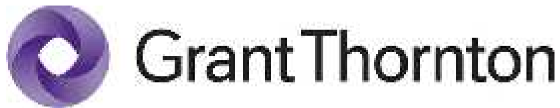

December 19, 2018

Susan M. Cosper, Technical Director
FASB
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

Grant Thornton LLP
Grant Thornton Tower
171 N. Clark Street, Suite 200
Chicago, IL 60601-3370

T +1 312 856 0200
F +1 312 565 4719
grantthornton.com

Via Email to director@fasb.org

Re: File reference number 2018-300

Dear Ms. Cosper:

Grant Thornton LLP appreciates the opportunity to comment on Proposed Accounting Standards Update, *Codification Improvements – Financial Instruments*. We support the Board's effort to engage stakeholders during the implementation of new accounting standards, through direct outreach and bodies like the Transition Resource Group (TRG) for Credit Losses, in order to identify areas in recently issued accounting guidance that require clarification and correction.

Our answers to selected questions for respondents follow.

Topic 1A: Accrued Interest

Question 2: Do you support the separate accounting policy elections that would allow an entity to choose to (a) write off accrued interest amounts by either reversing interest income or adjusting the allowance for credit losses and (b) elect not to measure an allowance for credit losses on accrued interest if the entity writes off uncollectible accrued interest amounts in a timely manner? If not, please explain why you disagree and what changes should be made instead.

a. We support providing an accounting policy election that would allow an entity to write off accrued interest amounts by either reversing interest income or adjusting the allowance for credit losses (ACL). However, if an entity elects to write off accrued interest by reversing interest income, we believe that the entity should disclose in each period the amount of accrued interest written off by reversing interest income.

b. We do not support providing an accounting policy election that would allow an entity to elect not to measure an ACL on accrued interest if the entity writes off uncollectible accrued interest in a timely manner. We believe that the guidance in ASC 326 should have a clear and consistently used definition of "amortized cost" as well as a clear and consistently followed measurement principle for the ACL. We believe the proposed accounting policy election would undermine both of those objectives. Our specific observations are:

- We do not believe there is a conceptual basis for treating accrued interest differently from other components of amortized cost when estimating the ACL. Paragraph 16 in the Basis for Conclusion (BC) of the proposed ASU says, in part, that "requiring an entity to record an ACL on accrued interest balances only to have it reverse or write off those balances would create an unnecessary burden." However, amounts for which an ACL is provided that are related to other components of the amortized cost basis would be reversed or written off ultimately, perhaps also in a "timely manner," so we cannot see why this component of the amortized cost basis should be treated differently.

- Introducing an accounting policy election not to provide an ACL against accrued interest receivable would result in allowing an entity to present their financial assets at an amount on the balance sheet that violates the core principle of the CECL model: The balance sheet should reflect the net amount of an entity's financial asset expected to be collected.

- Such an accounting policy election would result in decreased comparability between entities with different write-off policies, particularly between regulated and nonregulated lenders. In some cases, the differences between entities that apply, and entities that do not apply, such an accounting policy election may be quantitatively significant.

Finally, if the Board decides to proceed by allowing this accounting policy election, we believe the Board should provide specific and clear criteria for assessing what constitutes "writing off accrued interest in a timely manner".

In addition, we noted that the proposed amendments relating to this issue would require clarifying the guidance in ASC where presentation and measurement of a financial asset at amortized cost basis. For example:

- ASC 310-10-35-47 through 35-47A: The guidance states that certain trade receivables and nonmortgage loans should be reported in the balance sheet at amortized cost basis. We believe that the guidance should be clarified for the proposed guidance related to accrued interest on such financial assets.

- ASC 310-10-35-48: The guidance states that nonmortgage loans held for sale should be reported at the lower of amortized cost basis or fair value. It further states that the amount by which amortized cost basis exceed fair value should be accounted for as a valuation allowance. We believe this guidance need to be clarified for the proposed guidance related to accrued interest, specifically as it related to calculation of valuation allowance on accrued interest related to held for sale nonmortgage loans.

- ASC 948-310-35-2A: We believe the guidance should be clarified regarding the calculation of valuation allowance on mortgage loan that is transferred into held-for-sale classification form the held-for-long-term-investment classification for the proposed guidance related to accrued interest.

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

As noted in our response to Question 2, we do not support the policy election to not measure an ACL on accrued interest. However, if the Board decides to provide such a policy election, we would consider the following to be timely: reversal or writeoff of all accrued but uncollected interest at the earlier of (a) when the entity concludes that the amount is uncollectible, or (b) any amount of principal or interest is due and unpaid for 90 days.

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

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

We support the Board's conclusion to reverse in earnings any prior credit loss allowances or lower-of-cost-or-market adjustments on a gross basis upon the transfer of loans and debt securities between classifications or categories. However, we have noted the following matters in the proposed update that we believe could be clearer:

- *Transfers of AFS debt securities to HTM*: ASC 320-10-35-10 clearly states that transfers of securities between categories of investments are accounted for at fair value at the date of the transfer. However, the proposed amendments to ASC 320-10-35-10 state that this guidance does not apply to transfers of securities classified as available-for-sale (AFS) to the held-to-maturity (HTM) classification. Subparagraph b of ASC 320-10-35-10B states that the amortized cost basis of the reclassified security should be adjusted for "the amount of any remaining unrealized holding gain or loss reported in [other comprehensive income, or OCI]." However, the guidance does not specifically state that the amount of unrealized gain or loss reported in OCI should be determined by remeasuring the debt security at fair value on the date of the transfer, unlike ASC 310-10-35-48B, which is specific on this point related to nonmortgage loans. We would suggest that the Board clarify the proposed guidance on this point if this is, in fact, the Board's intention.

- *Transfers of non-HFS loans to HFS and HTM debt securities to AFS*: ASC 310-10-35-48A regarding loans and ASC 320-10-35-10A regarding debt securities indicate that "an entity shall reverse in earnings any allowance for credit losses previously recorded on [the financial asset previously measured at amortized cost] at the transfer date." This raises two questions:

  1. First, should an entity estimate the ACL on the financial assets previously held at amortized cost as of the transfer date to the AFS category or to HFS classification? We believe that this requirement exists in the proposed guidance as written. If however this is not the Board's intention, we would suggest that the Board should clarify.

2. Second, how should an entity allocate ACL related to the transferred non-HFS loans and HTM securities from the total ACL related to the pool of financial assets? The guidance in ASC 326-20 requires that unless a financial asset does not share risk characteristics with other financial assets, the unit of measure of the ACL is a pool of financial assets, not the individual financial asset. We believe the Board should consider providing illustrative guidance regarding appropriate ways which as entity may use to determine the ACL allocable to an individual financial asset when the ACL applicable to that financial asset was previously estimated on the basis of a pool of financial assets with similar risk characteristics, including whether the ACL must be estimated as of the date of the transfer.

Issue 1C: Recoveries

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

We do not believe that the proposed amendments clarify the measurement principle articulated in ASC 326-20-30-1, but rather amends the measurement principle. Our beliefs are based on the following:

- ASC 326-20-30-1 and paragraph BC42 of ASU 2016-13 refer to the ACL as being an amount **deducted** from the amortized cost basis. A simple understanding of a "negative allowance" (that is, an amount that is **added** to the amortized cost basis) would therefore violate this clearly articulated principle.

- Further, BC55 of ASU 2016-13 says "a financial asset's amortized cost net of the allowance for credit losses represents **the amount of amortized cost** expected to be collected". Accordingly, we believe the original principle in ASU 2016-13 is to present on the balance sheet the net amount of a financial asset's amortized cost that is expected to be collected.

- The definition of amortized cost states that write-offs are deducted from the amortized cost. When combined with BC55 of ASU 2016-13 and the guidance in ASC 326-20-35-9 stating "Recoveries…shall be recorded when received", it is clear that the measurement principle in ASU 2016-13 excludes expected recoveries.

We believe that the Board should describe in the basis for conclusion why it has chosen to amend the measurement principle.

We believe that the proposed amendments to ASC 326-20-30-1, ASC 326-20-35-4 through 35-5, and ASC 326-20-35-8 through 35-9 modify the guidance to make it clear that recoveries are inputs that should be considered when estimating the ACL. However, we are concerned that the proposed amendments to Example 9 in ASC 326-20-55-52 may contradict the clarity provided by the other proposed amendments.

Example 9 has been amended to state that "Bank K has no information that supports an expectation of a future recovery," implying that Bank K has not included an estimate of future

recoveries in its estimate of the ACL. We do not believe that an absence of information is sufficient to ignore an input to an estimate that should be considered. The measurement objective when estimating the ACL is, as amended, to present the net amount of an entity's financial instruments expected to be collected, including recoveries. Accordingly, we believe an entity is obligated to have an affirmative expectation regarding all key inputs that should be considered in its estimate of the ACL. For instance, if an entity does not retain records of its historical loss information and therefore lacks information that would support an expectation of a future loss, we do not believe it would be appropriate for that entity not to include an estimate of future expected losses when estimating its ACL.

We would suggest the following revision to the proposed amendment to ASC 326-20-55-52:

"…Bank K ~~has no information that supports an expectation of~~ does not expect a future recovery…"

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

Yes, we believe the proposed amendments make this clear, although, as noted above, we believe this is not a clarification of the measurement principle in ASU 2016-13, but rather an amendment of that measurement principle.

Question 7: Should an entity be permitted to record a negative allowance when measuring the allowance for credit losses on available-for-sale debt securities? If yes, why?

We do not believe an entity should be permitted to recognize a negative ACL when measuring the ACL on AFS debt securities. We believe this would violate the general recognition principle for AFS debt securities in which unrealized gains are recorded as a component of other comprehensive income.

Topic 2: Codification Improvements to Update 2016-13

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

We believe the proposed amendments generally clarify the guidance in Update 2016-13. However, we have one suggestion regarding Issues 2D (Projections of Interest Rate Environments for Variable-Rate Financial Instruments) and 2E (Consideration of Prepayments in Determining the Effective Interest Rate).

The proposed amendments pursuant to Issue 2D would require an entity to forecast future interest-rate environments when determining the effective interest rate (EIR) used to discount expected future cash flows under a discounted cash flow (DCF) measurement approach to the ACL if the entity forecasts future interest-rate environments to project future expected cash

flows. However, Issue 2E would provide entities with the option to consider expected prepayments when determining the EIR used to discount expected future cash flows under a DCF measurement approach to the ACL, though the entity must consider future expected prepayments when estimating future expected cash flows.

We do not understand why Issue 2D requires consideration of future interest-rate environments, while Issue 2E provides an option to consider future expected prepayments. Both Issues 2D and 2E address concerns about isolating credit risk within the estimate of the ACL when utilizing a DCF measurement approach. Accordingly, we believe the two issues should be treated similarly.

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

We did not identify as other changes that should be made related to the proposed amendments to the guidance in ASU 2016-13.

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

We did not identify any special considerations that the Board should for private companies.

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

We believe that requiring an entity to use a prepayment-adjusted EIR should be required because (a) entities are already required to consider prepayments when estimating expected cash flows, and (b) a requirement enhances comparability between entities.

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

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

We believe the proposed amendments clarify the guidance in Topic 815.

Question 15: Are there other changes that should be made that are directly or indirectly related to the proposed amendments? Please note that the proposed Codification improvements related to (a) the change in hedged risk guidance for cash flow hedges discussed at the March 28, 2018 Board meeting and (b) use of the word *prepayable* in

the shortcut method guidance discussed at the February 14, 2018 Board meeting will be included in a future proposed Update.

We do not have additional suggestions beyond the proposed amendments discussed at the March 28, 2018 and February 14, 2018 meetings.

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

We believe the existing relief provided to nonpublic entities in ASU 2017-12 provides sufficient relief for nonpublic entities and do not believe any additional relief is necessary.

Topic 4: Codification Improvements to Update 2016-01

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

We agree that the proposed amendments clarify the guidance in Update 2016-01. However we do not believe that the amendments made to the guidance in ASC 321 under Issue 4C qualify as codification improvements. We understand that the Board's intent when issuing ASU 2016-01 was to provide entities with a fair value expedient for investments in equity securities without readily determinable fair values, allowing them to use an observable transaction price of an identical investment in the same issuer as fair value of their investment in that issuer.

Paragraph BC84 of ASU 2016-01 states "…providing relief for investments without readily determinable fair values by requiring those investments to be measured at the observable price. Most also agreed with the proposed method because it would reduce the complexity, would increase operability…."

We agree that the proposed amendments makes the measurement basis of equity investments without readily determinable fair values consistent with the measurement basis of other equity investments, albeit the change in fair value will be recognized only upon existence of observable transaction. However we believe that taking away the practical expedient may be costly for preparers to implement, especially for private companies, and thereby undermine the Board's stated objective in paragraph BC84 of ASU 2016-01.

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

We did not identify as other changes that should be made related to the proposed amendments to the guidance in ASU 2016-01.

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

As stated in our response to question 20 above, we believe that the Board should consider the cost and benefit of such change for private companies.

Question 23: How much time would be needed to implement the proposed amendments for an entity that has already adopted Update 2016-01 before these proposed amendments are finalized? What transition method and transition disclosures should be required when adopting the proposed amendments and why?

We believe that entities that have already adopted Update 2016-01 should be given one year after issuance of the final guidance to adopt the proposed amendments. With regards to transition method, we believe that the guidance should be applied prospectively to all equity investments without readily determinable fair value that exist as of the date of adoption of the final guidance. We believe that a prospective transition approach is consistent with the transition method provided in ASU 2016-01 and will be operationally easier to apply rather than a retrospective method. In terms of transition disclosure we believe that the disclosure requirements in ASC 250-10-50-1(a) should be required. We do not believe any other transition disclosures will be necessary if the Board decided to allow a prospective transition approach.

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

We believe that the effective date and the transition requirements for entities that have not yet adopted Update 2016-01 should not be aligned with that of Update 2016-01 considering that private companies are required to adopt the guidance for fiscal years beginning after December 15, 2018. We believe that private companies should be given additional time to adopt the amendments in this proposed Update consistent with the entities that have already adopted the guidance in Update 2016-01. For transition disclosure refer to our comments in question 23.

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

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

We believe the proposed amendments are clear.

Question 26: Do the proposed amendments clarify how an entity should consider extension or renewal options (excluding those that are accounted for as derivatives in accordance with Topic 815) that are included in the original or modified contract at the reporting date and are not unconditionally cancellable by the entity? If not, please explain which proposed amendment(s) you disagree with and why.

We believe the proposed amendments could be clarified for the following matters:

- ASC 326-20-30-6(b) says that an entity shall consider expected extensions or renewals that are related to contractual extension or renewal options that are "not unconditionally cancellable by the entity." During the November 1, 2018 TRG for Credit Losses meeting, the TRG seemed to generally agree that an entity should consider contractual extension or renewal options that are "in the control of the borrower, whether they are conditionally exercisable or unconditionally exercisable." We believe that the term "not unconditionally cancellable by the entity" has the same meaning as "in the control of the borrower, whether conditionally exercisable or unconditionally exercisable," but we believe that a final ASU may benefit from addressing in the basis for conclusion the reason the Board used different terminology than that used during the TRG meeting so as to build a bridge from the TRG discussions to the final language in the ASU.

- The TRG discussed two potential approaches to estimating the impact of extension or renewal options that are not unconditionally cancellable by the entity on the contractual life of a financial asset:

    1. First, the approach included in the proposed amendments—that is, an entity shall evaluate the likelihood that the contractual extension or renewal option will be exercised.

    2. Second, an entity may assume the extension option is exercised and then apply prepayment expectations to the "maximum life" of a financial asset

BC104 says, in part, that "the Board acknowledged that various methods are available to entities on how to consider those contractual extension or renewal options [but] the Board decided that it would be inappropriate to prescribe one specific method." However, we believe that the guidance in ASC 326-20-30-6 in the proposed ASU requires approach 2 and a partial approach 1 to be followed since the guidance in ASC 326-20-30-6(b) requires entities to consider the likelihood that the contractual extension or renewal option will be exercised and the guidance in ASC 326-20-30-6 also requires entities to consider prepayments. We believe that the guidance should be clarified to reflect the Board's discussion in paragraph BC104 of proposed ASU and the TRG's discussion on this issue.

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We would be pleased to discuss our comments with you. If you have any questions, please contact Graham Dyer, Partner, 312.602-8107, Graham.Dyer@us.gt.com.

Sincerely,

/s/ Grant Thornton, LLP