## Letter of Comment No: 73 File Reference: 1204-001

Lee Irving
Executive Vice President
and Chief Accounting Officer

October 27, 2005

Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
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Re: File Reference No. 1204-001

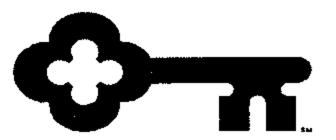
Dear Director:

We are writing in response to your invitation to comment on the Exposure Draft entitled, "Business Combinations - a Replacement of FASB Statement No. 141" ("Exposure Draft").

KeyCorp ("Key"), headquartered in Cleveland, Ohio, is a bank-based financial services company that, at September 30, 2005, had assets of approximately \$92 billion. One of the critical elements of Key's strategy to achieve its long-term goals is to deepen its relationships with existing clients and build relationships with new clients. Over the last several years, in support of its strategy, Key has completed numerous business combinations that have strengthened its market share thus enabling Key to build new client relationships and deepen existing ones. Selective and successful business combinations are a means to achieving Key's long-term goals. For this reason, Key is very interested in the business combination accounting proposed in this Exposure Draft.

We appreciate the opportunity to comment on this Exposure Draft and support the Board's commitment to developing high-quality financial accounting standards and improving comparability of financial information while promoting international convergence of accounting standards. Key takes pride in providing detailed, timely and comprehensive financial information to the investment community, and supports standards and interpretations that clearly result in reliable and relevant information that can improve investor understanding and allow for more informed decisions.

Key believes the use of fair value measurements in financial statements is relevant when such measurements are reliable and better reflect (as compared to the use of the historical cost basis of accounting) the current financial state of an entity. Some of the proposals in this Exposure Draft, if finalized as drafted presuming the use of fair value measurements, could result in entities providing financial information to investors that is unreliable as well as incompatible with the Board's commitments to improve comparability of financial information and to develop high-quality financial accounting standards. Key is keenly aware of the need for reliable and relevant financial reporting. Key's shareholders and regulators help keep us aware of this need. Apparently there is a perception among FASB Board members and staff that the investment community would be better served by greater use of fair value measurements in financial statements. We believe, however, that the FASB has a duty to acknowledge limitations on the reliability of fair value estimates and to limit the sanctioning of their use in published financial statements until they are reliable. Their use as contemplated in the Exposure Draft would not meet this standard. Moreover, we observe that to date demand for fair value information from Key's shareholders and regulators has been negligible.



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In support of the development of high-quality standards and interpretations that clearly result in reliable and relevant information and improve comparability of financial information, Key believes the following items need to be addressed in the Exposure Draft.

- the acquirer should recognize from the date of any business combination an allowance for loan losses associated with acquired loans
- contingent gains or losses and contingent consideration should continue to be recognized when the contingency is likely to occur and can be reasonably calculated
- acquisition costs incurred by an acquirer in connection with a business combination should continue to be capitalized and similarly restructuring costs associated with the acquired company should continue to be recognized as liabilities assumed and included in the acquirer's purchase price

Following are Key's specific comments and recommendations regarding the three items listed above.

## Separate Allowance for Loan Losses

At Key, loans comprise approximately 75% of total assets and a significantly larger percentage of earning assets. Due to their prominence on the balance sheet and related impact on the income statement, loans are continually scrutinized for payment performance and credit quality. External parties are continuously monitoring and tracking the adequacy of Key's loan reserve. Banking companies, such as Key, are benchmarked by numerous external parties against peers utilizing a sizeable number of statistical ratios of which the reserve is a critically important element. A primary example of such a ratio is that of the reserve to loans. Requiring loans acquired in an acquisition to be carried at fair value with no reserve carried over from the acquiree will adversely impact the analytical comparability valued by those numerous external parties who rely on the reserve and the related statistics as a key indicator of a financial institution's financial well-being.

Furthermore, the requirement as set forth in the Exposure Draft is in direct conflict with the FASB's commitment to improve comparability of financial information. Financial institutions that acquire loans through a business combination would, for example, immediately show a lower reserve to loan ratio. The combined financial institution may appear to be competitively disadvantaged when compared to another financial institution that has not undertaken a business combination. As an example, assume that Bank A having \$100,000 in loans outstanding, a \$2,000 reserve and thus a reserve to loan ratio of 2% acquires Bank B that also has loans outstanding of \$100,000, a reserve of \$2,000 and a reserve to loan ratio of 2%. The accounting guidance in this Exposure Draft would result in a combined bank with loans of \$198,000, a reserve of \$2,000 and a significantly lower reserve to loan ratio of 1%. At a minimum, a detailed explanation of the change would be necessary increasing the complexity of financial statements with no apparent benefit to financial statement users. From an investor's viewpoint this change in the reserve to loan ratio will be confusing. The application of this accounting guidance would make it appear either that the credit quality of the combined bank has improved solely by virtue of the business combination (when in fact in this example nothing has changed) or that management has chosen to assume a riskier position by maintaining a lower reserve for the same loan risk exposure. For this reason, Key would argue that the acquirer should continue to recognize a reserve associated with the acquired loans thereby providing comparable, reliable and relevant information to the investment and regulatory communities.

## **Contingencies and Contingent Consideration**

A contingency implies uncertainty and its determination is subject to events or circumstances that may or may not occur and generally are unknown. This is certainly true for many contingencies existing at the date of an acquisition. Such contingencies often are outside the control of the acquirer. For example, contingent consideration may be based on a percentage of a targeted and sustained level of earnings of the

acquired entity over several years following the acquisition date. Key would maintain that the acquirer has no verifiable basis to be able to determine, recognize and measure at fair value on the acquisition date the amount of probable contingent consideration. Whether the targeted level of earnings is to be achieved or not achieved is uncertain and therefore any such measurement is based on conjecture, particularly in light of the actual success rate of business combinations as compared to combination date projections. If reliability is about faithful representation and verifiability, if not precision, then this requirement of the Exposure Draft falls well short of promoting reliability. Therefore, Key's position is that contingencies and contingent consideration should continue to be recognized only when the contingency is determined to be likely to occur and can be reasonably calculated, enabling reliable and relevant information to be presented to investors.

## Acquisition and Restructuring Costs of the Acquired Company

A business combination generally comes to fruition because an acquirer identifies an opportunity to productively manage the assets and liabilities of the acquired company. The net assets of the acquired company are positioned through a business combination to maximize their use. Similar to the expenditures incurred to prepare a fixed productive asset for use, the acquirer in a business combination incurs acquisition-related costs such as finder's fees, advisory, legal, accounting, valuation and other professional or consulting fees to bring the productive assets and liabilities (net assets) of the acquired company to the condition necessary for their intended use. Current GAAP allows expenditures incurred to prepare a productive asset for use to be capitalized. In support of high quality accounting standards and to provide consistency in application, similar expenditures incurred to prepare the net assets of an acquired company for use should also be capitalized. Support for such capitalization is contained in FASB Statement No. 91 that allows for the capitalization of origination costs associated with successful loan originations. It is Key's position that the costs that an acquirer incurs in connection with a business combination should continue to be capitalized.

Restructuring costs associated with the acquired company are generally incurred to optimize the net assets of the acquired company so that the benefits contemplated from the combined entity may be realized. Such costs are incurred to prepare the net assets of the acquired entity for their intended use. Therefore, Key contends that restructuring costs associated with the acquired company should also continue to be capitalized as an element of the acquirer's purchase price.

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We hope these comments are useful and positively influence the final guidance. We welcome the opportunity to discuss this issue in more detail. Please feel free to contact Chuck Maimbourg, Director of Accounting Policy & Research at 216-689-4082 or me at 216-689-3564.

Sincerely,

Lee Irving
Executive Vice President
and Chief Accounting Officer