



March 31, 2011

**VIA ELECTRONIC FILING**

Leslie F. Seidman  
Chairman  
Attention: Technical Director  
File Reference No. 2011-150  
Financial Accounting Standards Board  
401 Merritt 7  
P.O. Box 5116  
Norwalk, CT 06856-6116

**Re:** *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities: Impairment, File Reference No. 2011-150*

Dear Mrs. Seidman:

The Commercial Real Estate (CRE) Finance Council appreciates this opportunity to provide comments on the supplementary document, *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities: Impairment* (“*Supplementary Document*”). The CRE Finance Council is the collective voice of the entire \$3.5 trillion commercial real estate finance market, including portfolio, multifamily, and commercial mortgage-backed securities (“CMBS”) lenders; issuers of CMBS; loan and bond investors such as insurance companies, pension funds and money managers; servicers; rating agencies; accounting firms; law firms; and other service providers.

Because our membership consists of all constituencies across the entire CRE finance market, the CRE Finance Council has been able to develop comprehensive responses to policy questions which promote increased market efficiency and investor confidence. Our members provide practical advice to policymakers at all levels on measures designed to restore liquidity and facilitate lending in the commercial mortgage market and have been extremely influential in helping to develop programs such as the Term Asset-Backed Securities Loan Facility. CRE Finance Council members have frequently been called on to testify at Congressional hearings on the state of the CRE market, financial regulatory overhaul measures, and proposed accounting standards.

Our principal missions include setting market standards, facilitating market information, and education at all levels, particularly related to securitization, which has been a crucial and necessary tool for growth and success in commercial real estate finance. To this end, we have worked closely with policymakers in an effort to ensure that legislative and regulatory actions do not negate or counteract economic recovery efforts in the CRE market. We will continue to work with policymakers on this effort, as well as our ongoing work with market participants and policymakers to build on the unparalleled level of disclosure and other safeguards that exist in the CMBS market, prime examples of which are our “Annex A” initial disclosure package, and our Investor Reporting Package™ (“IRP”) for ongoing disclosures.

Thus, we have a distinct perspective on the challenges facing the \$3.5 trillion market for commercial real estate finance and the need to craft policy measures that support, rather than undermine, the recovery of the commercial real estate sector and that of the nation’s economy as a whole.

Given our unique perspective on both the challenges facing the commercial real estate market and our commitment to policy reform, our comments and observations on the FASB and IASB’s proposed Supplementary Document for impairment modeling will remain focused on our core competency, the commercial real estate finance market.

## **I. OVERVIEW**

In an environment where lenders, legislators and financial regulators are striving to improve the quality of loan underwriting and information transparency, we welcome the FASB and IASB’s efforts to create a comprehensive approach to modeling impairments. The Supplementary Document proposes a dual impairment model (i.e. “good book” and “bad book”) for financial assets managed in an open portfolio, with credit losses determined base on the credit characteristics of the financial assets. For financial assets in the good book, impairment would be recognized over the life of the portfolio, with the allowance account recognized at the higher of (a) the time proportionate credit losses, or (b) credit losses expected to occur within the “foreseeable future.” For assets in the bad book, the Supplementary Document proposes that expected credit losses should be recognized immediately.

The CRE Finance Council supports and believes that FASB and IASB should create one converged impairment model. Furthermore, the Council believes that the impairment model as proposed in the Supplementary Document is both a welcome and marked improvement over the FASB’s initial proposal under its original Exposure Draft.<sup>1</sup> The updated approach allows firms to use reliable and expected forecasted data in lieu of simply considering conditions as they exist today.

That said, the Council has found it difficult to comment on the Supplementary Document since it only covers a portion of the impairment topic. Lack of information on the treatment of purchased loans with credit issues, definition of non-accrual, troubled debt restructures, etc. have made it difficult to assess this portion of the impairment model. The Council strongly believes that FASB and IASB should come to agreement on the classification and measurement portions of the

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<sup>1</sup> *Accounting for Financial Instruments and Revisions to the Accounting for Derivatives Instruments and Hedging Activities, File Reference No. 1810-100.*

financial instruments project and re-expose it along with a more comprehensive discussion of the model for impairment so that more thorough and well thought out comments may be formed. The Council has always been supportive of convergence. However, we are concerned that time pressures are having a negative impact on the end product.

Therefore, our comments will focus on (a) the global concern of the applicability of the updated impairment model to other asset classes beyond lending; and (b) concerns within the updated impairment model, with recommendations for improvement. Specifically, our comments will focus on the following:

- **Overall** – Concern with the ability to apply the updated impairment model to asset classes beyond lending;
- **Question 9** –The definition of “foreseeable future” with respect to the minimum allowance amount (floor) that would required under the proposed model for the “good book;” and
- **Question 11** – Flexibility in discounting.

## **II. The Applicability of One Impairment Model to All Asset Classes**

The Supplementary Document states that “financial assets would be included in and transferred between the two groups (i.e. the ‘good book’ and the ‘bad book’) in accordance with an entity’s internal risk management.”<sup>2</sup> Specifically, the definition allows for institutional flexibility in implementing the definition to fit both its risk profile and strategic business plans. The CRE Finance Council is supportive of this concept, and believes it is a marked improvement from FASB’s initial draft for impairment modeling.

Specifically, the Council believes that the Supplementary Document is a good model for loan portfolios. For a commercial loan portfolio, similar concepts to FAS 114 may be applied, to help determine which loans belong in ‘bad book’ verses ‘good book’. Furthermore, in section III of this letter, we provide a recommendation that we believe improves the definition of “foreseeable future” for the “good book.

However, the updated impairment model in the Supplementary Document does not cover impairment modeling in its entirety, including the application of the model to other asset classes (such as CMBS); troubled debt restructurings; or the definition of non-accrual. Therefore, the Council would strongly recommend both a discussion and clarification on how the impairment model would apply to different asset classes, such as bonds, loans and equities, with a re-exposure of the draft, prior to implementation.

## **III. Definition of Foreseeable Future**

Paragraph B2 of the Supplementary Document states that financial assets that are managed on an open portfolio basis should be differentiated into two groups (the “good book” and the “bad book”) for the purposes of determining the appropriate impairment allowance. For assets in the

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<sup>2</sup> *Accounting for Financial Instruments and Revisions to the Accounting for Derivatives Instruments and Hedging Activities, File Reference No. 1810-100, p 12.*

“good book,” the Supplementary Document proposes that the impairment allowance would be based on the “time-proportional credit losses expected to occur for the remaining lifetime are recognized, unless the minimum amount of credit losses expected to occur in the foreseeable future period applies.” For the “bad book,” the entire amount of credit losses expected to be incurred over the life of the asset would be recognized immediately.

However, we also wanted to raise two concerns to both FASB and IASB in implementing the updated definition.

The first concerns the definition of “foreseeable future.” We agree that for the “bad book” the entire amount of credit losses expected to be incurred over the life of the asset should be recognized immediately. However, we are concerned that the definition for the “good book” is open ended, and could lead to divergence in accounting. Specifically, while the proposed definition allows for great flexibility, the modeling capability of each institution could allow for diversity in impairment reserves among institutions. Specifically, the larger institutions would likely project longer into the future for impairments that a smaller institution, thus allowing for differences in impairment reserves which may not be the end result that was desired.

Therefore, the Council would recommend for the “good book” that the FASB and IASB amend the definition of “foreseeable future” for the impairment model be based upon the “greater of a year or the average of the period of resolution for the workout process.” For example, for a real estate backed collateral loans, the definition for “the average of the period of resolution for the real estate workout process” would start on the date a firm receives notice of a default and end on the date the firm takes ownership of the real estate. Our recommended approach for the “good book” would be similar to an incurred loss model with a longer loss emergence period. Furthermore, the Council’s suggested change to the definition for foreseeable future for the “good book” is not only more objective in allowing comparisons among firms, but also allows firms to take into account both upturns and downturns in the economic cycle. Furthermore, the recommendation increases the ability to audit the impairment modeling.<sup>3</sup>

Secondly, we are concerned that while the FASB and IASB have created a flexible and workable definition for impairment modeling, there is a distinct possibility that an unlevel playing field, as far as regulatory capital, could be created by regulators that hold differing viewpoints on how to apply Supplementary Draft.

The Council is aware that in previous cases, accounting standards have been applied unevenly among differing regulatory jurisdictions, and we would ask that FASB and IASB be mindful of this possibility when fully developing these standards.

#### **IV. Flexibility in Discounting**

The CRE Finance Council would also ask that FASB and IASB clarify whether the allowance for expected losses should be based on expected principal losses by itself, or on a

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<sup>3</sup> The CRE Finance Council also recognizes that while the suggested change to the definition for “foreseeable future” would work for whole loans, it would be difficult – if not impossible – to implement for CMBS or other asset classes, as noted in section II.

combination of both principal and interest losses. Furthermore, we would request the FASB and IASB to clarify the discount method to be used for modeling impairments

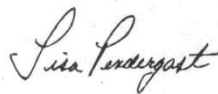
We believe that calculating the allowance for expected losses should be based on the expected principal losses. For loans in the “good book,” the interest losses should be minimal as the loans are of higher quality and therefore should not have many interest losses. For loans in the “bad book” the interest losses should also be minimal as these loans may already be categorized as non accrual. Therefore, utilizing the expected principal losses for both “good book” and “bad book” will allow consistency among constituents.

The Supplementary Document allows for flexibility in calculating the allowance by allowing discounting using the risk-free rate, the loans effective rate, or by utilizing an undiscounted approach. We believe that by allowing the different methods will cause confusion, inconsistencies and introduce operational complexity into the model. To avoid this, the impairment model should not be based on discounting, especially since the items in the “good book” are relatively short term in nature where discounting would not have a significant impact. However, if discounting is to be included or allowed in the impairment model, the use of the loan effective rate can be consistently and easily applied across institutions, and is auditable, thus allowing for comparison by users of financial statements.

## V. Conclusion

The CRE Finance Council recognizes and appreciates the efforts of both FASB and IASB to converge accounting standards internationally. Furthermore, we welcome the changes to the proposed impairment model as suggested in the Supplementary Document. We urge FASB and IASB to consider the Council’s recommended changes to the impairment model outlined herein as well as request that the guidance be re-exposed along with the classification and measurements portion of the financial instruments guidance so we may provide more comprehensive and complete comments. We stand ready to provide any additional assistance that may be helpful.

Sincerely,



Lisa Pendergast  
Managing Director  
Jeffries & Company; and  
President  
CRE Finance Council



John D’Amico  
Chief Executive Officer  
CRE Finance Council