NAVY FEDERAL
Credit Union

December 19, 2018

Technical Director – File Reference No. 2018-300
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

Via E-mail:
Attn: director@fasb.org
Re: File Reference No. 2018-300

FASB Technical Director:

On behalf of the Board of Directors of Navy Federal Credit Union, please accept and consider our comments regarding the Proposed Accounting Standards Update, *Codification Improvements—Financial Instruments* ("Exposure Draft"). We thank the Financial Accounting Standards Board ("FASB" or the "Board") for the solicitation of input from relevant stakeholders and look forward to additional guidance from the Board related to the changes and improvements under consideration within the Exposure Draft.

Navy Federal Credit Union is a member-owned, not-for-profit financial institution formed in 1933 to provide a variety of savings and lending programs to those individuals in its field of membership, which includes:

- Active Duty members, reservists, veterans, retirees and annuitants of the Army, Marine Corps, Navy, Air Force, and Coast Guard
- Army and Air National Guard personnel
- Delayed Entry Program personnel
- Department of Defense (DoD) civilians
- U.S. Government employees and contractors assigned to DoD installations
- Family members of any of the above

Today, we serve over 8 million members and financially account for over $96 billion in assets.

We are in support of the Board's efforts to improve the guidance within the various financial instrument accounting standards under review. Specifically, we offer the following comments related to the following areas discussed in the Exposure Draft in which we have feedback—accrued interest, recoveries, interest rate forecasts, prepayment-adjusted effective interest rate, and derivatives and hedging. Our responses are organized into the areas identified as follows:

Accrued Interest

We feel the amendments within the Exposure Draft related to accrued interest will simplify and reduce operational concerns resulting from the existing requirement to combine accrued interest balances with all other components of amortized cost when measuring and presenting expected credit losses in accordance with ASU 2016-13—*Financial Instruments, Credit Losses* ("CECL"). As a result, we are in support of all accrued interest accounting policy elections and practical expedients proposed.

Recoveries

Including recoveries as an input in the expected credit loss calculation would most accurately represent total expected credit losses over the life of a financial asset. As a major component in the estimation of total credit losses of financial assets, prohibition of the inclusion of recoveries in the estimation of credit losses would be inappropriate. As a result, we feel the proposed amendments adequately clarify the guidance outlined in paragraph 326-20-35-8. Since our view is that recoveries be included as an input in the estimation of total credit losses, we feel it is appropriate to be able to recognize a negative allowance related to all financial assets carried at amortized cost (e.g. loans, held to maturity ("HTM") debt securities, and available-for-sale ("AFS") debt securities) that have been previously fully or partially written off. We note the Board has specifically requested feedback related to recording a negative allowance on AFS debt securities:

"Question 7: Should an entity be permitted to record a negative allowance when measuring the allowance for credit losses on available-for-sale debt securities? If yes, why?"

We believe a negative allowance is appropriate to record for AFS debt securities that have been previously fully or partially written off. Consider a corporate bond classified as an AFS debt security that has experienced a decline in fair value relative to its amortized cost basis as of the end of the reporting period. In accordance with the existing guidance outlined in Topic 326-30, *Available-for-sale debt securities*, an allowance for credit loss is established through measurement of the present value of cash flows expected to be collected relative to the amortized cost of the security, limited by the amount of the decline in fair value. If a Company were then to determine a sale of the security will occur (whether voluntarily or if a sale is deemed "more-likely-than-not"), then the allowance for credit losses is written off and the amortized cost basis is written down to the fair value at the reporting date. Subsequent recoveries in fair value may not be added to the new amortized cost basis as noted in paragraph 326-30-35-14. As a result of the prohibition to increase the cost basis per paragraph 326-30-35-14 due to increases in fair value, we support allowing the ability to recognize a negative allowance. We believe a negative allowance limits the impact of the subjectivity required in determining whether an entity will "more-likely-than-not" be required to sell an impaired security in accordance with paragraph 326-30-35-11—as this determination results in a permanent write down under the existing guidance. The proposed amendment will limit the impact of this determination and will result in a more accurate portrayal of the financial condition of, as well as the total net losses related to, AFS debt securities in a given reporting period.

Interest Rate Forecasts

We agree with the Board's intent to provide flexibility in determining the allowance for credit losses by removing the prohibition of using projections of future interest rate environments when using a discounted cash flow method to measure expected credit losses on variable rate financial assets. We feel the option to allow for a projection of future interest rate environments is appropriate to consider, however, we suggest to the Board to not require the projection, but to instead offer the option as an accounting policy election.

Prepayment Adjusted Effective Interest Rate

We support the Board in allowing for the option for entities to adjust the effective interest rate ("EIR") for the expectations of prepayments used to discount expected future cash flows through an accounting policy election. We do not feel it is appropriate to require a prepayment adjusted EIR in a discounted cash flow method given the impact such a requirement may have on less sophisticated institutions in implementing CECL. We feel an accounting policy election option, rather than a requirement, accurately represents the intent of the Board to minimize cost and complexity of implementing CECL.

Derivatives and Hedging

We agree with all codification improvements related to Accounting Standards Update ("ASU") 2017-12—*Derivatives and Hedging*, that impact our business. All items requiring clarification relevant to Navy Federal—consideration of the contractually specified interest rate being hedged in the hypothetical derivative method and the ability to designate one or more separately designated partial-term fair value hedging relationships of a single instrument at the same time—appropriately addresses our questions related to ASU 2017-12. It is our view that all updates included in a final Accounting Standards Update be effective as of the beginning of the first annual period after the issuance date of any such Update to allow for adequate time to assess and implement any changes to processes, systems, and financial statement disclosures.

Irrespective of our responses included in the above correspondence, we encourage the Board to delay the effective date of CECL to allow for the appropriate amount of time for the Board and banking regulators, inclusive of the National Credit Union Association ("NCUA"), to conduct a comprehensive quantitative and qualitative impact study to review the systematic and economic risks posed by CECL to all financial institution types and sizes. Such a study, in our opinion, should include a review of the applicability of CECL to credit unions as our industry did not participate in the poor and predatory lending practices that led to the financial crisis. The unintended consequences of CECL involve a disproportionally severe and costly impact to all credit unions in the form of higher relative implementation costs, higher risk, competitive disadvantages, and increased regulatory burden.

We appreciate the opportunity to submit our views to the Board and we welcome any questions or comments you may have on this letter. Please contact Sharon Poach at (703) 255-8683 with any questions about Navy Federal's comments.

Sincerely,

Sharon Poach

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Navy Federal Credit Union

cc: Debra Freeman
Senior Vice President, Financial Operations
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