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December 19, 2018

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

File Reference No. 2018-300
Re: Proposed Accounting Standards Update, *Codification Improvements — Financial Instruments*

Dear Ms. Cospers:

Deloitte & Touche LLP is pleased to comment on the FASB's proposed Accounting Standards Update (ASU) *Codification Improvements — Financial Instruments*.

We support the Board's efforts to clarify certain aspects of ASC 326, ASC 815, and ASC 825-10 to reduce the costs and complexity of implementing the recently issued standards that amended the accounting guidance on financial instruments. In particular, we appreciate the clarifications made to the credit losses guidance in ASC 326 that reflect discussions held at recent credit losses transition resource group (TRG) meetings.

However, as noted in Appendixes A and B of this letter, we are concerned that the proposed ASU leaves open certain questions that the Board should address before issuing a final ASU to ensure consistent application in practice.

Appendixes A, B, and C contain our responses to the proposed ASU's questions related to ASC 2016-13,¹ ASU 2017-12² and other hedge accounting items, and ASU 2016-01,³ respectively.

We appreciate the opportunity to comment on the proposed ASU. If you have any questions concerning our comments, please contact Jon Howard at (203) 761-3235.

Yours truly,

Deloitte & Touche LLP

cc: Robert Uhl

¹ FASB Accounting Standards Update No. 2016-13, *Measurement of Credit Losses on Financial Instruments*.

² FASB Accounting Standards Update No. 2017-12, *Targeted Improvements to Accounting for Hedging Activities*.

³ FASB Accounting Standards Update No. 2016-01, *Recognition and Measurement of Financial Assets and Financial Liabilities*.

Appendix A Deloitte & Touche LLP Responses to Questions Related to ASU 2016-13

Topic 1: Codification Improvements Resulting from the June 11, 2018, Credit Losses TRG Meeting

Issue 1A: Accrued Interest

Question 1: *Will the amendments in this proposed Update to (a) measure expected credit losses on accrued interest separately from other components of amortized cost basis, (b) make an accounting policy election to present accrued interest amounts separately from the related loan balance, and (c) elect a practical expedient to separately disclose the total amount of accrued interest included in amortized cost basis as a single balance to meet certain disclosure requirements simplify and reduce operational concerns when implementing the guidance in Update 2016-13 related to accrued interest? If not, please explain why you disagree and what changes should be made instead.*

We support the Board's efforts to simplify and make more operable for entities the accounting for credit losses on accrued interest in the estimation of total expected credit losses. We generally agree that the proposed amendments accomplish that objective. However, we believe that the proposed amendments could be further clarified in the following instances to limit questions upon application:

- Proposed ASC 326-20-35-8A states that an "entity may make an accounting policy election . . . to write off accrued interest receivables by reversing interest income or recognizing credit loss expense, or a combination of both." We support the ability for an entity to write off accrued interest by either reversing interest income or recognizing a credit loss expense. However, we understand that writing off accrued interest by using such a combination could be limited to a small group of entities in specific industries. As a result, we recommend that (1) the guidance be amended to indicate when writing off accrued interest through such a combination would be appropriate and (2) the Background Information and Basis for Conclusions include the Board's rationale supporting its decision to allow an entity the ability to write off accrued interest by a combination of reversing interest income and recognizing a credit loss expense. In addition, we believe that this accounting policy election should be available only to entities that write off uncollectible accrued interest receivables in a timely manner.
- In the table beginning on page 2 of the proposed ASU that outlines the proposal's main provisions, the proposed accounting policy election that would allow entities to write off accrued interest amounts by either reversing interest income or recognizing the write-off in credit expense is not described in a manner consistent with the wording of the proposed Codification amendment. To make the description consistent with the proposed amendment, we would suggest modifying the wording in item (d) of the Summary of Proposed Amendments for Issue 1A: Accrued Interest to read as follows (new text is underlined, and deleted text is ~~struck out~~):
 - d. Make an accounting policy election to write off accrued interest amounts by either reversing interest income or adjusting the allowance for credit losses recognizing credit loss expense.

Question 2: *Do you support the separate accounting policy elections that would allow an entity to choose to (a) write off accrued interest amounts by either reversing interest income or adjusting the allowance for credit losses and (b) elect not to measure an allowance for credit losses on accrued interest if the entity writes off uncollectible accrued*

File Reference No. 2018-300
December 19, 2018
Page 3

interest amounts in a timely manner? If not, please explain why you disagree and what changes should be made instead.

We generally support the proposed accounting policy elections that would allow an entity to choose to (1) write off accrued interest amounts by either reversing interest income or adjusting the allowance for credit losses and (2) elect not to measure any allowance for credit losses on accrued interest if the entity writes off uncollectible accrued interest in a timely manner. However, we are concerned that the proposed guidance does not describe what is considered to be a “timely manner.” The lack of clarity may lead to diversity in how the policy elections are applied in practice, particularly between regulated and unregulated entities.

For example, regulated entities are required to write off an accrued interest receivable if it is uncollected after a certain period. As a result, in the absence of clarification of what is considered to be a timely manner, regulated entities may simply default to regulatory requirements of when the accrued interest must be written off. In contrast, unregulated entities do not have similar regulatory reporting requirements and therefore will need to determine what is considered to be a timely manner. As a result, the election of the accounting policy not to measure an allowance for credit losses on accrued interest could vary significantly among regulated entities and between regulated and unregulated entities. This diversity in practice may not result in decision-useful information for financial statement users.

Therefore, we believe that the final guidance should include a discussion on what is meant by a timely manner either in ASC 326-20-30-5A or through an illustration in an implementation example. Accordingly, we encourage the FASB to conduct additional outreach with constituents on what should be considered a timely manner. In addition, we believe that the final guidance should include a requirement that an entity disclose its policy on how it defines a “timely manner” (unless the final guidance eliminates subjectivity by specifying the number of days in which an entity must write off accrued interest to qualify for the accounting policy election).

Question 3: *If you agree with the policy election not to measure an allowance for credit losses on accrued interest if the entity reverses or writes off uncollectible accrued interest amounts in a timely manner, what period would you consider to be timely?*

As stated in our response to Question 2, we encourage the FASB to discuss this question with financial statement preparers.

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

Question 4: *Are the proposed amendments related to the transfer of loans and debt securities between classifications or categories operable? If not, please explain why you disagree and what changes should be made instead.*

We generally support the proposed amendments related to the transfer of loans and debt securities between classifications. However, we encourage the Board to consider the following suggestions, which we believe would reduce potential operational difficulties when an entity implements these amendments:

- We would support the FASB’s consideration of an amendment that would require an entity to reverse any gains or losses recorded in other comprehensive income when a debt security is transferred from available for sale to held to maturity. Once the debt security is transferred, the gain or loss that had been recorded in other

comprehensive income will not be realized upon sale or maturity of the instrument. As a result, we believe that it is no longer appropriate for an entity to continue recording in other comprehensive income gains or losses that resulted while the debt security was classified as available for sale after the entity has transferred the debt security from available for sale to held to maturity. In addition, the unrealized gain (loss) will need to be amortized (accreted) and will offset the accretion (amortization) of any related discount or premium for the security. This bookkeeping has no impact on the income statement, but it adds operational complexity.

- Proposed ASC 320-10-35-10B discusses transfers into the held-to-maturity category, but ASC 320-10-35-10B(b) discusses transfers into the available-for-sale category. We therefore believe that ASC 320-10-35-10B(b) should be amended to read as follows (new text is underlined, and deleted text is ~~struck out~~):
 - 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

Question 5: *Do the proposed amendments clarify that recoveries are inputs that should be considered when measuring the allowance for credit losses? If not, please explain why you disagree and what changes should be made instead.*

While we support the Board's attempt to clarify how entities should consider recoveries when measuring lifetime expected credit losses, we believe that some of the proposed amendments may lead to additional questions or create further complexity for preparers and users of the financial statements. In addition, we believe that while the meaning of a recovery under ASC 326 is largely understood consistently among users, preparers, and auditors in certain industries, the notion that a recovery constitutes only amounts recovered that were previously written off may not be intuitive to such constituents in industries that do not have uniform write-off policies. Some would consider a recovery to be any amount collected on an asset. In scenarios in which an asset has a partial write-off, this could be confusing.

To prevent this possible confusion, we believe the proposed amendment to ASC 326-20-30-1 should be revised. ASC 326-20-30-1 states that "[r]ecoverable amounts included in the valuation account shall not exceed the aggregate of amounts previously written off and expected to be written off by the entity." We note that the term "recoverable amount" is already included in the ASC master glossary but is defined differently from how it is discussed in ASC 326. However, we believe that the proposed added text in ASC 326-20-35-5 that refers to the allowance as the "net amount expected to be collected," which "shall not exceed amounts previously written off," is clear and understandable. Therefore, we encourage the Board to further amend ASC 326-20-30-1 to include language similar to that of ASC 326-20-35-5 as follows (new text is underlined, and deleted text is ~~struck out~~):

The allowance for credit losses is a valuation account that is deducted from, or added to, the amortized cost basis of the financial asset(s) to present the net amount expected to be collected on the financial asset. ~~Recoverable amounts included in the valuation account shall not exceed the aggregate of amounts previously written off and expected to be written off by the entity.~~ An allowance for credit losses, which is added to the amortized cost basis of the financial asset(s), shall not exceed amounts previously written off. At the reporting date, an entity shall record an allowance for credit losses on financial assets within the scope of this Subtopic. An entity shall report in net income (as a credit loss expense) the amount necessary to adjust the allowance for credit losses for management's current estimate of expected credit losses on financial asset(s).

File Reference No. 2018-300
December 19, 2018
Page 5

Although we believe further clarification is needed on what a recovery is, we do not believe that further guidance is needed on what is an acceptable source of recovery (i.e., cash collected from the borrower vs. proceeds from the sale of collateral or the sale of the nonperforming financial assets) since that is consistently understood among users, preparers, and auditors.

We also suggest removing the term "Recoveries" from the title "Writeoffs and Recoveries of Financial Assets" immediately preceding ASC 326-20-35-8 since the section bearing that title no longer discusses recoveries. In addition, we suggest that the Board consider retaining some of the language in ASC 326-20-50-13(e) to clarify that recoveries included in the rollforward of the allowance for credit losses represent amounts collected after write-off that were previously recognized in the item required by ASC 326-20-50-13(d).

Question 6: *Do the proposed amendments clarify that an entity may record a negative allowance when measuring the allowance for credit losses using the fair value of the underlying collateral in accordance with paragraphs 326-20-35-4 through 35-5?*

We agree that the proposed amendments clarify that an entity may record a negative allowance when measuring the allowance for credit losses by using the fair value of the underlying collateral. However, we do not support the proposed change to ASC 326-20-50-13(e). Its purpose is unclear, and we believe that it could lead to additional confusion for financial statement preparers and users. Therefore, we suggest that no amendments be made to ASC 326-20-50-13(e).

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 would support permitting an entity to record a negative allowance on available-for-sale securities. However, we would not support allowing a negative allowance for available-for-sale securities that an entity intends to sell or will more likely than not be required to sell before the recovery of its amortized cost basis.

Topic 2: Codification Improvements to Update 2016-13

Question 8: *Do the proposed amendments clarify the guidance in Update 2016-13? If not, please explain which proposed amendment(s) you disagree with and why.*

We believe that the proposed amendments clarify the guidance in ASU 2016-13. However, we do not agree with the proposed amendment to ASC 326-20-35-4 that would require an entity to adjust the fair value of collateral for the estimated costs to sell on a *discounted* basis. It is unclear why estimated costs to sell should be discounted when ASC 326-20-35-4 requires an entity to measure expected credit losses by using fair value when the entity determines that foreclosure is probable. If the FASB believes that estimated costs to sell collateral should be discounted, we suggest that the Board's rationale be included in the Background Information and Basis for Conclusions.

Question 9: *Are there other changes that should be made that are directly or indirectly related to the proposed amendments? Please note that the Board will conduct Codification improvement projects on a periodic basis and additional changes may be postponed to a subsequent Codification improvement project.*

We are not aware of other changes related to the proposed amendments that should currently be made.

File Reference No. 2018-300
December 19, 2018
Page 6

Question 10: *The proposed amendments would apply to public and nonpublic entities. Would any of the proposed amendments require special consideration for nonpublic entities? If so, which proposed amendment(s) would require special consideration and why?*

We do not believe that the proposed amendments would require special consideration for nonpublic entities.

Question 11: *Should an entity be required to use a prepayment-adjusted effective interest rate if it uses projections of interest rate environments in estimating expected cash flows, including expected prepayments and defaults?*

We agree that an entity should be required to use a prepayment-adjusted effective interest rate if it uses projections of interest rate environments in estimating expected flows, including expected prepayments and defaults.

Question 13: *Should the effective date and transition requirements for the amendments in this proposed Update align with that of Update 2016-13 for entities that have not yet adopted Update 2016-13 before these proposed amendments are finalized? What transition disclosures should be required when adopting the proposed amendments and why?*

We agree that the effective date and transition requirements for the amendments in the proposed ASU should be consistent with those of ASU 2016-13.

Topic 5: Codification Improvements Resulting from the November 1, 2018, Credit Losses TRG Meeting

Question 25: *Do the proposed amendments clarify how an entity should present line-of-credit arrangements that convert to term loans within the vintage disclosure table requirement in paragraph 326-20-50-6? If not, please explain which proposed amendment(s) you disagree with and why.*

We believe that the proposed amendments provide clarification of how any entity should present line-of-credit arrangements that convert to term loans within the vintage disclosure table. Proposed ASC 326-20-50-6A would require disclosure by class of financing receivable or major security type the amount of line-of-credit arrangements converted to term loans each reporting period. We believe that this disclosure requirement could be further illustrated by including the required disclosure in Example 15 of ASC 326 (ASC 326-20-55-79).

Question 26: *Do the proposed amendments clarify how an entity should consider extension or renewal options (excluding those that are accounted for as derivatives in accordance with Topic 815) that are included in the original or modified contract at the reporting date and*

File Reference No. 2018-300
December 19, 2018
Page 7

are not unconditionally cancellable by the entity? If not, please explain which proposed amendment(s) you disagree with and why.

Proposed ASC 326-20-30-6(b) states that an “entity shall evaluate the likelihood that the contractual extension or renewal option will be exercised.” It is unclear why an entity would be required to consider the likelihood that an option will be exercised when the option is not unconditionally cancelable by the entity. That is because if the option is not unconditionally cancelable by the entity, the entity cannot limit its exposure to credit risk. As a result, the probability that the counterparty will exercise such an option seems irrelevant to determining the contractual life of the agreement, which is what ASC 326-20-30-6(b) is supposed to address. For prepayable assets, an entity is not supposed to explicitly take prepayments into account when determining the contractual life of the agreement. Rather, prepayments are only supposed to be considered as a separate input in the method or embedded in the credit loss information when an entity estimates its credit losses.

Appendix B

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Responses to Questions Related to

ASU 2017-12 and Other Hedging Items

Topic 3: Codification Improvements to Update 2017-12 and Other Hedging Items

Question 14: *Do the proposed amendments clarify the guidance in Topic 815? If not, please explain which proposed amendment(s) you disagree with and why.*

We agree that the proposed amendments clarify the guidance in ASC 815. However, we have the following concerns about Issue 3A: Partial-Term Fair Value Hedges of Interest Rate Risk and Issue 3B: Amortization of Fair Value Hedge Basis Adjustments:

- *Issue 3A: Partial-Term Fair Value Hedges of Interest Rate Risk* — The proposed ASU would amend ASC 815-25-35-13B to clarify that one or more separately designated partial-term fair value hedging relationships can be outstanding at the same time for the same debt instrument. For example, for a 10-year debt instrument, an entity would be able to designate separate hedging relationships related to (1) consecutive interest cash flows in years 1–3 and (2) consecutive interest cash flows in years 5–7. However, such designations would cause an entity to assume for hedging purposes that a single security has multiple maturities, which could present practical application difficulties.

If entities are permitted to have more than one separately designated partial-term hedging relationship outstanding at the same time for the same financial instrument, we recommend that ASC 815-25-35-13B state that no single cash flow can be designated as a hedged cash flow in more than one outstanding partial-term hedging relationship at any given time (i.e., when an entity has designated multiple partial-term fair value hedging relationships for a single financial instrument, the designated cash flows cannot overlap). Also, we recommend that the final ASU clarify that for a forward-starting partial-term hedging relationship (e.g., the relationship that designated the cash flows related to years 5–7 in the example above), there would be an assumed issuance of the hedged item in addition to an assumed maturity. We believe that adding an implementation example to the final ASU would facilitate practical application of the guidance on partial-term fair value hedges of interest rate risk.

- *Issue 3B: Amortization of Fair Value Hedge Basis Adjustments* — The proposed ASU would amend ASC 815-25-35-9A to clarify that if an entity elects to amortize the basis adjustment in an outstanding partial-term hedge, that basis adjustment should “be fully amortized on or before the hedged item’s assumed maturity date in accordance with paragraph 815-25-35-13B.” We recommend clarifying the reasoning behind the language “on or before” in the proposed amendment since it is not clear why the basis adjustments for partial-term fair value hedges can be fully amortized before the hedged item’s assumed maturity date.

In addition, we believe that the final ASU should clarify that the amortization of the fair value hedge basis adjustments is related only to interest rate risk and not to foreign currency exchange risk, given that foreign currency risk would not result in a yield adjustment on an interest-bearing financial instrument.

Question 15: *Are there other changes that should be made that are directly or indirectly related to the proposed amendments? Please note that the proposed Codification*

File Reference No. 2018-300
December 19, 2018
Page 9

improvements related to (a) the change in hedged risk guidance for cash flow hedges discussed at the March 28, 2018 Board meeting and (b) use of the word prepayable in the shortcut method guidance discussed at the February 14, 2018 Board meeting will be included in a future proposed Update.

See our response to Question 14.

Question 16: *The proposed amendments would apply to public and nonpublic entities. Would any of the proposed amendments require special consideration for nonpublic entities? If so, which proposed amendment(s) would require special consideration and why?*

We are not aware of any special considerations that would be required for nonpublic entities.

Question 17: *Should partial-term fair value hedging be expanded to all risks eligible for hedge accounting?*

While we have expressed our concerns above about how certain aspects of the accounting model for partial-term fair value hedges of interest rate risk would be applied, we are not aware of a conceptual basis for limiting an entity's ability to designate and measure the change in fair value of a hedged item when the change is attributable to any risk that is eligible for hedge accounting.

Question 18: *Do you agree with the specific considerations for transition and the effective date for the proposed amendments to Topic 815? Please explain why or why not.*

Yes, we agree with the specific considerations related to transition and the effective date of the proposed amendments to ASC 815 since the effective date and transition provisions of the proposed ASU are aligned with those of ASU 2017-12 for entities that have not yet adopted ASU 2017-12. See our response to Question 19 below for considerations related to transition and the effective date of the proposed ASU for entities that have adopted ASU 2017-12.

Question 19: *Should the proposed amendments to Topic 815 be effective as of the earlier of the beginning of the first quarterly period (if applicable) or the first annual period after the issuance date of a final Update? Would this provide entities with sufficient time to implement these amendments?*

We do not believe that the transition period would need to be lengthy because the proposed amendments are further clarifying the simplifications that were already made to the existing hedging model in ASU 2017-12.

Appendix C
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Responses to Questions Related to ASU 2016-01

Topic 4: Codification Improvements to Update 2016-01

Question 20: *Do the proposed amendments clarify the guidance in Update 2016-01? If not, please explain which proposed amendment(s) you disagree with and why.*

We support the proposed amendments.

Question 21: *Are there other changes that should be made that are directly or indirectly related to the proposed amendments? Please note that the Board will conduct Codification improvement projects on a periodic basis and additional changes may be postponed to a subsequent Codification improvement project.*

We are not aware of other changes related to the proposed amendments that should currently be made.

Question 22: *The proposed amendments would apply to public and nonpublic entities. Would any of the proposed amendments require special consideration for nonpublic entities? If so, which proposed amendment(s) would require special consideration and why?*

We do not believe that the proposed amendments would require special consideration for nonpublic entities.

Question 24: *Should the effective date and transition requirements for the proposed amendments align with that of Update 2016-01 for entities that have not yet adopted Update 2016-01 before these proposed amendments are finalized? What transition disclosures should be required when adopting the proposed amendments and why?*

We agree that the effective date and transition requirements for the amendments in the proposed ASU should be consistent with those of ASU 2016-01.