population of modifications, instead of just those specifically designated as TDRs. We believe users would benefit from disclosures about all modifications, including those involving rate reductions (whether temporary or permanent). These disclosures could include the number of modified loans, recorded balance, and the pre and post modification weighted average yields which would allow financial statement users to understand the ongoing impact of the modifications to interest income.

Continuing a separate accounting and identification for TDRs is contrary to one of the proposal's main objectives which is to remove inconsistencies in accounting and reporting. We believe the proposed guidance to adjust the cost basis of a modified asset to enable the effective interest rate to continue to be the original effective rate is not preferred by users because it mixes yield and credit loss information, particularly for interest rate modifications. The proposed guidance would also be operationally challenging and complex. We recommend the model apply existing regulatory charge-off principles to modifications in which principal is contractually forgiven consistent with application to all other non-TDR loans, and apply nonaccrual accounting guidance and enhanced disclosures (described above) for interest rate modifications.

### ***Loss Models Should Consider the Business Model***

The FASB recently released a Proposed Accounting Standard Update – *Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities* (the “Recognition and Measurement ED”). The Recognition and Measurement ED proposes a comprehensive principles-based framework for the classification and measurement of financial instruments, which is predicated on the underlying principle that classification and measurement should be consistent with how an entity manages and expects to realize cash flows. Among other things, it requires financial assets to be classified and measured based upon the entity's business model for the asset. In particular, it proposes:

- Assets held with the objective of collecting cash flows would be classified and measured at amortized cost (“amortized cost assets”).
- Assets held with the objective of both collecting cash flow and selling would be classified and measured at fair value with changes in fair value recognized in other comprehensive income (“FV-OCI assets”).
- Assets held with the objective of selling (i.e. don't meet either of the two business model objectives above) would be classified and measured at fair value with changes in fair value recognized in net income (“FV-NI assets”).

The CECL Model would apply to both amortized cost and FV-OCI assets and requires recognition of *expected credit losses*, which is defined as the contractual cash flows an entity does not anticipate collecting. We believe the CECL Model is only appropriate for financial assets managed within a business model of holding for collection of cash flows (i.e., amortized cost assets) and not for FV-OCI assets.

Because the CECL Model is an expected credit loss model, it does not contemplate the ability to sell an asset and, as a result, is fundamentally disconnected from the FV-OCI business model. The outcome is the CECL Model would force income statement recognition of credit losses, irrespective of an entity's ability to immediately sell the asset for a gain. This is in direct conflict with the underlying principle of the Recognition and Measurement ED (the accounting should reflect how cash flows are realized). Further, because the CECL Model does not contemplate sales, it does not require income statement recognition for non-credit losses

that may be realized if an entity intends to sell or would be forced to sell an amortized cost or FV-OCI asset. This seems counter to the Board's objective of addressing delayed loss recognition inherent in an incurred loss model.

As an alternative approach, we recommend the Board retain existing other-than-temporary-impairment ("OTTI") guidance described in ASC 320-10-35 for all FV-OCI assets (including loans, if applicable). The existing OTTI guidance prevents the issues discussed in the paragraph above. Further, it is well-understood, operational, and we are not aware of any financial statement user concerns. However, we recommend targeted improvements to the existing OTTI guidance to align it to the CECL Model and eliminate certain confusing elements. In particular, we believe the OTTI guidance should allow for subsequent reversals of recorded impairment to the extent a reversal is supported by facts and circumstances. We also believe the income statement presentation guidance within ASC Topic 320-10-45-8A should be eliminated. This guidance requires separate income statement presentation of the total OTTI and reclassification of non-credit portions to other comprehensive income. This presentation is an on-going source of confusion for financial statement users. We recommend the income statement present only the portion of OTTI recognized in earnings; amounts classified to other comprehensive income should be addressed by the presentation and disclosure requirements under ASU 2013-02 – *Comprehensive Income (Topic 220) – Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income* ("ASU 2013-02").

Under this alternative approach, the CECL Model would apply only to amortized cost assets. The current practical expedient described in paragraph 825-15-25-2 applies only to FV-OCI assets and thus, under this alternative approach, would be unnecessary. However, we recommend a practical expedient be provided for amortized cost assets that have insignificant credit losses both individually and in aggregate. In particular, we believe loans or debt securities issued or guaranteed by highly-rated governments, such as U.S. Treasury securities, and mortgage-backed securities issued by Ginnie Mae, Fannie Mae, and Freddie Mac<sup>4</sup>, would have insignificant credit losses. To date, the U.S. government has not defaulted on its obligations (i.e., no loss history exists); this creates a challenge in developing a quantitatively supportable expectation of credit loss. Further, we do not see the benefit of measuring insignificant expected credit losses, which by definition would not materially impact the financial statements and thus would not be decision-useful to financial statement users.

If the Board agrees to introduce a practical expedient for amortized cost assets, the evaluation of fair value would be irrelevant, as sales of amortized cost assets generally would not be allowed under the Recognition and Measurement ED. Accordingly, the practical expedient would only apply when expected credit losses are determined to be insignificant. To ensure the practical expedient is actually "practical", we recommend the guidance be written in such a way that it acknowledges a determination of insignificant losses can be supported by a qualitative assessment of the credit risk.

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<sup>4</sup> Fannie Mae and Freddie Mac (collectively "the agencies") are currently in government conservatorship under the direction of the Federal Housing Finance Agency. The conservatorship, nor agreements the agencies have with the U.S. Treasury department, impact the guarantee obligations the agencies have to the respective MBS investors. The agencies are receiving various forms of significant support by the U.S. government, which can be used to meet the agencies guarantee obligations. The collective impact is that the U.S. government currently supports the agencies' guarantees.

If the Board does not accept the alternative approach described above, we suggest the following changes be made to the CECL Model to address the various conceptual issues noted above:

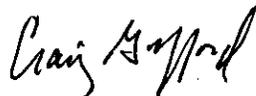
- Revise the practical expedient language to allow it to apply if the fair value is greater than the amortized cost basis or expected credit losses are insignificant. This could be accomplished by changing the word “both” to “any” found in the first portion of the sentence in paragraph 825-15-25-2. This change is important, for two reasons. First, it allows FV-OCI assets to not have credit losses recognized when they are in unrealized gain positions. Second, it allows for instruments expected to have insignificant credit losses to apply the practical expedient in all rate scenarios; without it, we anticipate the practical expedient may be unavailable in rising rate environments when FV-OCI assets are likely to be in unrealized loss positions.
- Expand the practical expedient to also apply to amortized cost assets. If the Board prefers, the fair value component of the practical expedient could be limited only to FV-OCI assets.
- Include within the practical expedient language an acknowledgment that insignificant credit losses can be supported by a qualitative assessment.
- Ensure non-credit losses are recognized on FV-OCI assets (for example, when there is an unrealized loss unrelated to credit and the institution intends to sell or does not have the ability to hold). This could be incorporated within the CECL Model itself. However, if there is a preference to keep the CECL Model focused only on credit losses, then loss recognition guidance could be included outside the CECL Model, perhaps similar to how the Recognition and Measurement ED addresses “impairment” of amortized cost assets when they are subsequently identified for sale (see paragraph 825-10-35-14).

Finally, we recommend the Board reconsider or otherwise simplify the credit quality disclosures in paragraphs 825-15-50-4 through 825-15-50-7 for debt securities. The credit quality of debt securities is typically monitored and managed differently than loans (typically individually assessed), and the availability of credit information for debt securities is significantly more limited.

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USB appreciates the opportunity to submit views and would be pleased to discuss our comments with you at your convenience. Please contact me at (612) 303-5238 with questions or if you need additional information.

Sincerely,



Craig E. Gifford  
Controller