



Kevin Stevenson
Chairman
Australian Accounting Standards Board
PO Box 204
Collins Street West VIC 8007

via email: standard@asb.gov.au

15 July 2013

Dear Kevin

Re: Exposure draft 237 *Financial Instruments: Expected Credit Losses*

I am enclosing a copy of PricewaterhouseCoopers' response to the International Accounting Standards Board's exposure draft ED/2013/3 *Financial Instruments: Expected Credit Losses*.

The letter reflects the views of the PricewaterhouseCoopers (PwC) network of firms and as such include our own comments on the matters raised in the request for comment. PwC refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

AASB specific matters for comment

We are not aware of any regulatory or other issues that could affect the implementation of either of the proposals for not-for-profit and public sector entities.

Subject to our concerns about specific matters as expressed in our submissions to the IASB, the proposals would result in financial statements that would be useful to users. Should the proposed amendments be approved by the IASB, we are not aware of anything that would indicate that the proposals are not in the best interests of the Australian economy.

I would welcome the opportunity to discuss our firm's views at your convenience. Please contact me on (02) 8266 4664 if you would like to discuss our comments further.

Yours sincerely,

A handwritten signature in blue ink, appearing to read 'P Brunner', with a small dot at the end.

Paul Brunner
Partner, PricewaterhouseCoopers

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International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

3 July 2013

Dear Sir/Madam,

Exposure Draft – Financial Instruments: Expected Credit Losses

We are pleased to respond to the invitation by the IASB (the 'Board') to comment on behalf of PricewaterhouseCoopers on the Exposure Draft ('ED'), *Financial Instruments: Expected Credit Losses*. Following consultation with members of the PricewaterhouseCoopers network of firms, this response summarises the views of those member firms who commented on the exposure draft. 'PricewaterhouseCoopers' refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

We recognise the significant efforts made by both the IASB and FASB (the "boards") over the past several years to respond to the accounting concerns raised by constituents following the financial crisis. We understand the fundamental difficulties associated with establishing a credit impairment model that balances conceptual theory, operational feasibility and economic reality. Furthermore, we are cognizant of the difficulties associated with creating a model that responds to the needs of constituents that operate in a wide variety of economic and political environments.

Notwithstanding these difficulties, credit impairment is consistently identified by constituents as a critical element of the accounting framework and thus an area where a converged model is needed. Therefore, we continue to support the development of a single converged model for credit impairment under both IFRS and US GAAP and urge the boards to resume collaboration during the re-deliberation process to achieve this goal.

We believe an expected loss approach that requires constituents to consider a broader information set, including future expectations, represents a significant improvement as compared to the incurred loss model used today. Consistent with our comment letters on the original IASB exposure draft, *Financial Instruments: Amortised Cost and Impairment*, the FASB proposed accounting standards update, *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities*, the joint supplementary document, *Financial Instruments: Impairment*, and the FASB's proposed accounting standards update, *Financial Instruments – Credit losses*, we continue to support an expected loss approach to accounting for the credit impairment of financial assets.

Our responses to the Board's questions are included in Appendix 1 to this letter. The key comments that we would like to raise with the Board are summarised below.

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The FASB model

We acknowledge the difficulties associated with an expected loss model, both conceptual and operational. Previous proposed expected loss approaches that attempted to match the recognition of credit losses with interest income were cited by many constituents as being conceptually sound, but too operationally complex to apply in practice. As we noted in our comment letter submitted to the FASB on 31 May 2013 (please see the letter in Appendix 2) the FASB's proposed standard would eliminate some of this complexity by requiring the recognition of all expected losses upon origination or purchase of a financial asset and the use of the effective interest rate for interest income recognition.

While we acknowledge the operational benefits of the FASB's proposed standard, we believe that requiring full recognition of expected losses upon origination would not reflect the economics of lending transactions. Financial assets subject to credit risk that are originated or purchased at market terms will be initially reflected on the balance sheet, after considering the allowance, at an amount below fair value, both individually and in the context of a portfolio. This is inconsistent with the economics of market based transactions. We do not believe the mere presence of credit risk that was inherently included in the transaction price for a financial instrument should give rise to a day 1 loss.

We believe the requirement to recognise all "lifetime" expected losses through the income statement upon origination or purchase is overly punitive, particularly to entities that operate in environments with high levels of growth or acquisitions of portfolios. Based on the factors summarised above, we do not support the FASB's proposed credit impairment standard.

The Alternative Model

We considered an alternative model that would require the initial estimate of "lifetime" credit losses to be deferred and amortised over the expected life of the asset. Subsequently, any changes in this initial estimate would be recorded through the provision expense each period, and the unamortised portion of the initial estimated credit loss would be written off upon reclassification of the loan to 'credit impaired'. We believed that this alternative model represented a potential for compromise, as it required the balance sheet to reflect the full expectation of credit losses, but also provided some degree of matching between the initial amount of credit risk and the interest income that compensates the lender for such risk.

The alternative model is consistent with the guidance for purchased credit impaired (PCI) assets within the FASB's proposed standard, and is also consistent with the IASB member's dissent on the IASB's proposed credit impairment model. Despite the alternative model having a number of perceived benefits, our significant outreach efforts suggested minimal support for this model due to its perceived operational complexity, as well as concerns raised about the nature of the 'debit' that is initially recognised as an offset to the allowance for credit losses. As a result of this feedback, we do not recommend the alternative model.

The IASB Model

The IASB's proposed model establishes a threshold prior to recognising full lifetime expected credit losses. We believe the presence of a threshold, based on an increase in credit risk, represents a conceptual improvement as compared to the FASB's proposed standard and is a good platform upon which the boards can develop a converged approach.

While we do not believe the mere presence of credit risk that was inherently included in the transaction price for a financial instrument should give rise to a day 1 loss, we appreciate the need for a loss allowance for assets recorded in Stage 1. We note the operational challenges raised by constituents in respect of the more conceptual previous proposals which sought to recognise the initial expected credit losses in the income statement over the life of the financial instrument. In this context, we believe that in moving away from conceptual purity to meet practical considerations, any impairment measure developed should be easy to understand and relatively straight forward to determine. The 12-month expected loss meets both of these criteria. In addition, the 12-month expected loss can be reconciled to the Basel expected loss measure so entities can leverage their Basel systems when calculating these amounts. We therefore support the Board's attempt to develop a practical solution for this issue.

While we support establishing a threshold prior to recognising full lifetime expected credit losses in the IASB model, we believe that the model, as written, may not adequately capture the concept that, for certain assets, a significant increase in credit risk that has taken place from that which was included in the pricing of the loan, will not be identifiable at an individual asset level until some point in the future. We believe these assets meet the criteria for recognition in the lifetime expected credit loss component of the model, especially given that the exposure draft states entities should use forward-looking information in determining whether there has been a significant increase in credit risk. However, the model provides an exception to the recognition of lifetime expected credit losses for those assets that have low credit risk, such as those with a credit rating equivalent to investment grade. The guidance also implies that assets that are less than 30 days past due may be exempt from the lifetime expected credit losses component of the model. Whilst we appreciate the benefit of having practical expedients, they appear to result in credit losses on these assets that are not identifiable at an individual asset level being excluded from the lifetime expected credit loss component of the model. We believe that further clarification should be made to ensure that credit losses on assets that have met the significant deterioration threshold, albeit not on an individually identifiable basis, are fully captured by the model.

As the IASB was finalising the proposed model, the terminology related to the credit deterioration threshold was changed from 'more than insignificant' to 'significant'. In practice, some constituents view the term 'significant' as conveying a higher threshold than the term 'more than insignificant' and therefore concluded that the Board changed the recognition criterion. Other constituents do not see a difference in those terms and concluded that the recognition criteria were unchanged. Regardless of which terminology is used, this highlights a potential lack of understanding as to the degree of deterioration that is necessary to trigger a move to the full lifetime expected credit loss category. We recommend the IASB clarify within the proposed standard or supplemental implementation guidance its intent regarding the threshold. That clarification would help to limit diverse interpretations of what constitutes a change in credit risk that requires the recognition of all expected losses.

Conclusion

We believe the model described in the IASB's Exposure Draft, together with our suggested modifications as set out above and in Appendix 1 to this letter, would achieve an appropriate balance between the faithful representation of the underlying economics and the cost of implementation. We also believe that these enhancements result in a credit impairment model that successfully achieves the principles established by the G20 subsequent to the financial crisis, primarily the need to establish



a model that is based on expected losses, allows entities to look forward into future periods and results in more timely recognition of credit losses.

If you have any questions, please contact John Hitchins, PwC Global Chief Accountant (+44 207 804 2497) or Gail Tucker (+44 117 923 4230).

Yours faithfully

A handwritten signature in black ink, appearing to read "PricewaterhouseCoopers", written in a cursive style.

PricewaterhouseCoopers

Appendix 1

Question 1:

(a) Do you agree that an approach that recognises a loss allowance (or provision) at an amount equal to a portion of expected credit losses initially, and lifetime expected credit losses only after significant deterioration in credit quality, will reflect:

- i. the economic link between the pricing of financial instruments and the credit quality at initial recognition; and
- ii. the effects of changes in the credit quality subsequent to initial recognition?

If not, why not and how do you believe the proposed model should be revised?

(b) Do you agree that recognising a loss allowance or provision from initial recognition at an amount equal to lifetime expected credit losses, discounted using the original effective interest rate, does not faithfully represent the underlying economics of financial instruments? If not, why not?

(a)

We believe an expected loss approach that requires constituents to consider a broader information set, including future expectations, represents a significant improvement as compared to the incurred loss model used today. Consistent with our comment letters on the original IASB exposure draft, *Financial Instruments: Amortised Cost and Impairment*, the FASB proposed accounting standards update, *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities*, the joint supplementary document, *Financial Instruments: Impairment*, and the FASB's proposed accounting standards update, *Financial Instruments – Credit losses*, we continue to support an expected loss approach to accounting for the credit impairment of financial assets.

We believe an impairment model should: (i) measure credit losses consistent with current expectations regarding collectability, and (ii) recognise the initial expected losses over the life of the instrument in a manner consistent with its pricing. We believe this better reflects the economics of lending transactions than recognising a portion of expected losses or full lifetime expected credit losses at initial recognition. For this reason we do not think that an approach that recognises a loss allowance (or a provision) at initial recognition at an amount equal to a portion of expected credit losses or full lifetime expected credit losses will reflect the economic link between the pricing of financial instruments and the credit quality. Financial assets originated or purchased at market terms will be initially reflected on the balance sheet at an amount below fair value, both individually and in the context of a portfolio, which is inconsistent with the economics of market based transactions.

However, we appreciate the need for a loss allowance for assets recorded in Stage 1 and we note the operational challenges raised by constituents in respect of the more conceptual previous proposals which sought to recognise the initial expected credit losses in the income statement over the life of the financial instrument. In this context, we believe that in moving away from conceptual purity to meet practical considerations, any impairment measure developed should be easy to understand and relatively straight forward to determine. The 12 month expected loss meets both of these criteria. In addition, the 12-month expected loss can be reconciled to the Basel expected loss measure so entities can leverage their Basel systems when calculating these amounts. We therefore support the Board's attempt to develop a practical solution for this issue.



We agree that recognising a loss allowance (or provision) at an amount equal to lifetime expected credit losses after significant deterioration in credit quality will reflect the effects of changes in the credit quality subsequent to initial recognition.

We also acknowledge that recognition of a portion of full lifetime expected credit loss allowance upon initial recognition and full lifetime expected credit loss allowance after a significant increase in credit risk addresses some of the criticisms of 'too little, too late' that arose during the financial crisis. However, as noted in our cover letter, we believe that further clarification should be made to ensure that credit losses on assets that have met the significant deterioration threshold, albeit not on an individually identifiable basis, are fully captured by the model.

(b)

We agree that recognising a loss allowance (or provision) in the profit or loss account from initial recognition at an amount equal to lifetime expected credit losses, discounted using the original effective interest rate, does not faithfully represent the underlying economics of financial instruments. We believe the requirement to recognize all "lifetime" expected losses through the income statement upon origination or purchase is overly punitive, particularly to entities that operate in environments with high levels of growth or acquisitions of portfolios.

Question 2:

(a) Do you agree that recognising a loss allowance (or provision) at an amount equal to 12-month expected credit losses and at an amount equal to lifetime expected credit losses after significant deterioration in credit quality achieves an appropriate balance between the faithful representation of the underlying economics and the costs of implementation? If not, why not? What alternative would you prefer and why?

(b) Do you agree that the approach for accounting for expected credit losses proposed in this Exposure Draft achieves a better balance between the faithful representation of the underlying economics and the cost of implementation than the approaches in the 2009 ED and the SD (without the foreseeable future floor)?

(c) Do you think that recognising a loss allowance at an amount equal to the lifetime expected credit losses from initial recognition, discounted using the original effective interest rate, achieves a better balance between the faithful representation of the underlying economics and the cost of implementation than this Exposure Draft?

(a-b)

As noted above, we agree that recognising a loss allowance (or provision) at an amount equal to 12-month expected credit losses and at an amount equal to lifetime expected credit losses after significant deterioration in credit quality achieves an appropriate balance between the faithful representation of the underlying economics and the costs of implementation.

Consistent with our comment letters on the original IASB exposure draft, *Financial Instruments: Amortised Cost and Impairment*, the FASB proposed accounting standards update, *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities*, the joint supplementary document, *Financial Instruments: Impairment*, and the FASB's

proposed accounting standards update, *Financial Instruments – Credit losses*, we continue to support an expected loss approach to accounting for the credit impairment of financial assets. An expected loss model would address the regulatory concerns around the recognition of incurred losses and some of the criticisms of ‘too little, too late’.

We acknowledge the difficulties associated with an expected loss model, both conceptual and operational. Previous proposed expected loss approaches that attempted to match the recognition of credit losses with interest income were cited by many constituents as being conceptually sound, but too operationally complex to apply in practice. As noted in our response to question 1 for this reason, we agree that the current proposal achieves an appropriate balance between the faithful representation of the underlying economics and the cost of implementation subject to the changes suggested in the paragraphs below.

While we support establishing a threshold prior to recognising full lifetime expected credit losses in the IASB model, we believe that the model, as written, may not adequately capture the concept that, for certain assets, a significant increase in credit risk that has taken place from that which was included in the pricing of the loan will not be identifiable at an individual asset level until some point in the future. We believe these assets meet the criteria for recognition in the lifetime expected credit loss component of the model, especially given that the exposure draft states entities should use forward-looking information in determining whether there has been a significant increase in credit risk. However, the model provides an exception to the recognition of lifetime expected credit losses for those assets that have low credit risk, such as those with a credit rating equivalent to investment grade. The guidance also implies that assets that are less than 30 days past due may be exempt from the lifetime expected credit losses component of the model. Whilst we appreciate the benefit of having practical expedients, they appear to result in some credit losses that are not identifiable at an individual asset level being excluded from the lifetime expected credit loss component of the model. We believe that further clarification should be made to ensure that credit losses on assets that have met the significant deterioration threshold, albeit not on an individually identifiable basis, are fully captured by the model.

Whilst we understand the IASB’s rationale for allowing entities to have a choice of discount rate when determining the impairment loss, we believe that such a wide choice (e.g. historic versus current and from risk free rate to EIR) will undermine comparability. We believe it would be preferable to calculate the impairment loss by using the EIR as the discount rate. This has the benefit of using the same discount rate for interest revenue and impairment and would avoid the need for a catch up adjustment when assets become credit impaired.

(c)

We do not think that recognising a loss allowance (or provision) in the profit or loss account at an amount equal to the lifetime expected credit losses from initial recognition, discounted using the original effective interest rate, would achieve a better balance between the faithful representation of the underlying economics and the cost of implementation as it does not accurately reflect the economics of lending transactions and is overly punitive particularly to entities that operate in environments with high levels of growth or acquisitions of portfolios.

Question 3:

(a) Do you agree with the proposed scope of this Exposure Draft? If not, why not?

(b) Do you agree that, for financial assets that are mandatorily measured at FVOCI in accordance with the Classification and Measurement ED, the accounting for expected credit losses should be as proposed in this Exposure Draft? Why or why not?

(a)

We agree with the proposed scope of the Exposure Draft. We support a single credit impairment model for portfolios of financial assets carried at amortised cost, financial guarantees in the scope of the financial instruments standard and loan commitments that are not accounted for at fair value through profit or loss (whether within the scope of IAS 39 and IFRS 9 or IAS 37). Many of these commitments will eventually become loans carried at amortised cost and financial institutions generally consider loans, loan commitments and financial guarantees together when making their credit assessments. Our outreach efforts suggested strong support for the application of the same impairment model for loans, loan commitments and financial guarantees as this is consistent with how financial institutions manage credit risk across their various portfolios. Hence we believe that the application of the same credit impairment model to loans, loan commitments and financial guarantees would be appropriate.

(b)

We agree that financial assets mandatorily measured at FVOCI in accordance with the Classification and Measurement ED should be included in the scope of the Exposure Draft. Consistent with our comment letter on the Exposure Draft *Classification and measurement: Limited amendments to IFRS 9* for financial assets that meet the criteria for FVOCI, we agree to having a profit or loss profile that is the same as financial assets measured at amortised cost with all other changes recognised in other comprehensive income. In most cases this provides users with relevant information that is consistent with the business model for those financial assets (since holding to collect and to sell includes both amortised cost and fair value information), although we recognise that when an entity plans to sell fair value information may be of greater importance.

Question 4:

Is measuring the loss allowance (or a provision) at an amount equal to 12-month expected credit losses operational? If not, why not and how do you believe the portion recognised from initial recognition should be determined?

Based on our outreach, we believe that measuring the loss allowance (or a provision) at an amount equal to 12-month expected credit losses will be operational. However, we encourage the IASB to discuss with preparers whether they foresee any operational difficulties with the 12-month expected credit loss measurement.

As this model seeks to sacrifice some conceptual purity for operational considerations, it is very important that the measurement basis is well understood and relatively straight forward to implement. We believe 12 month expected losses meets both of these criteria. In addition, 12-month expected loss

can be reconciled to the Basel expected loss measure so entities can leverage their Basel systems when calculating these amounts.

Question 5:

(a) Do you agree with the proposed requirement to recognise a loss allowance (or a provision) at an amount equal to lifetime expected credit losses on the basis of a significant increase in credit risk since initial recognition? If not, why not and what alternative would you prefer?

(b) Do the proposals provide sufficient guidance on when to recognise lifetime expected credit losses? If not, what additional guidance would you suggest?

(c) Do you agree that the assessment of when to recognise lifetime expected credit losses should consider only changes in the probability of a default occurring, rather than changes in expected credit losses (or credit loss given default ('LGD'))? If not, why not and what would you prefer?

(d) Do you agree with the proposed operational simplifications, and do they contribute to an appropriate balance between faithful representation and the cost of implementation?

(e) Do you agree with the proposal that the model shall allow the re-establishment of a loss allowance (or a provision) at an amount equal to 12-month expected credit losses if the criteria for the recognition of lifetime expected credit losses are no longer met? If not, why not, and what would you prefer?

(a)

We agree with the proposed requirement to recognise a loss allowance (or a provision) at an amount equal to lifetime expected credit losses on the basis of a significant increase in credit risk from that which was included in the pricing of the loan upon initial recognition. We believe that this is an appropriate threshold which is consistent with current expectations regarding collectability.

(b)

Please refer to our answer to question 2(b) above. We believe that further clarification should be made to ensure that credit losses on assets that have met the significant deterioration threshold, albeit not on an individually identifiable basis, are fully captured in the lifetime expected credit losses component of the model.

As the IASB was finalising the proposed model, the terminology related to the credit deterioration threshold was changed from 'more than insignificant' to 'significant'. In practice, some constituents view the term 'significant' as conveying a higher threshold than the term 'more than insignificant' and therefore concluded that the Board changed the recognition criterion. Other constituents do not see a difference in those terms, and concluded that the recognition criteria were unchanged. Regardless of which terminology is used, this highlights a potential lack of understanding as to the degree of deterioration that is necessary to trigger a move to the full lifetime expected credit loss category. We

recommend the IASB clarify within the proposed standard or supplemental implementation guidance its intent regarding the threshold. That clarification would help to limit diverse interpretations of what constitutes a change in credit risk that requires the recognition of all expected losses.

Our outreach noted that a trigger based upon a significant increase in credit risk may present operational challenges for some preparers since credit risk is managed based on the current credit risk of an instrument, as opposed to the original credit risk of the instrument. While we support the proposed model, we encourage the IASB to discuss with preparers the extent to which they foresee any operational challenges in implementing the proposals.

In addition, during our outreach, a large number of constituents raised concerns about the lack of a definition of default in the standard. These constituents note that at present there are different definitions of default applied by regulators, applied by entities and even, sometimes, applied by different parts of the same entity and that different definitions could give rise to a different recognition or measurement of expected losses. We believe that clarifying its definition in the standard or alternatively the Board's understanding of 'default' in the basis for conclusion would reduce potential diversity in practice.

(c)

We agree that the assessment of when to recognise lifetime expected credit losses should consider only changes in the probability of a default occurring. We think that the change in the probability of a default properly reflects the change in credit risk as opposed to the changes in the amount of loss given default that reflects the changes in the absolute amount of expected credit loss.

(d)

Please refer to our answer to question 2(a-b) above.

(e)

We agree with the proposal to allow the re-establishment of a loss allowance (or a provision) at an amount equal to 12-month expected credit losses if the criteria for the recognition of lifetime expected credit losses are no longer met (assets can move back to Stage 1). We believe it is essential that the model be symmetrical to properly address all significant movements in credit risk.

Question 6:

(a) Do you agree that there are circumstances when interest revenue calculated on a net carrying amount (amortised cost) rather than on a gross carrying amount can provide more useful information? If not, why not, and what would you prefer?

(b) Do you agree with the proposal to change how interest revenue is calculated for assets that have objective evidence of impairment subsequent to initial recognition? Why or why not? If not, for what population of assets should the interest revenue calculation change?

(c) Do you agree with the proposal that the interest revenue approach shall be symmetrical (i.e. that the calculation can revert back to a calculation on the gross carrying amount)? Why or why not? If not, what approach would you prefer?

(a-c)

We note that there are circumstances when calculating interest revenue on the basis of a gross carrying amount would overstate the overall economic return on a financial asset. Therefore, we support the change in the calculation of interest revenue when there is objective evidence of impairment, since we think that the risk of overstatement increases significantly at this point. We also agree that the interest revenue approach should be symmetrical (interest calculation can be switched back to gross basis if the assets are no longer credit impaired) as it is very important from an operational perspective to have only one approach to the calculation of interest for each individual stage of the model.

Question 7:

(a) Do you agree with the proposed disclosure requirements? Why or why not? If not, what changes do you recommend and why?

(b) Do you foresee any specific operational challenges when implementing the proposed disclosure requirements? If so, please explain.

(c) What other disclosures do you believe would provide useful information (whether in addition to, or instead of, the proposed disclosures) and why?

(a-c)

We agree with the disclosure objective in the Exposure Draft, and in particular the proposed disclosures of the amounts that arise from expected credit losses and the effect of deterioration and improvement in credit risk of financial instruments. However, we believe that the required disclosures taken as a whole will be onerous for many preparers and may cause operational difficulties. In particular, we consider the disclosure for modified assets and collateral to be too detailed and that the disclosure of the reconciliation from the opening to the closing of the gross carrying amount (required by paragraphs 35 and 36) puts significant burden on the preparers and has limited benefit for the users as it does not reflect how entities manage credit risk. We would suggest that this latter disclosure should be replaced by requiring the disclosure of the opening and the closing balance for each of the categories listed in paragraphs 35 (a)-(d) and in paragraph 36 with narrative description of the reasons for changes within the year.

Consistent with our comment letter on the original IASB exposure draft, we encourage the IASB to apply a “through the eyes of management” approach to disclosure. This should help users to understand how management determines the credit quality of their financial assets, how they track this quality over time (i.e. credit migration), how they determine their credit losses and how they assess the accuracy of their estimation process.

Question 8:

Do you agree with the proposed treatment of financial assets on which contractual cash flows are modified, and do you believe that it provides useful information? If not, why not and what alternative would you prefer?

We agree with the proposed treatment of financial assets on which contractual cash flows are modified. However, we believe that the Board should undertake a separate project to provide guidance on when a modification results in derecognition of the financial asset and when the asset should continue to be recognised. One of the issues encountered with during the sovereign debt crisis was determining when a troubled debt restructuring was so significant that it constituted an extinguishment.

Question 9:

(a) Do you agree with the proposals on the application of the general model to loan commitment and financial guarantee contracts? Why or why not? If not, what approach would you prefer?

(b) Do you foresee any significant operational challenges that may arise from the proposal to present expected credit losses on financial guarantee contracts or loan commitments as a provision in the statement of financial position? If yes, please explain.

(a-b)

As noted in our response to question 3 we agree with the application of the general model to loan commitments and financial guarantee contracts and we do not foresee any significant operational challenges as most entities manage credit risk for these contracts in the same way as they manage credit risk for financial assets.

However, certain entities currently assess impairment for credit risk management purposes based on the behavioural expectations of the entity. We agree that a provision should not be necessary for contractually revocable, on demand, loan commitments from a conceptual stand point as entities should, in theory, be able to contractually avoid a cash outflow. However, we note that in practice entities have incurred losses on contractually revocable commitments as they may not be able, from a practical perspective, to review all such contracts prior to funding the commitment. Therefore, we support allowing entities to continue to provide for these commitments on a behavioural basis.

Question 10:

(a) Do you agree with the proposed simplified approach for trade receivables and lease receivables? Why or why not? If not, what changes do you recommend and why?

(b) Do you agree with the proposed amendments to the measurement on initial recognition of trade receivables with no significant financing component? If not, why not and what would you propose instead?

(a-b)

We agree with the simplified approach for trade receivables and lease receivables since it provides operational relief by removing the requirement to track credit quality. Given their short-term nature, we expect that the loss allowance determined under the simplified approach should generally equate to the loss allowance determined under the general model.

We also agree with allowing an accounting policy choice for trade receivables with significant financing component and for lease receivables as this will allow entities to decide which model they wish to adopt from a cost/benefit perspective.

We also support the proposed amendment on initial recognition of trade receivables with no significant financing component.

Question 11:

Do you agree with the proposals for financial assets that are credit-impaired on initial recognition? Why or why not? If not, what approach would you prefer?

We agree with the proposal for financial assets that are credit impaired on initial recognition. We believe recognising interest revenue based on the credit-adjusted effective interest rate more faithfully represents the underlying economics for these assets.

Question 12:

(a) What lead time would you require to implement the proposed requirements? Please explain the assumptions that you have used in making this assessment. As a consequence, what do you believe is an appropriate mandatory effective date for IFRS 9? Please explain.

(b) Do you agree with the proposed transition requirements? Why or why not? If not, what changes do you recommend and why?

(c) Do you agree with the proposed relief from restating comparative information on transition? If not, why?

(a)

We recommend that sufficient time be given for companies to address the complexities of the new model and ensure the necessary processes and internal controls are in place. We also acknowledge that the new model might have regulatory capital implications that some financial institutions may also need time to address. As such, we encourage the IASB to seek feedback from preparers (in particular financial institutions) on what they believe is the appropriate time needed to implement the proposals. This feedback should be obtained from both large and small entities across the various industries and territories affected, as the lead times necessary to implement the proposals may be different depending on the size of the entity, its industry and market. It is important that all entities have enough time to properly implement the proposals.

(b)

A number of financial institutions issue loans at sub investment grade and for a large number of these it will be very difficult on transition to the new standard to obtain the probability of a default at initial recognition for existing portfolios without undue cost or effort. We believe that the requirement to recognise full life time expected losses for all of these assets (i.e. assets which do not have a low credit risk at transition) is overly punitive as certain of these assets will not have experienced a significant increase in credit risk, but entities will not have the probability of a default at initial recognition to prove this fact. We would urge the Board to develop an additional practical expedient for these assets on transition. We recognise the difficulties in developing such a practical expedient but would suggest the Board conduct additional outreach for the purpose of developing such an expedient.

(c)

We agree with the proposed relief from restating comparative information on transition as it would be difficult to do so without the use of hindsight. This also helps to meet the objective of setting the mandatory effective date for IFRS 9 as early as possible.

Question 13:

Do you agree with the IASB's assessment of the effects of the proposals? Why or why not?

With the exceptions of the matters above we agree with the IASB's assessment of the effects of the proposal.

However, in addition to our previous comments, we do not agree with the last sentence of paragraph BC215 on the comparison of the FASB and IASB model. Under the IASB model the loss allowance on assets with low credit risk would be recognised at 12-month expected credit loss whereas under the FASB model it would be recognised at full lifetime expected credit loss (when measured at amortised cost) or at most likely at nil (when measured at FV-OCI and meeting the practical expedient). Given that the impairment losses are calculated at different amounts under both proposals, we do not agree with the statement that there would not be a significant difference in the loss allowance on financial assets with low credit risk under both proposals.



Appendix 2

Comment letter on the FASB's Proposed Accounting Standards Update, *Financial Instruments - Credit Losses (Subtopic 825-15)* submitted to the FASB on 31 May 2013.



May 31, 2013

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PricewaterhouseCoopers LLP appreciates the opportunity to comment on the FASB's Proposed Accounting Standards Update, *Financial Instruments - Credit Losses (Subtopic 825-15)* (the "proposed standard").

We recognize the significant efforts made by both the FASB and IASB (the "boards") over the past several years to respond to the accounting concerns raised by constituents following the financial crisis. We understand the fundamental difficulties associated with establishing a credit impairment model that balances conceptual theory, operational feasibility, and economic reality. Furthermore, we are cognizant of the difficulties associated with creating a model that responds to the needs of constituents that operate in a wide variety of economic and political environments.

Notwithstanding these difficulties, credit impairment is consistently identified by constituents as a critical element of the accounting framework and thus an area where a converged model is needed. Therefore, we continue to support the development of a single converged model for credit impairment under both IFRS and US GAAP and urge the boards to resume collaboration during the re-deliberation process to achieve this goal.

We believe an expected loss approach that requires consideration of a broader information set, including future expectations, represents a significant improvement as compared to today's incurred loss model. Consistent with our comment letters on the original IASB exposure draft, *Financial Instruments: Amortised Cost and Impairment*, the FASB proposed accounting standards update, *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities*, and the joint supplementary document, *Financial Instruments: Impairment*, we continue to support an expected loss approach to accounting for the credit impairment of financial assets. We do not, however, support the proposed standard.

The proposed standard

We acknowledge the difficulties associated with an expected loss model, both conceptual and operational. Previous proposed expected loss approaches that attempted to match the recognition of credit losses with interest income were cited by many as being conceptually sound, but too operationally complex to apply in practice. The proposed standard would eliminate some of this complexity by requiring the recognition of all expected losses upon origination or purchase of a financial asset and the use of the effective interest rate for interest income recognition.

While we acknowledge the operational benefits of the approach set out in the proposed standard, we believe that requiring full recognition of expected losses upon origination would not reflect the economics of lending transactions. Financial assets subject to credit risk that are originated or purchased at market terms will be initially reflected on the balance sheet, after considering the allowance, at an amount below fair value, both individually and in the context of a portfolio. This is inconsistent with the economics of market based transactions. We do not believe the mere presence of credit risk that was inherently included in the transaction price for a financial instrument should give rise to a day 1 loss.



We also believe the requirement to recognize all "lifetime" expected losses through the income statement upon origination or purchase is overly punitive, particularly to entities that operate in environments with high levels of growth or acquisitions of portfolios. For these reasons, we do not support the proposed standard.

The alternative model

We considered an alternative model under which the initial estimate of "lifetime" credit losses would be deferred and amortized over the expected life of the asset. Subsequently, any changes in this initial estimate would be recorded through the provision expense each period, and the unamortized portion of the initial estimated credit loss would be written off upon reclassification of the loan to non-accrual status. We believed that this alternative model represented a good potential for compromise, as it required the balance sheet to reflect the full expectation of credit losses, but also provided some degree of matching between the initial amount of credit risk and the interest income that compensates the lender for such risk.

The alternative model is consistent with the guidance for purchased credit impaired (PCI) assets within the proposed standard, and is also consistent with the IASB member's dissent on the IASB's proposed credit impairment model. Despite the alternative model having a number of benefits, our significant outreach efforts suggested minimal support for this model due to its perceived operational complexity, as well as concerns about the nature of the "debit" that is initially recognized as an offset to the allowance for credit losses. As a result of this feedback, we do not recommend the alternative model.

The IASB's proposed model as written

We considered the credit impairment model as proposed in the IASB's credit impairment exposure draft, *Financial Instruments: Expected Credit Losses*, which establishes a threshold prior to recognizing full lifetime expected credit losses. We believe the threshold, which is based on an increase in credit risk, represents a conceptual improvement as compared to the proposed standard and is a good platform upon which the boards can develop a converged approach.

While we support this aspect of the IASB's proposed model, we believe that the model, as written, may not adequately capture the concept that, for certain assets, a significant increase in credit risk that has taken place will not be identifiable at an individual asset level until some point in the future. These assets would seem to meet the criteria for recognition in the lifetime expected credit loss component of the model, especially given that under the model, entities should use forward-looking information in determining whether there has been a significant increase in credit risk. However, the model provides an exception to the recognition of lifetime expected credit losses for assets that have low credit risk, such as those with a credit rating equivalent to investment grade. The guidance also implies that assets that are less than 30 days past due may be exempt from the lifetime expected credit losses component of the model. Thus, credit losses on these assets do not appear to be captured in the lifetime expected credit loss component of the model.

We considered whether the "12 month expected loss" component of the proposed model would instead capture the credit losses on these assets. However, we believe only a portion of the credit losses that are present in a portfolio, but are not yet identifiable on an individual asset basis, will be captured in the "12 month expected loss" component of the model. The remaining portion will not be captured because of the amount of time that lapses between the point a significant increase in credit risk has taken place and when the loss ultimately manifests itself into an identifiable event (such as default). This time period often varies based on the nature of the asset; and for some assets it can extend well beyond a twelve-month period. This has led some constituents to express concern that in certain cases, the IASB's proposed model, as written, could result in lower levels of credit allowances as compared to current practice in the United States.



Proposed changes to the IASB model

We recommend the boards pursue an enhanced version of the IASB's proposed model and offer the following suggestions.

We believe that the IASB model should more explicitly address assets that have experienced a significant increase in credit risk, but such increase is not yet identifiable at an individual asset level. Some may interpret the model as capturing a portion of this amount through the "12 month expected loss" component of the provision for individual assets that have not yet experienced an identifiable significant increase in credit risk. However, as discussed above, it is not clear that this will adequately capture the expected credit losses for all of these assets. Accordingly, we recommend that further clarification should be made to ensure that credit losses on assets that have met the significant deterioration threshold, albeit not on an individually identifiable basis, are fully captured by the model.

As the IASB was finalizing the proposed model, the terminology related to the credit deterioration threshold was changed from "more than insignificant" to "significant". In practice, some constituents view the term "significant" as conveying a higher threshold than the term "more than insignificant" and therefore concluded that the board changed the recognition criterion. Other constituents do not see a difference in those terms, and concluded that the recognition criterion was unchanged. We recommend the IASB clarify within the proposed standard or supplemental implementation guidance its intent regarding the meaning of "significant" as compared to "more than insignificant." That clarification would help to limit diverse interpretations of what constitutes a change in credit risk that requires the recognition of a credit loss.

Additional comments on IASB proposal

The IASB issued its exposure draft in March of 2013. In addition to the different impairment models proposed by each board, the timetables to provide comments are also different, with comments on the IASB's exposure draft not due until July 5, 2013. We will provide additional feedback on the details of the IASB's proposal in our response to its exposure draft.

Conclusion

We believe our proposed changes to the IASB's model would result in a model that more closely reflects the economics of lending transactions and the credit deterioration cycle than the model in the proposed standard. We also believe they would result in a credit impairment model that successfully achieves the principles established by the G20 subsequent to the financial crisis, primarily the need to establish a model that is based on expected losses, allows entities to look forward into future periods, and results in more timely recognition of credit losses.

Attachment 1 to this letter contains our responses to the questions accompanying the proposed standard.

If you have any questions regarding our comments, please contact Paul Kepple at (973) 236 5293, John Althoff at (973) 236 7021, or Christopher Gerdau at (973) 236 5010.

Sincerely,

A handwritten signature in black ink that reads "PricewaterhouseCoopers LLP". The signature is written in a cursive, flowing style.

PricewaterhouseCoopers LLP



Appendix 1:

As communicated in our cover letter, we recommend the boards resume collaboration with the goal of developing a converged impairment model. We believe the IASB's impairment model represents the best starting point for this collaboration. Our responses to the questions below address the FASB model specifically, and are provided in the event the FASB elects not to pursue convergence with the IASB.

Question for All Respondents

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

We are supportive of the FASB's efforts to establish one impairment model for all financial assets subject to losses related to credit risk that are not classified at fair value through net income. We generally agree with the scope of financial assets that are included in the proposed update, with two exceptions.

The proposed update includes reinsurance receivables that result from insurance transactions within the scope of Topic 944. Non-performance risk on reinsurance receivables is comprised of both credit risk and dispute risk. We believe recognizing each risk component under different measurement models will be complex. Accordingly, we recommend that reinsurance receivables be covered in the insurance contracts project. Both the insurance contracts project and the impairment project reflect expected loss models. Including reinsurance receivables in the insurance contracts project should not result in a fundamentally different measurement principle. But it would allow insurers to account for their insurance liabilities, as well as their reinsurance assets, under the same accounting model.

The scope of the proposed update does not include financial guarantees. We disagree with the FASB's decision to address financial guarantees in the insurance contracts project. We believe that financial guarantees should be subject to the same credit impairment model as funded financial assets, which also involve the transfer of credit risk. Additionally, we believe many financial institutions may find it operationally easier to evaluate and measure the credit risk associated with a financial guarantee in conjunction with that same customer's loans and loan commitments.

As noted in our cover letter, we do not support the FASB's proposal and believe the boards should continue working together to achieve convergence based upon enhancements to the IASB's proposed impairment model. In the event the FASB is unable to support this approach, we recommend that the FASB pursue targeted amendments to areas of current US GAAP most in need of revision rather than its current proposal. Certain areas that would be impacted by the proposed standard, including the accounting for impaired loans under ASC 310-10-35-12 (formerly FAS 114) and the accounting for other-than-temporary impairment of securities under ASC 320-10-35-18 (formerly FSP FAS 115-2), are well understood by preparers and users and are generally not viewed as requiring significant revisions. However, removing credit loss measurement from ASC 450 (formerly FAS 5) and establishing a separate impairment model that eliminates the probability threshold in favor of an expected credit loss model would be an improvement.

Recognition and Measurement

Questions for Preparers and Auditors

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



We support the consideration of relevant information such as those sources identified above. We note that the use of estimation techniques of reverting to a mean or assuming a "terminal" rate are not addressed in the proposed standard, but were subsequently addressed in the FAQ document published on March 25, 2013. We recommend the final standard explicitly address these techniques, given that we expect them to be common practices. Providing more explicit acceptance of these techniques will also potentially eliminate some of the operational concerns associated with long-term credit assumptions and estimates.

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

We believe that preparers are best suited to answer questions related to the availability of data needed to implement the proposed standard. We expect that many different sources of data will be available for preparers, including historical data, industry data, economic forecasts, and regulatory guidance, and they will be used to varying degrees. However, we believe it is important for the FASB to acknowledge the use of these different data sources, as well as the fact that preparers will have latitude in determining the best methods to use to develop credit loss estimates in their individual circumstances. This latitude will likely result in a range of reasonably acceptable credit loss estimates that might be determined by individual preparers faced with similar fact patterns.

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

We agree that allowances for expected credit losses should not be based solely on the "most likely" scenario. However, we disagree with the requirement to always reflect both the possibility that a credit loss results and the possibility that no credit loss results. We recommend that the requirement be revised to call for determination of a mean that considers sufficient relevant information and is representative of the expected credit losses. We agree with the proposed standard that many methods currently used in practice would satisfy the objective of a mean estimate.

The proposal to require consideration of a scenario in which a credit loss exists would create complexity in many areas that would not otherwise be complex, such as consideration of collateral. The FAQ document states that "collateral serves to reduce a lender's exposure to credit losses on a given loan and would be taken into consideration when estimating expected credit losses." While we understand and support the concept that collateral should be taken into consideration when estimating expected credit losses, it is unclear how the FASB wants this to be done. If the FASB intends for preparers to consider a scenario where a credit loss occurs on the instrument and the value of the collateral is insufficient, this should be more explicitly stated and additional guidance should be provided to aid in performing the analysis.

Requiring the consideration of a credit loss for certain instruments for which the risk of loss is expected to be insignificant creates an unnecessary burden to preparers for very little benefit to users. Examples include, but are not limited to, US treasury bonds, US government guaranteed loans, and other instruments of the highest credit



quality. In these situations, we do not believe there is a sufficient benefit to requiring preparers to specifically consider a scenario where a credit loss exists and compute a theoretical credit loss that has a remote chance of occurring.

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

We support the concept that a credit loss estimate should consider the time value of money. While a discounted cash flow calculation explicitly considers the time value of money, we recognize that there are significant operational challenges associated with requiring such calculations to be used and believe the costs would exceed the benefit. Therefore, we support accepting many methods that are currently used in practice and believe that users accept such practical expedients as well.

While we support the continuation of many current practices, we believe that the language in the proposed standard related to "implicitly" considering the time value of money creates confusion with respect to which methods may be acceptable. Therefore, we recommend the FASB consider eliminating the "implicit" references and instead state that many methods commonly used today, such as loss rates or probabilities of default/loss given defaults, are practical expedients that would be acceptable methods to measure the expected credit loss.

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

We support the FASB's efforts to simplify the accounting for purchased credit impaired (PCI) assets. Subsequent to acquisition, PCI assets are generally credit risk managed in the same way as originated assets that have experienced significant deterioration and therefore should be subject to the same subsequent measurement of expected losses. We believe that the PCI guidance included in the proposed standard represents an improvement to current practice under US GAAP, as it would reduce the complexity of today's accounting model for these types of assets. We also believe that recognizing interest income at a rate that is lower than the effective yield calculated from contractual payments is appropriate to reflect the contractual cash flows expected to be collected.

Currently, entities are required to estimate cash flows on PCI assets and continually update those estimates when calculating yield under ASC 310-30, *Loans and Debt Securities Acquired with Deteriorated Credit Quality*. Therefore, we do not see significant auditing or operational concerns with determining the discount embedded in the purchase price that is attributable to credit at the date of acquisition.



The fair value of purchased loans, both PCI and non-PCI, include many factors in addition to estimated credit losses (interest rates, credit spreads, expected maturity, etc). The FASB should provide additional clarity on the application of the proposed standard to loans purchased at premiums and discounts, particularly where such premiums and discounts are driven by factors other than estimated credit losses. Such complexity was introduced into the accounting model when "carrying over" allowance amounts were prohibited under FAS 141R (now codified in ASC 805).

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

As stated in our response to Question #11, we do not believe that there is sufficient benefit to requiring preparers to specifically consider a scenario where a credit loss exists and compute a theoretical credit loss for situations in which a credit loss has a remote chance of occurring. Therefore, we do not believe that a practical expedient is necessary. However, if the FASB retains the language currently in the proposed standard and therefore requires each credit loss estimate to consider a scenario where a credit loss exists, we support the practical expedient. We do not believe there are significant operability or auditing concerns associated with the practical expedient currently proposed.

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

We generally support the concept of no longer recognizing interest income when it is not probable that substantially all of the contractual cash flows will be collected. While the concept of non-accrual exists today in the banking industry and is generally well understood for loans, the concept will cause changes in the accounting for securities and will result in changes to current practice.

We support the FASB's efforts to move the non-accrual concept into US GAAP. However, this will present a number of challenges, particularly with the accounting subsequent to placing an asset on non-accrual status. For example, complexity can ensue with respect to subsequent charge-offs and recoveries of the asset. While these complexities exist currently with respect to loans, we expect the questions on these concepts to be even more pronounced with the decision to subject securities to non-accrual accounting. The FASB should consider providing additional implementation guidance and examples to more clearly illustrate the subsequent accounting for various asset types placed on non-accrual status.

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



We believe that the distinction between TDR and non-TDR is relevant for certain purposes. We agree with the FASB that a TDR represents a creditor's effort to recover as much of the original cash flows of the instrument as possible and therefore should not be considered a new loan. We believe that the TDR distinction, whereby a TDR cannot be a new loan, eliminates the complexity of having to subject these types of modifications to ASC 310-20-35-11 (formerly EITF 01-7) to determine whether a modification is a new loan or a continuation of an old loan. Therefore, we support retaining the concept of a TDR for this purpose.

We also recognize that information about a lender's troubled debt modification programs and the success of those modification programs is valuable to users of the financial statements. Therefore, we believe the distinction between TDR and non-TDR is relevant for disclosure purposes. We encourage continued dialogue about what the appropriate content and level of disclosure should be.

From a recognition and measurement perspective, we do not believe that the TDR distinction is necessary. We believe that subsequent to a TDR modification, the proposed standard should be applied consistently with other modifications not accounted for as new loans. Therefore, we believe it is not necessary to require an adjustment to the amortized cost basis of the asset to reflect the economic concession granted to the borrower, and that the measurement technique used to determine credit losses should be consistently applied.

The current TDR guidance is complex and rules driven. Because we believe that the TDR distinction is only relevant for certain purposes, we encourage the FASB to consider simplifying the current guidance by establishing principles upon which to determine whether a modification constitutes a TDR and is therefore subject to additional disclosure requirements.

If the FASB elects to proceed with the proposed guidance on TDRs, we recommend revising the guidance on the adjustment required to the amortized cost basis of the asset. That guidance requires creditors to calculate the effective interest rate (post troubled debt restructuring) based on the *contractual* terms of the modified asset. Consideration of the *contractual* term of the instrument, rather than its *expected* term, would result in the adjustment representing an economic concession granted over the entire contractual life of the instrument. In reality, the concession would only be given during the term the instrument is expected to remain outstanding. Therefore, we recommend the guidance allow lenders to consider prepayments when establishing the effective interest rate for purposes of calculating the adjustment to the amortized cost basis of the asset.

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

We are generally supportive of the disclosure proposals in the proposed update.

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

We do not foresee significant operability or auditing concerns with the disclosure proposals.

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

We are supportive of the FASB's inclusion of implementation guidance and illustrative examples to aid in understanding how to apply the principles of the proposed standard. However, we believe the current examples require enhancements to ensure constituents understand how certain commonly used methods, including loss rates, are acceptable practical expedients to comply with the model. We recommend that further information be provided, including how the data used in the examples was derived, to help highlight why these methodologies are



acceptable practical expedients. We also would recommend including an example of an approach that would not work, along with the rationale as to why, to help constituents draw comparisons between the potential methodologies.

Given the subjectivity of the methodologies and estimates required to calculate expected credit losses, constituents will benefit from the additional clarity provided by the FAQ document to effectively implement the proposed standard. We believe many of the concepts embedded in the FAQ document, including, but not limited to, interest income recognition, consideration of collateral, and methods to calculate expected loss should be incorporated into the final standard. We recommend the FASB give this consideration.

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

We generally support the transition provisions in the proposed update. However, we believe there are several areas where there could be operational complexity associated with transition and therefore additional guidance, including a practical expedient, should be provided.

The proposed definition of purchased credit impaired (PCI) financial assets in the proposed standard represents a change from current practice under ASC 310-30. Thus, hindsight would be necessary to determine whether assets would have met the proposed definition of PCI at initial purchase. In addition, even if assets accounted for as PCI under today's guidance are also determined to meet the proposed definition, hindsight would be required to determine the appropriate transition adjustment, as consideration would need to be given to cash flow estimates that were made at the time of purchase and any subsequent yield adjustments/impairments that were recorded on the asset. Furthermore, constituents often apply ASC 310-30 to assets that technically do not meet the definition of PCI as established in ASC 310-30. This was an accommodation made several years ago based on discussions with the SEC and banking regulators and is commonly referred to in practice as "applying SOP 03-3 by analogy." The accommodation was based on this model being deemed "superior" to the current model, which involves complexities with purchased non-impaired loans. These assets would not technically meet the definition of PCI as outlined in the proposed standard; therefore, preparers would face additional complexity in transitioning these assets out of the current PCI guidance and into the proposed non-PCI guidance.

We believe there could also be complexity with regard to other classes of assets. For example, securities that are currently accounted for under ASC 320-10-35-18 (formerly FSP FAS 115-2) have previously been subject to other-than-temporary impairment (OTTI) analyses. If an asset was determined to be OTTI, a loss would have been recorded and the cost basis of the asset adjusted. Under current guidance, the cost basis cannot be adjusted up if subsequent cash flow expectations improve. The proposed standard would establish an allowance for credit losses on securities that would be revisited each period, with subsequent improvements in cash flow expectations being recorded as gains. This represents a change to current practice that could present additional transition challenges.

We believe the types of analyses described above will be very difficult for preparers and, in some cases, the information required may not be available. We encourage the FASB to perform outreach to determine an acceptable practical expedient to alleviate the complexity of transitioning to the new standard.

Question 21: *Do you agree that early adoption should not be permitted? If not, why?*

We previously communicated, in our response letter to the classification and measurement exposure draft, that we do not support early adoption for the majority of the classification and measurement standard due to the fact that such early adoption would undermine comparability for financial statement users. We believe that the adoption date for classification and measurement and impairment should be the same given the clear inter-relationship between the two models. Therefore, we would also support not permitting early adoption of the impairment standard.



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

We generally support giving private companies additional time to implement the guidance and learn from the experiences of public companies. Moreover, we believe it is important that the effective date for the classification and measurement standard and the credit impairment standard be the same.

Questions for Preparers and Auditors

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

Subject to the clarifications and practical expedients requested in our response to Question #20, we believe that the transition provision in the proposed update is operable.

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

The amount of time necessary to implement the proposed standard will depend on the final standard and on the types and complexity of financial instruments originated by, invested in, and issued by companies. We recommend that ample time be given for companies to address the complexities of the new model and ensure the necessary processes and internal controls are in place. We encourage the FASB to seek feedback from preparers on what they believe is the appropriate time needed to implement the proposed standard. In addition, since the final standard will impact the accounting for financial instruments that are widely held in the US market, additional time may be needed to educate investors and allow market participants to react and make changes to accommodate the new developments. Finally, we note that the FASB will be issuing additional standards that impact the accounting for financial instruments as well as other major elements of the financial statements. We encourage the FASB to consider the impact of the adoption of all of these standards when determining an effective date.