June 26, 2019

Via Electronic Mail

Chief Counsel's Office
Office of the Comptroller of the Currency
400 7th Street, SW, Suite 3E-218
Washington, D.C. 20219

Ann E. Misback, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, D.C. 20551

Robert E. Feldman, Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington D.C. 20429

Re: Supplemental Call Report and FR Y-9C Reporting Instructions for Operating Lease Liabilities

Ladies and Gentlemen:

The Bank Policy Institute[1] appreciates the opportunity to comment on the Supplemental Instructions for Call Report and FR Y-9C reporting issued by the FFIEC in or about March, 2019 (the FFIEC Supplemental Instructions) and the Federal Reserve in or about March, 2019 (the Federal Reserve Supplemental Instructions and collectively, the Agency Supplemental Instructions) with respect to regulatory reporting for leases.[2] Although the changes in the Agency Supplemental Instructions are presented as mere revisions in reporting to implement the new lease accounting standard adopted by the FASB,[3] the changes are in substance and effect an increase to secured borrowings that is part of the calculation of FDIC assessments for large banks. These revisions were not issued for notice and comment and we do not agree that reporting operating lease liabilities as "secured" borrowings is

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[1]The Bank Policy Institute is a nonpartisan public policy, research and advocacy group, representing the nation's leading banks and their customers. Our members include universal banks, regional banks and the major foreign banks doing business in the United States. Collectively, they employ almost 2 million Americans, make nearly half of the nation's small business loans, and are an engine for financial innovation and economic growth.

[2] FFIEC March 2019 Call Report Supplemental Instructions, First Call, Number 287, *available at* https://www.ffiec.gov/pdf/FFIEC_forms/FFIEC031_FFIEC041_FFIEC051_suppinst_201903.pdf at 9-10; Federal Reserve Board of Governors Supplemental Instructions March, 2019 at 14-16, *available at* https://www.federalreserve.gov/reportforms/supplemental/SI_FRY9_201903.pdf .

[3] ASU 2016-02, "Leases," which added ASU Topic 842, Leases.

consistent with other reporting instruction definitions of that term. Accordingly, we urge the FFIEC and the Federal Reserve to withdraw the Agency Supplemental Instructions and reissue revised Supplemental Instructions for public notice and comment and also clarifying that operating lease liabilities should be reported as unsecured borrowings. In the event the FFIEC and the Federal Reserve determine that operating lease liabilities should be reported as other liabilities rather than as other borrowed money, the reporting of such leases as a result of implementation of the new lease accounting standard should not result in an increase in the FDIC assessment fees since this accounting change does not affect the underlying economics of a transaction.

The new U.S. GAAP lease accounting standard maintains the accounting and underlying economic distinctions between operating leases and capital leases, but now describes capital leases as finance leases. Under the new accounting standard, operating lease lessees continue to not report the operating lease asset on their balance sheets but are required instead to recognize a right-of-use (ROU) intangible asset and a lease liability on their balance sheets. However, to implement this accounting change for Call Report reporting purposes, the FFIEC and Federal Reserve issued Agency Supplemental Instructions requiring that operating lease liabilities be treated *exactly the same* as finance lease liabilities, with the FFIEC Supplemental Instructions also requiring that operating lease liabilities be reported as secured liabilities.[4] These changes in reporting are required notwithstanding that there has been no change in the underlying economic exposure of operating leases from the change in U.S. GAAP and the distinct legal remedies available between operating leases and finance leases remain unchanged. Indeed, the *sole* support offered by the FFIEC for this significant regulatory change is the conclusory statement that "[t]he balance sheet classifications are consistent with the current Call Report instructions for reporting a lessee's capital leases."

The impact of these reporting changes will have significant consequences. Under the FDIC assessment methodology used by banks of all sizes to calculate their FDIC assessment fees,[5] unsecured debts are considered an adjustment to the calculation of the applicable fee. Accordingly, changes to reporting requirements and treatment of operating lease liabilities as "secured" for Call Report and FR Y-9C reporting purposes directly affect the calculation of FDIC assessment fees for banks of all sizes. The changes are also particularly disconcerting as there was no prior notice and comment period for the public, other interested stakeholders and the banking industry to comment on these reporting revisions. Nor do the Agencies provides any discussion or analysis of why the revised FDIC fees resulting from these changes would be more appropriate and provide no data, analysis or information on which the FFIEC or the Federal Reserve relied in formulating the revisions.

In addition, the treatment of operating lease liabilities as "secured" for Call Report and FR Y-9C reporting purposes is inconsistent with the current definition of that term. The Instructions to the Call Report[6] and FR Y-9C define "well secured" as an asset

> secured (1) by collateral in the form of liens on or pledges of real or personal property, including securities, that have a realizable value sufficient to discharge the debt (including accrued interest) in full, or (2) by the guarantee of a financially responsible party.

Treatment of finance (capital) lease liabilities as "secured" for purposes of Call Report and FR Y-9C reporting purposes is appropriate since interest expense for the liability representing the borrowing that finances the purchase is separately recognized for U.S. GAAP. This treatment also is in accord with the underlying economics of the

[4] "For Call Report purposes, all ROU assets for operating leases … including ROU assets for operating leases recorded upon adoption of ASU 2016-02, should be reflected in Schedule RC, item 6, 'Premises and fixed assets.' A lessee should report lease liabilities for operating leases and finance leases, including lease liabilities recorded upon adoption of the ASU, in Schedule RC-M, items 5.b, "Other borrowings," and 10.b, requiring "Amount of 'Other borrowings' that are secured. The balance sheet classifications are consistent with the current Call Report instructions for reporting a lessee's capital leases."

[5] Part VII unsecured liabilities reduce the overall assessment for banks of all sizes by increasing the unsecured adjustment rate.

[6] Call Report Instructions, *available at* https://www.fdic.gov/regulations/resources/call/crinst/897rc-n.pdf.

transaction, i.e., the control of the underlying asset is transferred to the lessee in a typical finance lease. The leased asset is accordingly derecognized from the lessor's books for accounting purposes, although the lessor retains legal title to the asset and has the ability to reclaim the asset in the event of a default by the lessee. The substance of this arrangement is that the leased asset acts as collateral for the obligation of the lessee.

An operating lease, on the other hand, is different from a finance lease because it does not grant rights similar to those conveyed by ownership. In contrast to the lessee in a finance lease, the lessee in an operating lease does not obtain substantially all of the benefits from the underlying asset and will not be exposed to or benefit from any changes in the value of the underlying asset during the lease term. As a result, under ASU Topic 842, the leased asset remains on the books of the lessor, and accordingly the lessor continues to depreciate the asset on its books and record non-interest revenue (i.e., rental income). While operating lease lessees must record a ROU asset and lease liability on their balance sheet, U.S. GAAP makes explicit the economic differences between finance leases and operating leases by prohibiting the lessee's operating lease ROU assets and liabilities from being reported in the same line as finance lease assets and liabilities.[7] Amortization of the ROU operating lease asset and interest expense on the lease liability result in rent expense, i.e., interest expense is not separately reported. The lessee's ROU operating lease asset cannot be viewed as collateral for the lease liability since there is no transfer of ownership of the leased asset in an operating lease, either legally or substantively; only an intangible asset representing the use of the underlying asset for a limited period is transferred. Nor is any asset of the lessee, liens or pledges of the lessee's real or personal property (including securities) transferred to the lessor as security in an operating lease. Accordingly, operating lease liabilities should not be treated as "secured" for Call Report or FR Y-9C reporting purposes.

Notwithstanding the foregoing, in the event that the Agency Supplemental Instructions are not withdrawn and reissued in proposed form for notice and comment and operating lease liabilities are not treated as unsecured borrowings for purposes of Call Report and FR Y-9C reporting, operating lease liabilities should be excluded from the calculation of the FDIC fee assessment; accounting changes that do not affect the underlying economics of a transaction should not affect the calculation of the FDIC assessment fee.

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[7] 842-20-45-3. The Financial Accounting Standards Board explained why operating leases are accounted for differently from finance leases in paragraph BC57 of its Accounting Standards Update 2016-02—*Leases* (Topic 842) Section C—Background Information and Basis for Conclusions as follows:

"A lease is not the same as a purchase of the underlying asset, even when the lease is a finance lease. The rights that a lessee obtains under any lease (whether that lease is classified as a finance lease or an operating lease) are different from the rights that are obtained from the outright purchase of an asset (for example, a lessee cannot sell the underlying asset). However, the Board decided that a finance lease is economically similar to an acquisition of the underlying asset because the terms of a finance lease generally (a) permit an entity to direct the use of the underlying asset in a manner that allows it to obtain substantially all of the remaining benefits from the asset and (b) impose obligations on the lessee that are similar to those an entity incurs if it finances the purchase of an asset. …**Operating leases on the other hand grant different rights to and impose different obligations on the lessee than finance leases** and other "rights of use," such as licenses of intellectual property. **Rather than granting rights similar to those conveyed by ownership, the lessee in an operating lease has no rights or exposure to a generally more significant residual asset (that is, the lessee does not obtain substantially all of the remaining benefits from the underlying asset—frequently, the lessee obtains only a minor portion of the remaining benefits and will not be exposed to or benefit from any changes in the value of the underlying asset during the lease term). In the case of lessee bankruptcy (at least under U.S. law), the lessee's obligations in an operating lease are treated differently than the way its obligations in a finance lease are treated (or a license of intellectual property)—that is, operating lease obligations generally do not survive bankruptcy because they are not considered to be debt**. In contrast, financial obligations arising from purchased assets, licenses, and finance leases generally survive in bankruptcy. Consequently, Topic 842 differentiates the financial statement reporting of finance leases from that of operating leases…(emphasis added)."

BPI would be pleased to discuss these issues further with you. Please contact the undersigned at 646.736.3958 or by email at david.wagner@bpi.com if you have any questions.

Respectfully submitted,

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cc: Michael S. Gibson
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