



April 1, 2014

Mr. Russell Golden
Chairman
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-05116

Re: File Reference No. 2013-220: Financial Instruments - Overall (Subtopic 825-10)
Recognition and Measurement of Financial Assets and Financial Liabilities (“Recognition and Measurement Proposal”); and
File Reference No. 2012-260: Proposed Accounting Standards Update, *Financial Instruments—Credit Losses (Subtopic 825-15)* (the “Credit Losses Proposal” and together, the “Proposals”)

Dear Mr. Golden:

The Clearing House Association L.L.C. (“The Clearing House”),¹ an association of major commercial banks, is aware that the Financial Accounting Standards Board (the “FASB” or the “Board”) is currently redeliberating the above-referenced Proposals. The Clearing House supports the recent decision by the Board to limit the Recognition and Measurement Proposal to targeted improvements to the existing Accounting Standards Codification (“ASC”). As both of these Proposals are significant to us, we would like to take this opportunity to suggest areas in which the Board might focus its efforts. In particular, The Clearing House:

¹ Established in 1853, The Clearing House is the oldest banking association and payments company in the U.S. 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.

- *strongly recommends* that the fair value option not be limited as it has worked well in the past, reduces hedge accounting complexity and promotes prudent risk management;
- *urges* that all purchased loans be treated the same under the Credit Losses Proposal, since having two separate models for purchased loans will be difficult for investors to understand, especially after a business combination is effected;
- *believes* the Troubled Debt Restructuring (“TDR”) designation is not meaningful in light of the proposed measurement changes in the Credit Losses Proposal, and should therefore be eliminated;
- *recommends* retaining the ability to transfer loans out of the Held-for-Investment (“HFI”) category, as it allows banks to appropriately manage credit, liquidity and concentration risks related to their loan portfolios; any concerns regarding such transfers could be addressed via additional disclosures regarding the purpose and nature of significant sales of loans out of the HFI category; and
- *agrees that* foreign currency gains and losses on debt securities measured at fair value through other comprehensive income (“FVOCI”) should be recognized in net income.

A detailed discussion of each suggestion is provided below.

A. The fair value option is not in need of improvement and should not be limited.

We note that in the Recognition and Measurement Proposal, the Board proposed limiting the application of the fair value option to hybrid financial instruments classified as liabilities that would otherwise be required to be bifurcated.²

We believe the fair value option has worked well in practice, reduces accounting complexity, and promotes prudent risk management. The fair value option allows entities to better match the accounting measurement of assets and liabilities to hedging instruments, without the undue complexity associated with existing hedge accounting rules. For example, many banks elect the fair value option for mortgage loans held for sale (such as loans warehoused for sale to an agency mortgage-backed securitization) in lieu of a fair value hedge under ASC Topic 815, as it avoids complexities such as similar asset testing and measuring hedge effectiveness. Prior to the fair value option, the complexities around hedge accounting and the accounting mismatches that could occur if an economic hedge were used

² Recognition and Measurement Proposal, page 8.

resulted in some banks not hedging interest rate risk on funded loans. With the advent of the fair value option, banks are now able to enter into transactions that will economically hedge their positions without having to elect hedge accounting. This illustrates that the fair value option has promoted prudent risk management more broadly across the industry.

Furthermore, the fair value option currently allows entities to measure an entire hybrid instrument at fair value, rather than bifurcating the embedded derivative from the host contract and separately measuring each instrument at fair value. This is important, as market prices for bifurcated derivatives typically do not exist, and thus the fair value measurements can be complex and require significant judgment. In contrast, market prices for the entire hybrid instrument (or similar instruments) often exist which simplifies the fair value measurement process and results in measurements that are market-observable, thereby requiring less judgment.

In addition, due to the economic and operational incentives to elect the fair value option, we believe that the use of the fair value option has resulted in greater comparability across banks for business activities for which hedge accounting is eligible but not simple to apply. Furthermore, per current disclosure requirements, the use of the fair value option is fully disclosed, providing investors with an understanding of when and why the fair value option has been employed.

Due to the reasons discussed above, we do not believe that limiting the fair value option would result in an improvement to financial reporting. On the contrary, we believe it would represent a step backwards, as it would lead to greater measurement and recognition inconsistencies between assets and liabilities within banks, and possibly across financial institutions as well, that would prove confusing to investors, as well as reintroduce disincentives to sound risk management. Accordingly, we strongly recommend that the Board leave the fair value option as it exists today. Should the Board decide to revisit the fair value option, we recommend that this be done in conjunction with the reconsideration of ASC Topic 815.

B. All purchased loans should be treated the same under the Credit Losses Proposal.

We note that the Board recently affirmed its decision not to extend the impairment model for “purchased credit impaired” (“PCI”) loans to other loans that are purchased, but do not meet the definition in the Credit Losses Proposal of “significantly impaired.” We are concerned that having two distinct models for PCI loans and other purchased loans will prove confusing to investors, particularly so after a financial institution effects a business combination (that is, the impact will be much more significant for purchases of large portfolios of loans versus the impact of individual loan purchase transactions).

From a practical perspective, we are also concerned that questions will arise as to which loans meet the definition of “significantly impaired.” For instance, for acquired loans that have some impairment, but the impairment is not significant enough to cause the loan to meet the definition of a PCI loan, the Proposal would require an entity to subsequently recognize provision expense for its estimate of these credit losses, even though the acquisition-date fair value already reflects a lifetime

estimate of expected credit losses. This would result in double-counting the expected losses inherent in the loan in the purchase price at acquisition.

As we have noted in our prior comment letter,³ the current model for PCI loans under U.S. generally accepted accounting principles (“U.S. GAAP”) is operationally complex, and we believe that neither the methodology nor the disclosures are well understood by investors. Conceptually, we see no need for a distinction between PCI loans and other purchased loans, and we therefore strongly support the elimination of the existing U.S. GAAP guidance for PCI loans and the introduction of a single approach to measurement that applies to all purchased loans. Specifically, we recommend entities separately record the credit loss component of the purchase price of a loan as an allowance at the date of acquisition. Subsequent changes in expected future credit losses should be recorded as a release or increase in the allowance with an offset to expense.

C. The TDR disclosures are no longer meaningful under the Credit Losses Proposal and should be eliminated.

We understand the Board desires to retain the TDR designation, as the Board believes disclosure of TDRs provides useful information to financial statement users. However, we believe that under the Credit Losses Proposal, the TDR designation will no longer be meaningful. This is because the significance of the TDR designation today is to require loans to be measured for impairment pursuant to ASC Topic 310 (formerly, FAS 114) instead of under ASC Topic 450 (formerly, FAS 5). Once these two approaches are eliminated and all loans are required to be measured under the Current Expected Credit Losses approach, the TDR designation will no longer be meaningful and should therefore be eliminated.

To address user concerns regarding the performance of loan modifications of lesser credit quality, we suggest an alternative to the current disclosures related to TDRs. Specifically, the disclosure of information regarding the types of loan modifications, including forgiveness of principal and reductions in interest, could be revised to include modifications on all loans of lesser credit quality. These could be disaggregated to be consistent with other credit quality disclosures (e.g., subprime and/or loans with lower internal credit quality ratings) and would include re-defaults of these loan modifications, consistent with the existing requirements in ASC 310-10-50-33 and 310-10-50-34, *Receivables – Disclosure - Modifications*.

D. Sales of loans from the HFI portfolio should not be further restricted; additional disclosures should be considered instead.

³ TCH letter to FASB dated May 31, 2013, File Reference No. 2012-260 (available at <https://www.theclearinghouse.org/issues/finance/accounting/improvements-to-fasb-credit-loss-proposal>).

Under the current accounting framework, financial institutions are permitted to transfer loans from the HFI portfolio under certain circumstances.⁴ We continue to believe that transfers out of the HFI portfolio should be permissible in order to support prudent credit, liquidity and concentration risk management activities and in certain other circumstances (e.g., the exit of a product line, expiration of co-branding or similar arrangements in the credit card business, and loan sales executed as a means to terminate a relationship with a servicer).

If the FASB is concerned about transfers out of HFI, additional qualitative disclosures about the nature and purpose of sales of loans from the HFI portfolio could be considered, in addition to the quantitative disclosures that are already required, in lieu of further limiting transfers/sales of loans out of HFI. We believe this could provide useful information to investors while at the same time preserve an important risk management technique for financial institutions.

E. Foreign currency gains and losses on debt securities measured at FVOCI should be recognized in net income.

The Recognition and Measurement Proposal proposed that for foreign currency-denominated debt securities measured at FVOCI, an entity would separately recognize changes in fair value attributable to foreign currency gain or loss in net income in the reporting period in which the gain or loss occurs.⁵ We support that approach for several reasons. The current approach of including the foreign currency gain or loss in OCI is inconsistent with the requirements of Topic 830, *Foreign Currency Matters*, for other foreign currency-denominated transaction remeasurement gains or losses (e.g., foreign currency-denominated loans or debt). Moreover, changes in foreign currency exchange rates result in realized gains and losses as the entity receives the foreign currency cash flows on the debt instrument (including those received at maturity); this is distinctly different from rate-related unrealized gains and losses excluded from net income, which would eventually reverse if the debt instrument is held to contractual maturity. In addition, these securities are also often funded by foreign currency denominated liabilities that are remeasured through income in the current period. For these reasons, we believe the Board should proceed with this proposed change.

We support the Board's decision to focus its efforts on select areas of improvement for the Recognition and Measurement Proposal. We hope that you find our suggestions regarding areas of possible focus for this and the Credit Losses Proposal by the Board useful. We would be happy to meet

⁴ For example, ASC 310-10-35-49 states that "once a decision has been made to sell loans not previously classified as held for sale, such loans shall be transferred in the held-for sale classification..."

⁵ See paragraphs 825-10-45-14 through 45-15 of the Recognition and Measurement Proposal.

with you to discuss these suggestions in more detail in person. If you have any questions, please contact me at (212) 613-9883 (email: david.wagner@theclearinghouse.org) or Ryan Pozin at (212) 613-0135 (email: ryan.pozin@theclearinghouse.org).

Sincerely yours,



David Wagner
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The Clearing House Association L.L.C.

cc: Ms. Susan M. Cospers
Technical Director
Financial Accounting Standards Board

Mr. Paul Beswick
Chief Accountant
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Mr. Mark Kronforst
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