

September 25, 2012

Ms. Leslie Seidman
Chairman
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-05116

Re: FASB File Reference No. 2012-200, Proposed ASU, *Financial Instruments (Topic 825): Disclosures about Liquidity Risk and Interest Rate Risk* (the “Proposal”)

Dear Ms. Seidman:

The Clearing House Association L.L.C. (“The Clearing House”), an association of major commercial banks,¹ appreciates the opportunity to comment on the Proposal.

Executive Summary

The Clearing House supports the efforts of the Financial Accounting Standards Board (the “FASB” or the “Board”) to provide users of financial statements with decision-useful information about an entity’s liquidity risk and interest rate risk. However, we believe the Proposal does not achieve its intended objective. The proposed standardized tables generally only provide a static view and would not accurately reflect the dynamic nature of liquidity and interest rate risk and how banks actually monitor and manage these risks. Thus, the disclosures would not be relevant and likely will confuse or mislead financial statement users.

We understand the standardized tables were proposed to address user feedback requesting comparability and the intent was to provide data that could be reconciled back to

¹ Established in 1853, The Clearing House is the oldest banking association and payments company in the United States. It is owned by the world’s largest commercial banks, which collectively employ over 2 million people and hold more than half of all U.S. deposits. The Clearing House Association L.L.C. is a nonpartisan advocacy organization representing—through regulatory comment letters, amicus briefs and white papers—the interests of its owner banks on a variety of systemically important banking issues. Its affiliate, The Clearing House Payments Company L.L.C., provides payment, clearing, and settlement services to its member banks and other financial institutions, clearing almost \$2 trillion daily and representing nearly half of the automated-clearing-house, funds-transfer, and check-image payments made in the U.S. See The Clearing House’s web page at www.theclearinghouse.org.

the statement of financial position². While we recognize the perceived benefit of having static standardized data presented, we believe the dynamic nature of liquidity and interest rate risk does not lend itself to a “one-size fits all” approach. Moreover, given the various judgments that entities must make to prepare certain of the disclosures (e.g., expected maturities for the liquidity gap analysis, fair value changes for the interest rate sensitivity analysis), we do not believe that the disclosures will provide information that is truly comparable across institutions.

We also note that the Proposal (i) does not converge with the disclosures required by International Financial Reporting Standards 7, *Financial Instruments: Disclosures* (“IFRS 7”), (ii) overlaps with but is incremental to a substantial amount of information already required by the SEC, and (iii) also differs from the reporting required by the Federal Reserve (3G and 4G liquidity monitoring tools), which may also be different from those that will be required by the regulators pursuant to the capital and liquidity frameworks announced in December 2010 (“Basel III”)³ when the United States implements Basel III reporting. We also understand that the Financial Stability Board is planning to develop its own set of required liquidity and interest rate risk disclosures. We believe that having to produce at least four distinct sets of disclosures, all of which are intended to capture the same type of information, will be confusing to investors and will impose an undue burden on preparers.

Given the importance and sensitivity of these disclosures, especially the liquidity risk disclosures, we believe that it is crucial that the FASB develop a set of disclosures that are truly meaningful and reflective of the actual risk measurement and monitoring practices of the preparers. In addition, while we agree that a robust analysis and discussion regarding these risks are critical, we believe that this discussion is most appropriately included by public companies in Management’s Discussion and Analysis (“MD&A”) section of the required U.S. Securities and Exchange Commission (“SEC”) filings, similar to Value at Risk and other qualitative and quantitative risk analyses, rather than in the notes to the financial statements.⁴ We are concerned about the ability of auditors to express an opinion on this type of information, which would be required if it is included in the notes to the financial statements. Moreover, much of this information would be forward-looking and, while there is a safe harbor for forward-looking information in the MD&A, a safe harbor for the audited financial statements in SEC filings may not always be available.

The proposal related to liquidity disclosures has a number of positive and meaningful aspects, such as the disclosure of available liquid funds. However, we urge the FASB to use the guidance related to Section 165 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) and the Basel III framework in defining liquid assets. The

² Proposal, BC6.

³ Basel III: International framework for liquidity risk measurement, standards and monitoring at <http://www.bis.org/publ/bcbs188.pdf>.

⁴ In this regard, our recommendations relate only to public financial institutions. The FASB should consider the feedback from private companies in determining the most appropriate disclosures for those entities.

harmonization of this definition is an important building block in creating a “common language of risk” for banks and their investors.

In short, The Clearing House:

- **recommends** that the FASB not proceed with the current Proposal, and instead work with the SEC and other regulators to determine the best method for public companies to disclose liquidity and interest rate risk that, ideally, is more consistent with the way institutions actually manage their liquidity and interest rate risks; and
- **recommends** that disclosures regarding liquidity and interest rate risk be included in MD&A rather than in the footnotes to the financial statements.

We believe that the time spent redeveloping the disclosure format to be more consistent with the disclosures required by other regulators and with how institutions actually manage risk would be time well spent, in order to ensure that the ultimate disclosures are truly meaningful to investors such that the benefits of providing these disclosures will justify the cost of preparing them.

If, however, the FASB does decide to proceed with the Proposal as currently drafted, we have some specific recommendations included in the Appendix to this letter.

A. The Static Liquidity Gap Maturity Analysis is not Commonly Used by Financial Institutions to Measure or Monitor Liquidity Risk and Will Not Achieve Comparability Across Institutions.

Given the fundamental importance of managing liquidity risk, many entities use a number of metrics to measure and monitor this risk exposure. Such measures include a variety of liquidity metrics and ratios, including those that measure whether the entity can meet its obligations over a short time period in a severe stress scenario; whether the entity’s asset base is funded by sufficiently long-dated liabilities and capital; the potential impacts of various credit ratings downgrades; and liquidity stress testing and scenario analyses. Such scenarios include assumptions about key changes in funding sources, market triggers (such as credit ratings), potential uses of funding and political and economic conditions in certain countries.

In contrast, the static liquidity gap maturity analysis that is proposed is no longer commonly used by financial institutions to measure or monitor liquidity risk. The analysis uses an artificial basis for measuring “liquidity”, as it requires presentation of maturities at balance sheet values, rather than a presentation of projected cash inflows and outflows. Additionally, events such as loan renewals are not considered in a static liquidity analysis. If a large portion of issued loans mature in one year for a particular institution, a static analysis would suggest

that it is very liquid, when, in reality, the institution is planning to renew these loans, thereby impacting its liquidity. Further, the use of expected maturity (as defined) for the analysis is not realistic, as it ignores the entity's expected timing of the sale or transfer of the instrument. Such expectations regarding sales and transfers are fundamental to a liquidity analysis that would actually be used by management to make decisions regarding its liquidity risk profile (and ultimately its funding decisions), and, we believe, should be taken into account in estimating expected maturity. For example, an entity may have the ability and intent to sell a security in the next several months, but the proposed guidance requires the instrument be presented as if the entity was required to hold it, which could be an expected life of 10 years, whereas the entity's funding for this security may be short-term in nature, due to the entity's intention to sell the asset. This creates the illusion of a "liquidity gap" that does not actually exist, and thus is not an accurate depiction of actual liquidity risk. Lastly, most liquidity analyses conducted by banks use a stress scenario because liquidity events do not typically arise without stress.

Furthermore, even if all entities followed the framework proposed, the results would still not achieve the FASB's intended objective of comparability across institutions, because the underlying assumptions for "expected maturity" will likely differ among firms. Thus, the proposed disclosures would result in voluminous data, but the disclosure likely would not provide either particularly meaningful or comparable information to an investor regarding an entity's expected liquidity sources and uses.

We believe it is of the utmost importance to produce a disclosure standard that is actually reflective of how firms manage and measure their liquidity risk. Liquidity disclosure has the potential, if misinterpreted, to actually cause a liquidity event which, in turn, could lead to even more serious systemic disruption – even if the underlying fundamentals are sound. As a result, given the special nature of liquidity risk, we believe that thorough discussions are required, and should involve all stakeholders.

Given the differences in liquidity risk profiles that can exist among firms with different business models, any meaningful disclosure should start with information related to the firm's specific liquidity risk management policies and procedures. This qualitative information should be supported by quantitative disclosures that the firm finds relevant and useful in the context of its own management approach. Simplified "one size fits all" quantitative disclosures would not be risk-based and run the potential risk of misinforming users as they would not necessarily be reflective of the true liquidity risk profile of the firm.

In light of the number of significant discussions regarding measurement and disclosure of liquidity risk that are currently under way, we recommend that the FASB not proceed with

the Proposal and instead work closely with the SEC and other regulators to benefit from their extensive public discussion and due process regarding these issues to determine the best method for public companies to disclose liquidity risk.

B. The Interest Rate Table and Sensitivity Analysis Will Not Provide Useful Information to Investors or Analysts, since they are not used by Financial Institutions to Measure or Monitor Risk and Will Likely Differ from MD&A Disclosures. Instead, TCH Recommends a Sensitivity Analysis that should be Presented in the MD&A.

Similar to our concerns regarding the proposed liquidity disclosures, the interest rate repricing gap table and the sensitivity analysis proposed do not reflect the way financial institutions actually monitor their interest rate risk. Rather, financial institutions typically produce a variety of measures, including net interest income simulation analyses, economic value of equity analyses, and similar dynamic, rather than static, interest rate sensitivity measures based on possible or expected interest rate environments.

In particular, most financial institutions have found the static repricing gap analysis is of limited use, as it ignores the optionality of financial instruments and does not accurately reflect the impact of hedging. Optionality is important to consider, as optionality can drastically change the interest rate profile of an entity as time progresses. For example, while a static repricing gap analysis may suggest an entity has significant repricing gaps due to holding a substantial amount of fixed rate assets, during a rising rate environment the fixed rate assets would be expected to have sizable prepayments which would reduce (or eliminate) the reported repricing gaps. Hedging is frequently used by banks to eliminate repricing gaps, but the proposed presentation of the hedging instrument in the table would not accurately reflect the elimination of this risk. To illustrate: assume an entity has a \$1 billion fixed rate loan and a \$1 billion floating rate liability that resets monthly. To eliminate the interest rate mismatch between the asset and the liability, the entity enters into a \$1 billion notional fixed to floating rate swap. For purposes of the repricing gap analysis, the entity would show the \$1 billion asset in the column corresponding with its maturity, the \$1 billion liability in the "next quarter" column, and the fair value (i.e., not notional amount) of the derivative in the "next quarter" column. While the entity has eliminated the repricing gap with the derivative, the repricing gap analysis would not make this apparent to the financial statement user.

Regarding the interest rate sensitivity analysis, we believe that the Proposal's requirement to perform a parallel, static shock to the yield curve is highly unrealistic. We are especially concerned that the Proposal does not permit entities to incorporate any forward-looking expectations into the analysis (paragraph 825-10-50-23AF) other than those based on contractual provisions. Many banks perform a variety of interest rate scenarios but typically

these are not static shocks to the yield curve. Rather, they consist of dynamic scenarios that model various changes in interest rates. While certain factors, such as changes in volumes, credit spreads and margins may be kept constant, other factors, such as changes in loan prepayment speeds, anticipated deposit runoffs, growth of the loan book in different scenarios, mix changes, etc., are typically taken into account, in order to arrive at a more realistic representation of interest income at risk. In fact, many institutions already disclose these scenario analyses, but because of the forward-looking nature of the underlying assumptions, the disclosures are included in MD&A rather than in the footnotes to the financial statements. These types of assumptions are so fundamental to this type of analysis that to ignore them would produce a highly artificial result that would be of little or no use to investors.

Because the analyses proposed are not used by financial institutions to measure or monitor risk and will likely differ from the disclosures banks provide in their MD&A, we do not believe the proposed disclosures will provide any useful information to analysts. In fact, it may be difficult for management to explain these tables to analysts or answer any questions regarding them. As a result, we are concerned that the Proposal imposes a substantial operational cost without producing any real benefit for users of financial statements.

As an alternative, we suggest an approach whereby financial institutions would present a sensitivity analysis that presents the impact on net interest income of pre-determined, standardized shocks to the yield curve, but allows financial institutions to incorporate their own assumptions regarding the behavior of the portfolio, such as those mentioned above: changes in loan prepayment speeds, anticipated deposit runoffs, growth of the loan book, mix changes and the like. We believe this would improve the comparability of the impact on net interest income of various rate changes while at the same time hewing much more closely to the type of real-world scenario analyses that financial institutions currently perform in order to monitor and manage their interest rate risk exposures. Given that these analyses will by definition incorporate forward-looking information, we believe that it would be inappropriate to include them in the notes to the financial statements and should instead be presented in the MD&A.

C. Any Revised Disclosure Proposal should be Implemented at the Earliest at the Beginning of the First Reporting Period Following One Year After the Issuance of a Revised ASU.

As noted above, we believe that it is critical that FASB devote the time necessary to work with the SEC and other regulators to determine the most appropriate method of disclosing interest rate and liquidity risk. We believe it would be preferable to invest some additional time up front in order to ensure that the ultimate disclosures are truly meaningful to

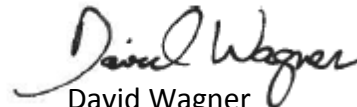
investors, rather than rush to produce some stop-gap measures that will be costly to produce yet at the same time will still not provide comparable or relevant measures for investors.

Given the quantity of detailed information required and the fact that most financial institutions do not currently produce this information in the format required, we request that the FASB require any revised ASU to be implemented, at the earliest, at the beginning of the first reporting period following one year after the issuance date of a revised ASU, so that financial institutions have a sufficient amount of time to produce the required information. We agree that the disclosures should not be required for prior periods presented.

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We thank you for considering the comments provided in this letter. If you have any questions or are in need of any further information, please contact me at (212) 613-9883 (email: david.wagner@theclearinghouse.org) or Brett Waxman at (212) 612-9211 (email: brett.waxman@theclearinghouse.org).

Sincerely yours,



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Appendix

If the FASB decides to proceed with the liquidity and interest rate measures that are currently included in the Proposal, we have the following comments:

Liquidity Gap Table

- A key area of concern is the definition of the term “expected maturity” as “the expected settlement of the instrument resulting from contractual terms.” This definition would not capture the behavioral characteristics of the firm’s balance sheet or off-balance sheet obligations. To be an effective measure of liquidity gaps, the term “maturity” should encompass a firm’s modeling of the mismatches in a firm’s assets, liabilities and off-balance sheet commitments and contracts. For example, categorizing liquid investment securities held in an Available-for-Sale liquidity portfolio in their contractual maturity buckets does not represent the true “time to funding,” given the ability to sell these securities at any time. This analysis becomes more complex when modeling repurchase and reverse repurchase agreements, the impact of covering short positions and the like. These factors, and numerous others, are the subject of intense study related to the behavioral characteristics of the underlying instrument. We are concerned that the use of the term “expected maturity,” as defined, is inherently misleading, as it does not represent an institution’s true expectations regarding the maturity, and hence liquidity, of an instrument. We recommend that the FASB permit institutions to take these types of expectations into account when preparing the liquidity gap table.
- It is not clear how an entity would present liquidity maturities among the different time intervals for derivatives with differing maturities that are currently netted by counterparty for balance sheet presentation purposes. Another complexity with derivatives arises with how to treat collateral receivables and payables and cash collateral. One possible solution is not to allocate derivatives based on contractual maturity but rather present them in the table in the total carrying amount column. This would be consistent with how debt securities classified as held for trading purposes are presented. In addition, because derivatives are often fully margined, and are frequently terminated or settled before maturity (and often daily), we believe this would be the best way to present them. Another alternative is to present the derivatives on a gross basis and then present a reconciling column for the amount that has been netted, as well as the net amount of collateral paid/received, in order to agree to the amount presented on the balance sheet, similar to the approach used by many institutions today for the fair value measurement disclosures required by Topic 820, *Fair Value Measurement*. However, this approach could prove confusing to the financial statement user.

- Another complexity arises with respect to how the allowance for loan losses should be presented, because if it is not included in the table, the amounts will not reconcile to the balance sheet. We recommend that the allowance be included in the total carrying amount column.

Interest Rate Risk Disclosures

- Regarding the repricing gap table, we believe that including periods beyond two years in the future is of less value to analysts because of its static nature. After two years, the actual repricing gap is likely to be substantially different as a result of the impact of hedging relationships, changes in floating rate instruments and prepayment optionality. Accordingly, we suggest that, if the repricing gap table is required in its proposed static form, it should extend out only to two years in the future, with everything beyond year two captured in a "total" column.
- It is not clear how entities should determine the base yield curve in the sensitivity analysis disclosure. If FASB's overall goal is comparability among institutions, is it the FASB's intent to provide guidance on the composition or derivation of the base yield curve?
- In paragraph 825-10-50-23AD, it is not clear what distinction is meant by "the entity shall consider the effects of the full fair value change on equity ... when analyzing the effect on shareholders' equity from the effect of hypothetical changes in the yield curve..." (emphasis added) as opposed to the requirement to present the effect of changes in rates on net income. For example, does this mean that the entity shall consider the effects of interest rate changes on changes in the fair value of trading instruments and changes in the value of Available-for-Sale securities that are recorded in Other comprehensive income; or is an entity required to consider factors other than changes in interest rates that occur when the yield curve shifts, such as changes in credit risk or foreign currency exchange risk; or something else entirely?
- In Example 11, it is not clear whether the first table, Hypothetical Yield Curves, is for illustrative purposes only or is required to be included in the disclosures.

Scope

- The guidance in paragraph 825-10-50-23B is also unclear. It appears that the Proposal does not require these disclosures for the individual segments of a financial institution; rather, we read this section to state that it is intended to capture entities that are not financial institutions on a consolidated basis but that have one or more segments that qualify as a financial institution. If this is indeed the FASB's intention, we suggest that the guidance be clarified to specify a two-step process, as follows:

1. First, determine if the entity as a whole is a financial institution;⁵ if so, the entity would provide the required disclosures on a consolidated basis;
2. If the entity is not a financial institution on a consolidated basis but has any segments that are financial institutions, the required disclosures would be provided for all individual segments that are considered financial institution segments on a combined basis.

Issuance of Time Deposits

- It is unclear how time deposits that are subject to automatic renewal or rollover should be presented in the tables. We are concerned that if rollovers are presented as new issuances, this could prove confusing to investors: for example, a daily rollover of a customer's balance could be shown as 365 "new issuances" for a twelve-month period. Accordingly, we recommend that rollovers and renewals should not be deemed new issuances for the presentation in the time deposit table as this would be more consistent with economic reality and therefore would provide more decision-useful information to investors.

⁵ Proposal, paragraph 825-10-50-23A provides in relevant part that, "For the purposes of these disclosures, the term *financial institution* refers to entities or reportable segments for which the primary business activity is to do either of the following: a. Earn, as a primary source of income, the difference between interest income generated by earning assets and interest paid on borrowed funds; or b. Provide insurance."