American Bankers Association
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Mr. Russell Golden
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Via email: director@fasb.org

File Reference: No. 1810-100 *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities*

RE: Credit Impairment of Financial Assets (ABA letter 2 of 3 on File Reference No. 1810-100)

Dear Mr. Golden:

The American Bankers Association (ABA) appreciates the opportunity to comment on the Exposure Draft: *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities* (ED). ABA represents banks of all sizes and charters and is the voice for our nation's $13 trillion banking industry and its two million employees. The majority of ABA's members are banks with less than $165 million in assets. ABA's extensive resources enhance the success of the nation's banks and strengthen America's economy and communities.

Because of the importance of the issues addressed in the ED, as well as the wide range of issues within, ABA has split our response to the ED in three parts: 1) classification and measurement of financial assets and liabilities, 2) credit impairment of financial assets, and 3) derivative instruments and hedging activities. We have already submitted our comment letter regarding classification and measurement of financial assets and liabilities (ABA letter also dated August 31, 2010). This is the second of our three responses, and it focuses on credit impairment of financial assets.

During the financial crisis, two accounting issues rang loud and clear: mark to market accounting rules for securities were not reflecting actual credit performance and the accounting standards for loan loss provisioning needed to be reconsidered. ABA believes loan loss provisioning is the key international accounting issue of concern to the Financial Stability Board.[1] Criticisms of the current "incurred loss"

[1]Report of the Financial Stability Board to G20 Leaders, *Overview of Progress in the Implementation of the G20 Recommendations for Strengthening Financial Stability*, June 18, 2010: "*Impairment of financial assets:* The FSB recommended that the IASB and FASB incorporate a broader range of available credit information than existing provisioning requirements, so as to improve transparency of information provided to investors while also potentially helping lessen procyclicality. Both the IASB and FASB have proposed alternative loss provisioning approaches that incorporate more information about credit losses into impairment measurements and provide for earlier assessment of expected losses. The proposals have significant differences from each other and

model of impairment have also been expressed for many years.[2] Indeed, in responding to the Savings and Loan Crisis, the main recommendation related to accounting in the 1991 GAO report "Failed Banks: Accounting and Auditing Reforms Urgently Needed" was in regard to changes to the "probability thresholds" within the loss provisioning process. This recommendation has never been officially addressed and, over the years, industry practice further narrowed how those thresholds were defined. Many point to the SEC's narrowing interpretation of the accounting standards in the late 1990s as the event that led banks to maintain loan loss reserves that were generally at their lowest levels when the financial crisis hit. With all this in mind, ABA strongly supports efforts by the Board to consider changes to evaluating impairment for those assets accounted for at amortized cost.

In recognition of the competitive global market, ABA also encourages the efforts of both FASB and IASB to not only consider the "more forward-looking" methods of impairment evaluation, but also to agree on a single, world-wide methodology. Such a methodology would go a long way to the accounting convergence that many groups, including ABA, support.

A brief summary of our views is as follows:

- ABA agrees that a longer loss emergence period than what is currently contained in the accounting standards is appropriate.

- ABA supports FASB's acknowledgement that considerable judgment is required in estimating impairment losses. Thresholds (as referred to in the GAO report) or triggers for determining "probable" losses are challenging to administer and often hinder efforts to provide decision-useful information.

- ABA does not support the stipulation that banks must assume that economic conditions existing at the reporting date will remain unchanged for the remaining lives of the assets. Based on our understanding of the ED (from reading the ED and follow-up discussions with your staff), it appears to us that such a requirement contradicts the very nature of management expectations: it nullifies the usefulness of historical data as a basis for those expectations, and it contradicts common sense in general. To be sure, historical data, the basis for the initial expectations of loan losses, normally result from complete business cycles. To then assume that economic cycles no longer exist is to test the bounds of credulity. From a practical perspective, this will also unnecessarily create enormous swings in loan loss allowances.

the Boards are seeking to converge their provisioning approaches with input from investors, banks, auditors, and regulators, including an Expert Advisory Panel."

[2] This has involved various parties. For example, the principals from the federal banking agencies wrote to the FASB on April 20, 1999, requesting that FASB "consider a broad reexamination of FAS 5 in light of the changes that have occurred since the issuance of this important standard" and to "reconsider the fundamental concepts of FAS 5 in developing loan loss allowance guidelines." SFAS 5 was written in 1975. The FASB's response to the 1999 letter indicated that a special project on loan losses would not be undertaken and that, instead, its project on fair value accounting would likely change the measurement basis.

- ABA strongly recommends that the income recognition proposal be dropped. While we understand the conceptual thinking behind the requirement to record income based on an amortized cost that is calculated after applying the allowance for loan losses, both bank management and buy-side analysts place high reliance on their separate analyses of net interest margin and of credit losses. Commingling these metrics will be confusing and result in the need to do additional work. Additionally, the costs of engineering and implementing such systems would be enormous. Credit management and investment income systems currently have no way of handling such a process in an integrated fashion. In addition to the software systems changes, accounting department closing processes will be turned upside down compared to the current practice. Credit performance and interest rate performance should be processed, managed, and analyzed separately. Thus, this portion of the proposal should be rejected.

A Recommended Framework for Impairment

ABA believes that impairment is the most important issue for the Board to address, and, by far, it is the most difficult issue. Changing how management and investors understand reported losses and how systems collect and analyze loss data is an enormous challenge. It is critical that there be broad consensus that changes made to the impairment model provide understandable and highly relevant information that reflects the way credit is actually managed. Such a model must also be operable on a cost-effective basis, as well as auditable.

Due to the short time frame for comments on the ED, our focus with regard to impairment is to propose a framework for which we believe broad consensus on loan impairment can be achieved.

Investors, depositors, and other users of bank financial statements want to see a practical solution that is easily understood and that minimizes cost. Rather than a wholesale installation of totally new concepts, such a solution will leverage existing systems, retain familiar analytical metrics, and add processes only as needed. With this in mind, bankers have a higher confidence level in loss projection models that estimate *incurred* losses over an emergence period that typically range from 12 to 24 months. However, the precision and confidence levels related to projecting incurred or expected losses beyond that time period gives bankers pause. As a result, ABA recommends that the Board consider developing a model that:

- Recognizes the significant judgment required in the estimation process. ABA believes that longer time horizons than currently used in accounting standards are needed for loss emergence periods, and the use of judgment should be acknowledged and encouraged without strict adherence to probability thresholds. A “life of loan” or “life of portfolio” impairment concept is acceptable, but must be clearly defined.

- Considers future expectations of conditions or events that do not exist at the measurement date but are reasonably expected to occur, based on historical experience or other information. Such expectations would necessarily include national/global macroeconomic trends, community-based activity, as well as borrower-specific information.

- Separates the process of interest income recognition from the process of credit impairment. Interest income should continue to be calculated based on contractual terms and not on an after-impairment basis. The current standards for nonaccrual loans and charge-offs should also be maintained.

- Maintains symmetry in the way increases and decreases of loss estimates are recorded. For example, increases and decreases in incurred losses should both be recorded immediately through earnings. This contrasts with current accounting of purchased credit impaired assets, where decreases in estimated cash flows are recognized immediately and increases are amortized prospectively.

- Reflects, within the context of loans recorded on the balance sheet that are actually held as securities by third parties, only the net amount of loss exposure to the company. Current GAAP disallows recognizing any reduction of the allowance for amounts owed to security holders until virtual realization of the allowance. The FASB has indicated that this portion of the allowance is viewed as a "contingent gain." Such gains, however, result from terms in the security agreement that contractually limit the cash flows to be received by the third party throughout the life of the security. The current accounting results in unnecessary "front loading" of losses (or "back ending" of gains) and does not reflect the terms of the security agreement or how these assets are managed by either the company or the security holder.

- Recognizes the value of current metrics and analysis by retaining the current principles and methods to record *incurred* losses.

    - For assets that have been individually identified as impaired under current U.S. GAAP, expected cash flow forecasts that are defined in the ED (and conform to practice generally referred to as FAS 114 reserves) appear appropriate, as this generally reflects the workout and recovery process in managing these assets.

    - For assets that have not been individually identified as impaired, a well-defined process for estimating losses (conforming to the process relating to the standard generally referred to as FASB Statement No. 5) and emergence period is disclosed.

    - There must be a world-wide standard as to the definitions critical to the impairment process, such as what constitutes an "incurred loss", an "expected loss", an "impaired loan", and a "nonperforming loan", among others.

- Efficiently operates within a community bank environment. No matter the specific model, we anticipate that an expected loss methodology will add (in many cases, significantly) to the resources required for a bank's quarterly closing process. Given the limited resources of smaller banks, which make up the vast majority of banking institutions in the U.S., it is critical that such a model can be implemented and maintained in a cost-effective manner.

- Builds upon the current framework and further recognizes distinctions in longer-term losses that may precipitate different accounting treatment altogether for such losses. For example:

    - There is a lower level of precision and higher volatility in estimates of expected "life of loan" losses, compared to shorter-term, incurred loss estimates.

    - Longer-term expected loss estimates are normally managed to expected yields within a context of dynamic, "open" portfolios that have constantly changing individual loans.

- Passes intense field testing with banks of all sizes, portfolios, and stakeholders.

We do not at this time recommend how to treat, for accounting purposes, the long-term expected loss provisions for the unimpaired portfolio (for those long-term expected losses that have not yet been incurred according to the definitions provided). While investors we have talked to generally favor knowing management's estimates for the future, when asked about details, there is no consensus on how (or whether) those estimates should be recorded or analyzed. Instead, they generally want to know management's expectations in light of credit characteristics and default data. It is also critical, considering world-wide efforts to redefine regulatory capital, to understand how banking regulators will treat such reserves within their capital calculations. Finally, given the level of judgment required, how such estimates will (or can) be audited is a very important consideration.

With this in mind, ABA is encouraged by the discussions that have been held by the Expert Advisory Panel (EAP) on loan loss provisioning. As a result, we recommend that both the FASB and IASB further examine models that have been reviewed by the EAP. In addition to adhering to the principles noted above, these models also appear to satisfy banker, investor, and regulator objectives in a number of ways:

- The models give investors more quantitative detail as to what is emerging and how the bank is managing the portfolio for the long-term.
- The models do not necessarily discard the current infrastructure for either the analytical metrics or required operational systems to prepare such estimates. As a result, the cost of implementing and administering the model is significantly less than, for example, the model proposed by the IASB.
- The models allow for "life of loan" loss estimates that address the "too little, too late" problem of the current incurred loss model.

Because of the critical nature of impairment – ABA again emphasizes that this is ***the*** most critical aspect of reform for the financial instruments project – we are eager to further work with FASB to study this important issue and develop an appropriate impairment model as the Board deliberates on this issue.

Transition

Because of the complexities of reengineering loan processing systems to determine interest income on an after-allowance basis, as well as gathering and analyzing life of loan loss data – much that has never been collected – and education of management and financial statement users, significant time and cost will be required for any change in impairment models. Because of the significance of the potential change to regulatory capital, creation of any system will be premature prior to knowing how banking regulators will treat these allowances. Once that is determined, we believe a minimum of three years will be required to implement the proposed model.

On the attached pages, ABA provides responses to many of the various questions posed in the ED that relate to impairment. Thank you for your attention to these matters and for considering our views. Again, this is our second of three comment letters on the ED, and accompanies comment letters sent by ABA on classification and measurement of financial assets and liabilities and on derivatives and hedging activities. Please feel free to contact Mike Gullette (mgullette@aba.com; 202-663-4986) or me (dfisher@aba.com; 202-663-5318) if you would like to discuss our views.

Sincerely,

Donna J. Fisher

Donna J. Fisher

Questions and Answers for Exposure Draft on Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities

ABA Comment Letter 2: Credit Impairment

Credit Impairment: For All Respondents

Question 37: Do you believe that the objective of the credit impairment model in this proposed Update is clear? If not, what objective would you propose and why?

> **Response**: The objective is not sufficiently clear. The objective is confusing due to the phrase "shall not consider potential future events beyond the reporting date." An expectation of future events is fundamental to a bank's expectations about the collectibility of cash flows. Indeed, per paragraph 59 of the ED, an "appropriate historical loss rate shall reflect the cash flows that the entity does not expect to collect…" However, per paragraph 42, the entity "shall not forecast future events or economic conditions that did not exist at the reporting date…" These statements appear to contradict each other, as it is the very historical data that may often form the basis that the economic conditions will actually change after the reporting date.
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> Inconsistencies will naturally flow from such a contradiction. For example, assume that 10 years of rolling historical data indicate an expected loss of 50 bps on a segment of the loan portfolio. During the current economic downturn, which has lasted for 3 years, 75 bp losses have been experienced on the portfolio segment. Based on paragraph 59, it would appear that the 10 year historical data (forecasting 50 bp losses), which is based on whole economic cycles that have both growth and recessionary periods, should be relied upon if there is nothing to indicate that the length of the economic cycle would be different from other cycles. However, per paragraph 42, it appears that banks are not able to forecast that economic conditions will change (as was assumed under the initially-recorded projected loss) and that 75 bp losses should be used.
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> Compounding this confusion is that loss reserves for individually-evaluated assets are based on a present value technique that would normally take into account future expectations, while those future expectations may not be assumed for assets evaluated on a pool basis. While this differentiation might make sense in an "incurred loss" model, it brings further confusion to the proposed model.
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> Finally, while ABA is opposed to the fair value accounting model that is proposed in the ED, the objective of the proposed credit impairment model also does not fit within the context of the fair value model itself. Within the proposed impairment model, the difference between the net loan balance (amortized cost, net of the allowance for loan losses) and its fair value is blurred. For example, utilizing an incurred loss impairment model, the difference between the net loan balance and the fair value could conceivably represent those additional losses expected in the future, plus liquidity and market-related credit discounts. However, under the proposed model, it is unclear what losses are included in the difference.
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> With that in mind, ABA recommends that the objective of the credit impairment model be to include true expectations in credit losses. This will necessarily include the expectation of

changes in economic conditions where appropriate. While this may lead to greater subjectivity, the basis for such decisions can be provided within footnote disclosure.

Question 38: The proposed guidance would require an entity to recognize a credit impairment immediately in net income when the entity does not expect to collect all contractual amounts due for originated financial asset(s) and all amounts originally expected to be collected for purchased financial asset(s).

The IASB Exposure Draft, *Financial Instruments: Amortised Cost and Impairment* (Exposure Draft on impairment), would require an entity to forecast credit losses upon acquisition and allocate a portion of the initially expected credit losses to each reporting period as a reduction in interest income by using the effective interest rate method. Thus, initially expected credit losses would be recorded over the life of the financial asset as a reduction in interest income. If an entity revises its estimate of cash flows, the entity would adjust the carrying amount (amortized cost) of the financial asset and immediately recognize the amount of the adjustment in net income as an impairment gain or loss.

Do you believe that an entity should immediately recognize a credit impairment in net income when an entity does not expect to collect all contractual amounts due for originated financial asset(s) and all amounts originally expected to be collected for purchased financial asset(s) as proposed in this Update, or do you believe that an entity should recognize initially expected credit losses over the life of the financial instrument as a reduction in interest income, as proposed in the IASB Exposure Draft on impairment?

Response: ABA supports immediately recognizing known impairments in net income. . However, for most assets, banking models are not nearly as reliable in projecting such losses farther than the current emergence time period used today. This emergence time period typically runs between one and two years.

Banking analysts we have talked to, while to wanting to understand management's expectations of losses, are unsure of the details as to what that means. Further, it is unclear how banking regulators will treat such allowances for capital purposes, as well as how such long-term loss estimates can be efficiently audited. Although we desire a model that is useful and workable to all stakeholders, we have not been able to reach a consensus during the comment period among bankers about how such long-term expected losses beyond that emergence period should be treated. However, bankers do believe there is a distinct difference in how such longer term losses should be *understood* by investors and regulators, and this may precipitate a difference in accounting treatment and/or disclosure.

Bankers believe that this difference in understanding aligns with a notion that there is a difference between how banks manage their normal book of business (for long-term yield) and their impaired loans (for workout and recovery). The difference in understanding is also consistent with both banker and investor desires to understand how "soft" such estimates are. Therefore, ABA encourages a process where all constituencies participate in a field test that includes banks of all sizes, portfolio mixes, and ownership structures. ABA believes that agreement with all stakeholders is critical to ensure a strong and workable model.

Question 39: Do you agree that a credit impairment should not result from a decline in cash flows expected to be collected due to changes in foreign exchange rates, changes in expected prepayments, or changes in a variable interest rate? If not, why?

> **<u>Response</u>**: ABA believes that any reason that a borrower cannot pay the contractual cash flows should be recognized as credit impairment.
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> That said, consistent with accounting for foreign currency changes currently in effect for securities (other than available for sale securities), changes in currency exchange rates that reduce the contractual cash flows received (where the borrower has satisfied its obligation) should be recognized in net income as a foreign currency adjustment. The ED's use of current accounting for available for sale securities is inappropriate in this case, as it is based on the inappropriate notions that: 1) loans and debt securities held for long-term investment should be recorded at fair value on the balance sheet, and 2) the bank would recoup such losses/gains if applicable foreign exchange rates subsequently adjusted back to levels in effect at the time of the original transaction. Past contractual cash flows based on the local currency are not normally retrospectively adjusted.
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> In regards to changing prepayment assumptions, ABA agrees that prepayments have nothing to do with credit impairment.
>
> As variable rate financial products are priced with the expectations of future interest rate increases and decreases, so should estimating cash flows for the purpose of determining credit impairment. Therefore, paragraph 49 must be clarified to ensure that rate changes that are likely to be recognized are included in its analysis of cash flows. For example, changes in interest indices may consistently precede those used in the loan agreement. Forward rate curves may also indicate interest rate movement where historical data indicates this will occur.

Question 40: For a financial asset evaluated in a pool, the proposed guidance does not specify a particular methodology to be applied by individual entities for determining historical loss rates.

Should a specific method be prescribed for determining historical loss rates? If yes, what specific method would you recommend and why?

> **<u>Response</u>**: ABA believes there should be no prescribed method for determining historical loss rates. A prescribed method is likely to eventually prove to be inappropriate for various industries, segments, products, or geographic locations, and may need to change over time. Further, such prescriptions will also lead to more detailed guidance regarding issues such as the number of years of data required, the weight given to more recent years, etc.
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> Noting that use of models based on historical data, while often a reliable basis for decision-making, obviously has limitations. In fact, the term "historical loss rates" may inadvertently exclude other methods of expected loss projection, such as using migration analysis. However, applicability to new products and geographic regions and determining the appropriate time frames used are just two of the problems that exist in relying on historical data. With that in mind, ABA recommends that FASB consider expanding implementation guidance on estimating

allowances for loan losses, as well as allowing qualitative and other quantitative methods that do not solely rely on historical data to determine expected losses for pools of assets.

Question 41: Do you agree that if an entity subsequently expects to collect more cash flows than originally expected to be collected for a purchased financial asset, the entity should recognize no immediate gain in net income but should adjust the effective interest rate so that the additional cash flows are recognized as an increase in interest income over the remaining life of the financial asset? If not, why?

Response: ABA recommends that there be consistent treatment of declines in expected cash flows (impairment) and increases in those cash flows, whether the assets are purchased or originated. The current metric of interest yields and net interest margin is well understood by both investors of banks and bank management. Confusion, however, reigns when applying the standard originally known as American Institute of Certified Public Accountants Statement of Position 03-3 "Accounting for Certain Loans or Debt Securities Acquired in a Transfer" (SOP 03-3) – precisely because of the inconsistent treatment of these changes in expectations. In fact, SOP 03-3 has caused dramatically higher costs for the banks that have implemented the SOP, in part because investors do not understand what the results mean. ABA believes that immediate recording of gains in net income for a purchased asset would provide meaningful information to investors and management and would properly reflect how the bank is managing these long-term cash flows.

As indicated in our response to question 38, ABA supports considering models that have been considered by the Expert Advisory Panel in which increases and decreases to the allowance for loan losses related to shorter-term emergence periods of purchased financial assets are treated consistently (through net income), as well as increases and decreases to the allowance for loan losses due to changes in long term expectations (amortized). In such a model, splitting the treatment between short-term and long-term gains further provides better information to the user regarding portfolio performance. ABA believes it is important to try to reach agreement among the banker, user, auditor, and regulator communities as to the final model.

Question 42: If a financial asset that is evaluated for impairment on an individual basis has no indicators of being individually impaired, the proposed guidance would require an entity to determine whether assessing the financial asset together with other financial assets that have similar characteristics indicates that a credit impairment exists. The amount of the credit impairment, if any, would be measured by applying the historical loss rate (adjusted for existing economic factors and conditions) applicable to the group of similar financial assets to the individual financial asset.

Do you agree with this requirement? If not, why?

Response: ABA agrees that the bank should *consider* assessing such an asset together with other similar financial assets for collective impairment. However, ABA disagrees with a *requirement* that the asset be assessed with other assets. Such a requirement would be appropriate only in the circumstance that an asset that is already included in a pool of assets evaluated collectively shows some characteristic that may indicate impairment (such as payment delinquency) but upon specific evaluation is determined not to be impaired (for example, where sufficient collateral value exists).

With this in mind, ABA recommends that FASB expand the guidance on measuring impairment for individually-evaluated assets. Banks that manage certain assets on an individual basis often have no pools of assets to appropriately compare. They will use qualitative considerations as well as metrics such as loan-to-value or debt-to-equity. There may be historical data that generally applies to various loans, but it certainly is questionable of the applicability to the many commercial loans that have unique terms, collateral structures, and guarantee arrangements.

Impairment: For Preparers and Auditors

Question 46: The proposed guidance would require that in determining whether a credit impairment exists, an entity consider all available information relating to past events and existing conditions and their implications for the collectibility of the cash flows attributable to the financial asset(s) at the date of the financial statements. An entity would assume that the economic conditions existing at the end of the reporting period would remain unchanged for the remaining life of the financial asset(s) and would not forecast future events or economic conditions that did not exist at the reporting date. In contrast, the IASB Exposure Draft on Impairment proposes an expected loss approach and would require an entity to estimate credit losses on basis of probability-weighted possible outcomes.

Do you agree that an entity should assume that economic conditions existing at the reporting date would remain unchanged in determining whether a credit impairment exists, or do you believe that an expected loss approach that would include forecasting future events or economic conditions that did not exist at the end of the reporting period would be more appropriate?

Are both methods operational? If not, why?

Response: Since historical loss rates are assumed to be based on the lives of loans and are the result of changing economic conditions, an expected loss approach naturally should include expected changes economic conditions and future events. While this will involve judgment, and, thus, could result in comparability issues, there is no accuracy whatsoever in assuming there will be no change to economic conditions (i.e., this portion of the loss estimate may be comparable, but inaccurate). Indeed, assuming economic conditions do not change, depending on the economic cycle, could cause unnecessarily wide swings in expected losses.

Further, bankers that have intimate knowledge of a borrower's operations should be allowed to consider events that are expected to impact the borrower's business. While this may, of course, provide more subjectivity to the evaluation process, it will better reflect a more realistic expectation about impairment.

Question 47: The proposed guidance would require that an appropriate historical loss rate (adjusted for existing economic factors and conditions) be determined for each individual pool of similar financial assets.

Historical loss rates would reflect cash flows that the entity does not expect to collect over the life of the financial assets in the pool. Would such an approach result in a significant change in practice (that is, do historical loss rates typically reflect cash flows that the entity does not expect to collect over the life of the financial assets in the pool or some shorter period)?

> **<u>Response</u>**: Current models used by banks typically project losses expected to emerge within one to two years. Due to this convention, historical data is typically based on comparative year loss rates. For companies that have impaired purchased assets (i.e., are following SOP 03-3) current processes to estimate expected losses over the remaining life of a loan are in place for impaired assets. However, those models are cumbersome and imprecise. Therefore, life of loan loss rates currently are not in wide use.

<u>Interest Income: For All Respondents</u>

Question 48: The proposed guidance would require interest income to be calculated for financial assets measured at fair value with qualifying changes in fair value recognized in other comprehensive income by applying the effective interest rate to the amortized cost balance net of any allowance for credit losses.

Do you believe that the recognition of interest income should be affected by the recognition or reversal of credit impairments? If not, why?

> **<u>Response</u>**: The current metric of interest yields and net interest margin is well understood by investors of banks, bank regulators, and bank management. Changes in yields and margins often reflect adjustments in underwriting standards, product mix or liquidity management strategies. Confusion, however, is introduced by commingling credit risk and interest rate risk by calculating interest income on an after-credit impairment basis. While we understand the academically-conceptual basis for providing such information, given the volatility of loan loss estimates (even when recording expected losses), this methodology is flawed because it will not add value to investment decisions except on a very long-term basis (even then, such yields can be easily determined by factoring in loss provisions). It also makes "soft" the accuracy of interest income and net interest margins by introducing judgment into the calculation.
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> This approach to interest income recognition also causes significant operational difficulty for banks, which must totally reconfigure the timing of their closing processes and virtually calculate such revenue on a loan-by-loan basis. Given the operational difficulties with this proposal and the expected tiny, if any, benefits to investors and management, ABA recommends this portion of the proposal be rejected.

Question 49: Do you agree that the difference in the amount of interest contractually due that exceeds interest accrued on the basis of an entity's current estimate of cash flows expected to be collected for financial assets should be recognized as an increase to the allowance for credit losses? If not, why?

> **Response**: Under the proposed interest recognition methodology described in question 48, this treatment appears appropriate. However, the methodology, as noted in our response to question 48, is flawed and should not be adopted.

Question 50: The proposed guidance would permit, but would not require, separate presentation of interest income on the statement of comprehensive income for financial assets measured at fair value with all changes in fair value recognized in net income. If an entity chooses to present separately interest income for those financial assets, the proposed guidance does not specify a particular method for determining the amount of interest income to be recognized on the face of the statement of comprehensive income.

Do you believe that the interest income recognition guidance should be the same for all financial assets?

> **Response**: Yes. For the sake of operational and analytical reasons, consistency in income recognition is critical. Such consistency will avoid confusion not only as investors and management analyze income between business strategies within financial reporting, but also with how such income is reported for regulatory purposes.

Question 51: Do you believe that the implementation guidance and illustrative examples included in this proposed Update are sufficient to understand the proposed credit impairment and interest income models? If not, what additional guidance or examples are needed?

> **Response**: More guidance is required on the use of historical data as a basis for estimating expected losses over the life of a loan, while being required to assume economic conditions existing at a point in time would remain unchanged for the remaining life of the assets.

Disclosures: For All Respondents

Question 65: Do you agree with the proposed disclosure requirements? If not, which disclosure requirement do you believe should not be required and why?

> **Response**: Due to our opposition on how interest income is calculated in the ED, ABA opposes the disclosure requirements in paragraph 102 and 103, which are required only because of the proposed method change.

Disclosures: For Preparers and Auditors

Question 68: Do you agree with the transition provision in this proposed Update? If not, why?

> **Response**: ABA believes that a one-time cumulative effect adjustment is acceptable, though it will require at least three years of prior period data (in many cases four years of prior year data) in order to provide comparative information for investors and other users. With this in mind, significant systems work is needed for virtual retrospective application of the standards proposed in the ED.

Effective date and Transition: For Preparers and Auditors

Question 70: How much time do you believe is needed to implement the proposed guidance?

> **Response**: There is no current "life of loan or loan portfolio" expected loss data that is maintained on existing loans. We believe a minimum of three years is required to gather and analyze impairment data, as well as redesign systems to calculate how interest income will be reported. This three year period must also start after regulatory guidance has been issued as to how specific provisions and allowances may be treated for capital purposes.

Question 71: Do you believe the proposed transition provision is operational? If not, why?

> **Response**: See our response to question 68.