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Letter of Comment No: 75
File Reference: 1204-001

Technical Director
Financial Accounting Standards Board
401 Merritt 7
Norwalk, CT 06856

Re: File Reference 1204-001

National City Corporation appreciates the opportunity to comment on the FASB's proposed statement on Business Combinations. National City Corporation acquired three financial institutions in 2004 and continues to consider future acquisition opportunities. Accordingly, we are very interested in the FASB's proposed changes regarding accounting for business combinations.

We concur with the FASB that additional accounting guidance is needed for business combinations in order to improve financial reporting, as the existing authoritative guidance is widely dispersed in numerous FASB Statements, EITFs and interpretative guidance. A comprehensive standard is needed to prescribe consistent and proper treatment for various acquisition-related matters that are not presently addressed in the current literature, and to improve preparers' understanding of the existing principles. However, we have the following concerns regarding certain changes proposed in the exposure draft:

Fair Value Measurement Date (Q. 5)

The exposure draft proposes that the fair value of consideration paid for an acquired entity should be measured as of the acquisition date. When equity securities are issued as part or all of the consideration, this principle would add an element of uncertainty to the purchase price as the market value of stock will fluctuate over time. We prefer the current accounting model which values equity securities at an average of market prices around the date that the terms of the transaction are agreed to by the parties and announced to the public.

In the banking industry, several months may pass between the date the terms of the acquisition are agreed to and the closing date in order to obtain the required regulatory approvals. During this period, changes could occur in the financial markets, the economy or world events which may result in significant changes in the acquirer's stock. These events cannot be controlled or predicted by the acquirer but would influence the ultimate purchase price under the proposed accounting.

In our opinion, the price of the transaction should be measured at the time the transaction terms are agreed. Once the parties have made a firm commitment to the terms of the transaction, the acquiree's shareholders bear the risk/rewards of changes in the stock price. Therefore, we do not believe that the purchase price of the acquisition should be impacted for changes occurring subsequent to the date the parties agree to the transaction terms. Subsequent changes in the stock price should be treated similar to a Type II subsequent event, which would not adjust the value of the consideration to be paid.

Contingent Consideration Remeasurement (Q. 6)

The exposure draft proposes that an acquirer shall measure and recognize the fair value of contingent consideration at the acquisition date. After the initial recognition, changes in the fair value of contingent consideration to be paid in cash shall be remeasured and recognized in income.

We disagree with the concept that contingent consideration can be adequately valued at the acquisition date. By its nature, the determination of whether contingent consideration will be paid is dependent upon the occurrence of future events. Contingent consideration cannot be precisely measured until future events transpire. The acquirer may have little or no control over the outcome of these future events which will trigger the payment of contingent consideration. The proposed accounting is contrary to the principles in SFAS 5 which require an obligation to be probable and estimable before a liability is recognized in the financial statements.

We also do not concur with the recommendation that subsequent changes to the fair value of contingent consideration should not be recognized as part of the purchase price. Recognizing changes in the fair value of contingent consideration through earnings would introduce inappropriate volatility to earnings. We do not believe it is appropriate to recognize in earnings changes in the fair value of a nonfinancial instrument which cannot be objectively determined.

The exposure draft would also proscribe different accounting for contingent consideration depending on whether it will be issued in cash or equity. A charge to postcombination earnings would be required for changes in the fair value of contingent consideration issued in cash while contingent consideration issued in the form of equity would not be remeasured. The form of the contingent consideration should not impact the accounting treatment.

Valuation Allowances (Q. 8)

The exposure draft states that an acquirer shall not recognize a separate valuation allowance as of the acquisition date for assets required to be measured at fair value. This proposal would result in the allowance for loan losses of a financial institution being eliminated upon acquisition.

We believe that loans acquired in a business combination should be recognized at fair value exclusive of credit considerations and the related allowance for loan losses should be carried over at its historical basis. Eliminating the allowance for loan losses on acquired loans would result in a less useful presentation to readers of financial institution's financial statements, as comparisons of the loan loss reserve adequacy between different financial institutions and between periods would be cumbersome, if not impossible. The allowance for loan losses is an important financial measure for the financial institution industry which should not be eliminated for acquired entities.

The exposure draft's proposed elimination of the allowance for loans losses, in its entirety, is also inconsistent with SOP 03-3, Accounting for Loans Acquired in a Transfer. In SOP 03-3, the allowance for loan losses is only eliminated to the extent it relates to loans which have been specifically identified as credit impaired. The exposure draft's elimination of the allowance is much broader than the provisions of SOP 03-3.

The proposed accounting would also be extremely difficult to manage postcombination. Subsequent changes in the credit risks of loans obtained in an acquisition would need to be tracked separately from all other loans as the initial fair value assigned already reflects a certain level of anticipated credit losses. We are not aware of any financial institution that has a system that has the capability to track this type of information. This process would be very burdensome to administer and may increase the occurrence of errors in accounting for loan losses.

Contingent Gains and Losses (Q. 8)

The exposure draft proposes that the fair value of contingent assets and liabilities should be recognized as of the acquisition date, even if the SFAS 5 criteria of probable and estimable are not met. Subsequent remeasurements of the fair value of these contingent assets or liabilities would be recognized in postcombination earnings.

We disagree with the concept that contingent assets and liabilities should be recognized as acquired assets and assumed liabilities even if they are not probable. This model could result in recognizing an asset or liability that does not exist and would subsequently be reversed through earnings of the acquirer when future events confirm it is not required. Alternatively, if the contingent asset or liability is ultimately deemed probable, the fair value assigned at the acquisition date would likely not be an accurate estimate of its true value. We believe the SFAS 5 criteria works well for acquisition-related contingencies. We do not see a benefit in creating a different standard for acquisition-related contingencies.

We also strongly believe that a measurement period is needed to estimate the true value of contingent assets and liabilities. In most instances, an acquirer does not have full and complete information about an acquiree's contingencies as of the acquisition date. New or additional information may become available during the measurement period that results in a more accurate valuation of acquired contingencies. We believe that contingencies should be recognized and included in the purchase price based on the best information obtained during the measurement period. We do not see the purpose of having a 12-month measurement period for acquisitions if changes in the initial values assigned to contingencies are required to be recognized in postcombination earnings.

Restructuring Costs (Q. 8)

The FASB proposes that liabilities for restructuring, severance or other exit costs should only be recognized as assumed liabilities if they meet the recognition criteria in SFAS 146, Accounting for Costs Associated with Exit or Disposal Activities, as of the acquisition date. We concur with this proposal as it would conform the accounting for these costs with the accounting applied to nonacquisition-related restructuring and severance costs.

Measurement Period (Q. 13)

The exposure draft proposes that an acquirer recognize adjustments made during the measurement period as if the accounting for the business combination had been completed at the acquisition date. Thus, comparative information for prior periods presented in financial statements would be adjusted, including changes in depreciation, amortization, or other income and expense amounts recognized as a result of completing or revising the initial estimates assigned to acquired assets and assumed liabilities.

We disagree with the proposal that prior period's financial statements be restated to adjust for measurement period adjustments. It is not practical for an acquirer to have all the information needed to accurately value all acquired assets and liabilities within one month of the close of an acquisition. For an acquisition of a large and/or complex organization, it can take up to a year or more for the acquirer to fully understand the detailed components of the acquiree's balance sheet, to obtain appraisals on fixed assets, to value intangibles and to obtain actuarial valuations of benefit plan obligations. For a registrant that is an active acquirer, restating prior period's financial statements for remeasurement adjustments would result in continuous restatements of prior periods' financials which would be very confusing to the users of the financial statements. We believe that measurement period adjustments should be treated similar to changes in estimates which are recognized in the period identified and/or future periods.

Disclosures (Q. 15)

The exposure draft significantly expands the required disclosures for acquisitions. For public companies, the exposure draft would require disclosure of the postcombination revenue and net income of the acquiree included in the registrant's consolidated financial statements. It was unclear to us for how long after an acquisition that this disclosure would be required. When we convert the acquiree from its legacy information systems to our own information systems, the separate legal entity of the acquired entity is dissolved and the acquiree is merged into one of our own companies. At this point, separate financial data of the acquired entity ceases to exist. Accordingly, we would only be able to produce revenues and net income of the acquired entity for a short period of time postcombination.

The exposure draft also retains the requirement in SFAS 140 that a condensed balance sheet of the acquired entity be disclosed if a material business combination is completed after the balance sheet date but before the financial statements are issued. We believe it is not practical to complete the allocation of purchase price to acquired assets and liabilities to produce an accurate or meaningful condensed balance sheet in this short time period. Since this is a subsequent event which did not exist at the balance sheet date we do not feel that presentation of a condensed balance sheet of the acquiree is necessary. In these situations, we believe that an overview of the acquired entity and the terms of the transaction would be sufficient information for the readers of the financial statements.

Intangible Assets (Q.16)

We believe that noncompete agreements are an example of an intangible asset that cannot be sold or otherwise transferred and has cash flows that are inextricably linked with the cash flows of the business as a whole. The valuation of noncompete agreements is very subjective. Even valuation specialists often disagree on how to value such intangibles. In some instances, a value is assigned by estimating the economic damage that could have been done if an individual were allowed to compete. This what-if situation cannot be reliably measured, verified by past experience or derived from market data. Accordingly, we recommend that noncompete agreements should not be considered a separately recognizable intangible asset.

We appreciate the opportunity to share our views on this exposure draft. We also commend the FASB on their plans to hold public roundtables to understand interested parties' views on this important subject. We encourage the FASB to broadcast the public roundtables so that we may listen to the discussions held on this topic.

Sincerely,

Jeffrey D. Kelly
Vice Chairman and Chief Financial Officer