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Russell G. Golden
Chairman
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Via email: director@fasb.org

RE: File Reference No. 2018-300

Dear Chairman Golden:

The American Bankers Association¹ (ABA) appreciates the opportunity to comment on the Exposure Draft, *Proposed Accounting Standards Update—Codification Improvements—Financial Instruments* (ED). The ED proposes amendments based on 23 separate issues related to *Accounting Standards Update No. 2016-13, Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments* (“the CECL standard”), *Accounting Standards Update No. 2017-12, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities* (“Hedging”), and *Accounting Standards Update No. 2016-01, Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities* (“ASU 2016-1”). As some of the proposed guidance addresses ASU 2016-13 (the CECL standard), this letter is written in light of the serious overall concerns related to CECL and expressed in previous ABA comment letters.² Appropriate implementation of accounting standards, however is critical and the ABA supports FASB’s continual efforts to correct and improve issued accounting standard updates. The ABA is concerned with certain proposed amendments and seeks clarifications regarding other amendments, as noted below.

Issue 1A: Accrued Interest

The ABA appreciates the additional flexibility the ED proposes regarding how to address CECL reserves for accrued interest, including the ability to make policy elections to (a) reserve for accrued interest separately and carry that reserve within the same balance sheet line item as accrued interest or (b) to timely reverse accrued interest on delinquent loans, in lieu of reserving for accrued interest.

Regarding the election to timely reverse accrued interest, we believe banks generally apply non-accrual policies to their loan portfolios. However, at CECL adoption, institutions (including non-banks) may need to adopt or otherwise make adjustments to their non-accrual policies, such as to incorporate interest reversals or to better

¹ The American Bankers Association is the voice of the nation’s \$17 trillion banking industry, which is composed of small, regional and large banks that together employ more than 2 million people, safeguard \$13 trillion in deposits and extend more than \$10 trillion in loans.

² See ABA.com/CECL for more detail on specific CECL-related concerns.

align their policies to any expectation of what is considered “timely.” We do not believe the CECL transition guidance is clear regarding how to treat accrued interest reversals at adoption. Therefore, we believe that if, as part of their policy election at CECL adoption, an institution adopts or changes their non-accrual policy to timely reverse interest, the impact of the policy change (i.e., reversals of interest income) should be captured as part of the transition/cumulative effect adjustment recorded to retained earnings. We believe this treatment will align the treatment of transition impacts across the varying accrued interest policy elections available under CECL.

Further, the ABA suggests providing clarification on the meaning of “timely writeoff.” The Uniform Retail Credit Classification and Account Management Policy adopted by the Federal Financial Institutions Examination Council (FFIEC), on behalf of the Board of Governors of the Federal Reserve System (FRB), the Federal Deposit Insurance Corporation (FDIC), and the Office of the Comptroller of the Currency (OCC) established standards for the classification and treatment of retail credit in financial institutions, and generally requires that closed-end loans be charged off when 120 days past due from the contractual due date, and that open-end credit be charged off when 180 days past due from the contractual due date. We believe reference to this guidance as an example of what might constitute a “timely writeoff” could assist preparers in determining a practical and consistent methodology under this guidance.

Regarding the applicability to available for sale (AFS) securities, the proposed change does not also amend Subtopic 326-30. This seems inconsistent with Paragraph 44 of TRG Memo No. 13, which highlighted the applicability of this issue to AFS debt securities, noting that any expedients should also extend to Subtopic 326-30. Also, prior to ASU 2016-13, the ASC Glossary definition of amortized cost (which is utilized for AFS securities accounting in Subtopic 320-10) did not explicitly include “applicable accrued interest.” Accordingly, some financial institutions currently present accrued interest receivable in a separate financial statement line item from the associated AFS securities (similar to their presentation for accrued interest receivable on loans). Therefore, the same operational complexities and change to existing practice that would have resulted for loans also apply for AFS securities, absent these expedients. Further, debt securities held in regulated entities are also subject to nonaccrual guidance. Therefore, the ABA suggests the guidance also be applicable to AFS securities in Subtopic 326-30.

Regarding the applicability to held-to-maturity (HTM) securities, we believe that the practical expedient to exclude accrued interest from the amortized cost basis when measuring credit losses should also apply to HTM debt securities. However, because debt securities are excluded from the definition of financing receivable in ASC 310-10-55-15, ABA recommends considering the following edit to ensure it is clear that the practical expedient is also permitted for HTM debt securities:

326-20-50-3B As a practical expedient, an entity may exclude the applicable accrued interest that is included in the amortized cost basis of financing receivables and held-to-maturity securities for the purposes of the disclosure requirements in paragraphs 326-20- 50-4 through 50-22. If an entity elects this practical expedient, it shall disclose the total amount of accrued interest excluded from the disclosed amortized cost basis.

Paragraph 326-20-45-5 indicates that an entity may elect to separately present accrued interest receivable in the statement of financial position, if the entity meets the disclosure requirements in paragraph 326-20-50-3A. It

does not seem necessary that meeting the disclosure requirements is a precondition to make the separate presentation election; rather, the disclosure requirements would need to be met if an entity made the election.

Further, the ABA believes the presentation was not intended to require consistent application across all financial instruments within the scope, but was meant to provide flexibility across classes of financing receivables and major security types, consistent with paragraph 326-20-30-5A. The ABA suggests the elimination of the reference to “entire” accrued interest receivable balance within paragraph 45-5.

In accordance with the preceding comments, the ABA recommends amending the paragraph as follows:

326-20-45-5 For financial assets measured at amortized cost and net investments in leases within the scope of this Subtopic, an entity may elect to separately present on the statement of financial position or within another statement of financial position line item the ~~entire~~ accrued interest receivable balance net of the allowance for credit losses (if any) ~~if the entity meets the disclosure requirements in paragraph 326-20-50-3A.~~

Regarding paragraph 326-20-50-3A, the ABA recommends clarifying that an entity’s policy for presenting accrued interest receivable balances within the statement of financial position should be disclosed irrespective of the approach selected to ensure clarity of where related amounts are presented across an entity’s products. The ABA recommends amending the paragraph as follows:

326-20-50-3A An entity shall disclose its policy for presenting accrued interest receivable balances within the statement of financial position. For example, an entity that chooses to present the accrued interest receivable balance within another statement of financial position line item as described in paragraph 326-20-45-5 shall disclose the total amount of accrued interest presented separately from the amortized cost basis and shall disclose in which line item on the balance sheet that amount is presented. An entity also shall disclose the amount of the allowance for credit losses measured on the applicable accrued interest, if any.

Issue 1B: Transfers between Classifications or Categories for Loans and Debt Securities

The ABA supports the principle of the amendments, namely, to require an entity to reverse any allowance for credit losses or valuation allowance previously measured on a loan or debt security, transfer the loan or debt security to the new classification or category, and apply the applicable measurement guidance in accordance with the new classification or category. However, within the specific amendments, the ABA notes there appears to be limitations that exclude financial assets in the scope of ASC 310 or the CECL standard. Generally, the ABA recommends the amendments expand the discussion to be fully inclusive of all financial assets within the scope of ASC 310 and the CECL standard. Specific examples include:

- Paragraph 310-10-35-47 & 47A – Please clarify why these two paragraphs are limited to nonmortgage loans and trade receivables only.
- Paragraph 310-10-35-48 – Please clarify why held for sale is limited to nonmortgage loans only. For example, trade and other receivables can be sold via factoring.

- Paragraphs 310-10-35-48A & 48B – Transfers from “not held for sale” classification to “held for sale” can occur for instruments other than loans, including trade receivables, lease receivables, etc. Guidance on transfers should not be limited to loans.
- Paragraphs 310-10-45-2 – Please clarify why presentation matters relating to transfers of financial assets from not held for sale to held for sale and vice versa are limited to nonmortgage loans and trade receivables.
- Paragraph 326-20-35-7 – This paragraph identifies only loans for treatment once a decision has been made to sell. However, other financial instruments measured at amortized cost could be subject to a decision to sell.

In addition, we believe an example is necessary to appropriately illustrate the intended accounting model for transfers from AFS classification of debt securities to HTM, as articulated in paragraph 320-10-35-10B. The example on pages 12 & 13 of CECL TRG Memo No. 10 illustrates a transfer from AFS to HTM whereby the unrealized holding loss on the AFS security (which excludes amounts recognized via the allowance) is added to the AFS security’s amortized cost basis to arrive at the carrying value of the HTM security. If paragraph 320-10-35-10B is intended to be an articulation of the model underpinning the example in the TRG Memo, we believe the following updates are required:

- The example in 320-10-55-24 should be updated (or a new example should be added) to illustrate the intended model;
- References to the term “fair value” in paragraphs 320-10-35-10B(d) and 320-10-55-24 should be removed and/or updated; and
- Guidance should be added to clarify how/whether the transfer impacts the security’s amortized cost basis (i.e., whether OCI amounts added to/subtracted from to the previous amortized cost basis change only the HTM security’s carrying amount or also its amortized cost basis)..

Additionally, sub-bullet “b” of paragraph 320-10-35-10B should be edited as follows:

- b. Reclassify and transfer the debt security to the ~~available for sale~~ held-to-maturity category at its amortized cost basis (which is reduced by any previous writeoffs but excludes any allowance for credit losses) plus or minus the amount of any remaining unrealized holding gain or loss reported in accumulated other comprehensive income.

Issue 1C: Recoveries

In paragraph 326-20-30-1, consider adding explicit language that the allowance for credit losses, a contra-loan account, can have a debit balance.

In paragraph 326-20-30-4 & 5, the guidance does not speak to whether changes (particularly expectations of recoveries) should also be based on fair value of the collateral at the reporting date, as opposed to recovery expectations based on forecasts. Please clarify that the expected credit loss for a probable foreclosure must be on the fair value of the collateral on the reporting date on an ongoing basis. In addition, paragraph 326-20-30-4

does not mention the ability to have a debit to the allowance for estimating expected recoveries. We recommend considering adding language regarding the limit to not recover beyond the amounts written off.

We also recommend considering the following edits to (1) clarify first that a negative allowance is permitted, and then the fact that any negative allowance should be limited to the amount of prior write offs; and (2) re-order paragraph 35-5 to address recognition of the allowance before addressing the potential recognition of a negative allowance:

326-20-35-4 Regardless of the initial measurement method, an entity shall measure expected credit losses based on the fair value of the collateral at the reporting date, when the entity determines that foreclosure is probable. When an entity determines that foreclosure is probable, the entity shall remeasure the financial asset at the fair value of the collateral at the reporting date so that the reporting of a credit loss is not delayed until actual foreclosure. An entity also shall consider any credit enhancements that meet the criteria in paragraph 326-20-30-12 that are applicable to the financial asset when recording the allowance for credit losses. When the fair value (less costs to sell, if applicable) of the collateral at the reporting date exceeds the amortized cost basis of the financial asset, an entity shall adjust the allowance for credit losses to present the net amount expected to be collected on the financial asset to equal the fair value (less costs to sell, if applicable) of the collateral. An allowance for credit losses, that is added to the amortized cost basis of the financial asset(s), shall not exceed amounts previously written off.

326-20-35-5 An entity may use, as a practical expedient, the fair value of the collateral at the reporting date when recording the net carrying amount of the asset and determining the allowance for credit losses for a financial asset for which the repayment is expected to be provided substantially through the operation or sale of the collateral when the borrower is experiencing financial difficulty based on the entity's assessment as of the reporting date (collateral-dependent financial asset). If an entity uses the practical expedient on a collateral-dependent financial asset and repayment or satisfaction of the asset depends on the sale of the collateral, the fair value of the collateral shall be adjusted for estimated costs to sell (on a discounted basis). However, the entity shall not incorporate in the net carrying amount of the financial asset the estimated costs to sell the collateral if repayment or satisfaction of the financial asset depends only on the operation, rather than on the sale, of the collateral. ~~When the fair value (less costs to sell, if applicable) of the collateral at the reporting date exceeds the amortized cost basis of the financial asset, an entity shall adjust the allowance for credit losses to present the net amount expected to be collected on the financial asset to equal to the fair value (less costs to sell, if applicable) of the collateral. An allowance for credit losses, that is added to the amortized cost basis of the financial asset(s), shall not exceed amounts previously written off.~~ If the fair value of the collateral is less than the amortized cost basis of the financial asset for which the practical expedient has been elected, an entity shall recognize an allowance for credit losses on the collateral-dependent financial asset, which is measured as the difference between the fair value of the collateral, less costs to sell (if applicable), at the reporting date and the amortized cost basis of the financial asset. An entity also shall consider any credit enhancements that meet the criteria in paragraph 326-20-30-12 that are applicable to the financial asset when recording the allowance for credit losses. When the fair value (less costs to sell, if applicable) of the collateral at the reporting date exceeds the amortized cost basis of the financial asset, an entity shall adjust the allowance for credit losses to present the net amount expected to be collected on the

financial asset to equal to the fair value (less costs to sell, if applicable) of the collateral. An allowance for credit losses, that is added to the amortized cost basis of the financial asset(s), shall not exceed amounts previously written off.

Paragraph 326-20-30-8 & 9– All references to recoveries have been removed. Consider editing the title of this section as follows:

Writeoffs ~~and Recoveries~~ of Financial Assets

In addition, it is unclear to us whether the ED was intended to require an entity to apply the recovery and negative allowance guidance to AFS securities. For example, the ED amends ASC 326-30-35-13 (on page 38) to cross-reference writeoff and recovery guidance in ASC 326-30 (implying that the guidance in fact applies), but Question 7 (on page 19) asks whether an entity should be permitted to record a negative allowance on AFS debt securities. If the Board’s intent was to require negative allowance guidance to be applied to AFS securities, we believe updates are required to clarify the interaction of this guidance with the fair value floor guidance in paragraphs 326-30-35-2 & 35-6 and other guidance in paragraph 326-30-35-12. If negative allowance guidance is required to be applied to AFS securities, we recommend amending certain paragraphs as indicated below:

326-30-35-12 An entity shall reassess the credit losses each reporting period when there is an allowance for credit losses. An entity shall record subsequent changes in the allowance for credit losses on available-for-sale debt securities with a corresponding adjustment recorded in the credit loss expense on available-for-sale debt securities. An entity shall not reverse a previously recorded allowance for credit losses to an amount below zero (except to the extent a negative allowance is required in accordance with paragraph 326-30-35-13).

326-30-35-13 An entity shall recognize writeoffs and recoveries of available-for-sale debt securities in accordance with paragraphs 326-20-30-1 and 326-20-35-8 through 35-9. While the guidance in paragraphs 326-30-35-2 and 35-6 limits the amount of positive allowance that may be recorded, that guidance does not impact the amount of any negative allowance required to be recorded in accordance with this paragraph (if applicable).

Issue 2D: Projections of Interest Rate Environments for Variable-Rate Financial Instruments

We believe the guidance in Paragraphs 326-20-30-4 & 326-30-35-11 could be enhanced to provide further clarity on how the related elections interact with the interest income recognition guidance in Topic 310. Per Paragraphs 326-20-30-4 & 326-30-35-11, projections of factor changes used for estimating cash flows should also be used in determining the effective interest rate to discount those cash flows. The guidance in ASC 310-20-35-18(c) stipulates that the calculation of constant effective yield on a floating rate loan shall be based either on (i) the factor (the index or rate) that is in effect at the inception of the loan or (ii) the factor as it changes over the life of the loan. This would suggest that projections of rates are not permitted for interest income recognition. However, the use of the term “effective interest rate” (which has a particular meaning within the context of interest income recognition guidance) in Paragraphs 326-20-30-4 & 326-30-35-11 could result in confusion as to whether this election would also impact interest income recognition. Therefore, we recommend either (1) clarifying in Paragraphs 326-20-30-4 & 326-30-35-11 that projections of factor changes are not

permitted for interest income recognition purposes under ASC 310-20, or (2) updating the current cross-references in Paragraphs 326-20-30-4 & 326-30-35-11 from “Subtopic 310-20” to “paragraph 320-10-35-18(c) to enhance the usefulness of the cross-reference.

Issue 4D: Remeasurement of Equity Securities at Historical Exchange Rates

Regarding the amendments to paragraph 830-10-45-18, the introduction to the proposed changes indicates that the FASB intends for HTM securities to be considered non-monetary for purposes of foreign currency remeasurement. However, HTM securities are currently monetary assets subject to remeasurement, and meet the monetary asset definition of being fixed in terms of units of currency by contract or otherwise. This would be a significant change, likely requiring significant systems/operational changes. If the Board intends to make this change, we believe that it must be exposed and deliberated in a separate standard project rather than in a codification improvement.

Further, the proposed guidance deletes the guidance related to equity securities carried at cost and replaces it with reference only to nonmarketable securities. It is possible there would still be cost method securities that should be considered non-monetary, such as Federal Reserve or Federal Home Loan Bank stock, and require exchange memberships. As such, we think that the reference to cost method securities generally should be retained.

Issue 5A: Vintage Disclosures—Line-of-Credit Arrangements Converted to Term Loans

Paragraph 326-20-50-6A introduces the concept of "credit decision," in assessing appropriate disclosure classification. This concept is not clearly defined nor historically tracked. Introducing a new disclosure concept this late in the implementation has significant implications. We recommend that this condition be replaced with the requirement to assess whether the original arrangement has undergone a “more than minor” modification, as that term is defined in ASC 326-20-35-5. We believe that it would be preferable to use an existing approach concept that is well-defined and well-understood for purposes of this presentation guidance, rather than introducing an entirely new term that may be subject to different interpretation by different institutions.

The vintage disclosures in ASC 326-20-50-6 only apply to financing receivables and net investment in leases (except for reinsurance receivables and funded or unfunded amounts of line-of-credit arrangements, such as credit cards. Because debt securities are explicitly excluded from the definition of financing receivable (per the ASC Master Glossary and ASC 310-10-55-15), the vintage disclosures do not apply to HTM debt securities. However, the last sentence in ASC 326-20-50-6A of the Proposal states that “An entity shall disclose each reporting period, by class of financing receivable or major security type, the amount of line-of-credit arrangements that are converted to term loans each reporting period”. We recommend removing the reference to “major security type” in this paragraph to avoid implying HTM securities are subject to vintage disclosures.

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Consider the following edits to (1) replace the new disclosure concept (“credit decision”) with the requirement to assess whether the original arrangement has undergone a “more than minor” modification; and (2) remove the reference to “major security type”:

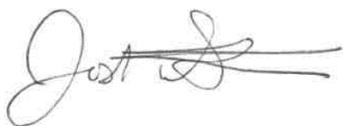
326-20-50-6A For the purpose of the disclosure requirement in paragraph 326-20- 50-6, an entity shall present the amortized cost basis of line-of-credit arrangements that are converted to term loans as a result of a more than minor modification that is not a troubled debt restructuring within each credit quality indicator in the origination year that corresponds with the period in which the entity made the modification ~~its most recent credit decision after the original credit decision~~. For amounts of line-of-credit arrangements that are converted to term loans according to the loans original contractual terms ~~without an additional credit decision after an entity made its original credit decision~~ or that are converted to term loans because of a troubled debt restructuring, the entity shall disclose the amortized cost basis in a separate column (see Example 15). An entity shall disclose each reporting period, by class of financing receivable ~~or major security type~~, the total amount of line-of-credit arrangements that ~~are~~ have been converted to term loans as of the date of the each reporting period.

Issue 5B: Contractual Extensions and Renewals

As noted in the basis for conclusions, paragraph BC 104, the Board did not want to prescribe the method for assessing the extension or renewal options in determining the life of the loan. At both the TRG and at the November 7, 2018 Board meeting, the ability to assume that the extension or renewal would be exercised and then to apply a prepayment analysis was discussed as one way to appropriately consider the extension or renewal options when assessing the life of loan. However, the language in paragraph 326-20-30-6 (b) does not appear to allow that flexibility by the use of the word “shall” in the requirement to evaluate the likelihood that the contractual extension or renewal option will be exercised. More specifically, paragraph 326-20-30-6 already requires that the entity consider prepayments and that stating the entity “shall evaluate the likelihood that the contractual extension or renewal option will be exercised” indicates a requirement to perform a separate analysis specific to the extension or renewal option. The ABA recommends considering amending the wording from “shall” to “may” evaluate the likelihood that the contractual extension or renewal option will be exercised to allow the additional flexibility intended.

Thank you for your attention to these matters and for considering our views. Please feel free to contact me (jstein@aba.com; 202-663-5318) if you would like to discuss this in more detail.

Sincerely,



Joshua Stein