May 31, 2013

Ms. Leslie F. Seidman, Chairman
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, Connecticut 06856-5116

Mr. Hans Hoogervorst, Chairman
International Accounting Standards Board
30 Cannon Street, First Floor
London, EC4M 6XH
United Kingdom

Re: File Reference No. 2012-260, Financial Instruments – Credit Losses (Subtopic 825-15)

Exposure Draft ED/2-013/3, Financial Instruments: Expected Credit Losses

Dear Ms. Seidman and Mr. Hoogervorst:

Thank you for the opportunity to comment on the FASB's recent proposal regarding credit losses and other related matters. SNL Financial, my employer, has submitted a comment letter based upon the results of surveys and discussions regarding this matter. However, I would like to offer some additional comments.

1. **It's not clear why the expected lifetime credit loss associated with securities and loans are being fully expensed on Day 1, while on the other hand, many other items on the balance sheet, with a limited life and an amount on the balance that will only decrease over time, are treated differently. For example, under the FASB's proposal, loans are being treated differently than a computer, a vehicle, or goodwill. It's unclear what is so different about loans and securities that is causing an inconsistency in accounting treatment with other assets on the balance sheet.**

   If a firm buys a delivery van for the delivery of goods that it sells, the moment the company drives the van off the lot, the delivery van is worth less than what the firm paid for it. And yet, on Day 1, the firm will recognize the van as PP&E on its balance sheet for the value it paid for it. Over the next several years, the company will slowly expense the van.

   If the same accounting treatment that the FASB is proposing for loans were applied to the delivery van, the delivery van would be completely written off and fully expensed on Day 1 since

the “expected lifetime loss” of the van is equal to the amount paid for the van. This does not seem to make sense.

Or consider goodwill that is created as a result of an acquisition. Eventually, the goodwill will be worth zero and fully written off. However, on Day 1 and for every day thereafter until there is evidence of deterioration of the recognized goodwill value on Day 1, there is no expensing of the goodwill.

If the same accounting treatment that the FASB is proposing for loans were applied to goodwill, there would be no such thing as goodwill and firms would instead recognize a huge one-time expense in the period of the acquisition. Again, this does not seem to make sense.

Many people would argue that the proposed accounting treatment for loans is counter-intuitive when compared to the accounting treatment for a vehicle or goodwill. The vehicle and the goodwill seem to be receiving more “favorable” accounting treatment in spite of two key differences that would seem to indicate that the loans should receive more favorable accounting treatment.

One, the vehicle and the goodwill do not directly generate revenue for the firm. On the other hand, a loan does directly generate revenue via interest income. And in almost all cases, this interest income will significantly exceed the expected lifetime credit losses.

Two, a firm can’t sell the vehicle or the goodwill 30 days after the purchase or transaction closing for anywhere close to the price paid on Day 1. Vehicles depreciate quickly and goodwill can’t be sold separately.

On the other hand, so long as there is a liquid market, such as with residential mortgage loans, a loan issued by a bank can be sold for more than the original loan amount. For example, based upon discussions with various mortgage brokers, the value of a newly originated residential mortgage on Day 1 is approximately $5,000 to $7,000 greater than the principal amount.

2. **It’s not clear why credit-related expenses associated with a loan are all immediately expensed upfront while other recurring expenses associated with a loan, such as servicing fees, are expensed on an annual basis.**

   The annual servicing expenses associated with a loan are even more certain to occur than the expected credit losses associated with a loan. In addition, it’s much easier to accurately forecast the future servicing charges for a loan than it is to forecast future credit losses. In spite of this, the servicing expenses are expensed over time while the FASB proposal would require the expected lifetime credit losses to be immediately expensed.

3. **This proposal could result in many banks showing a net loan amount on their balance sheet that is clearly less than the fair market value of the loan.**

   In determining the price of a loan, the market takes into account the expected credit losses associated with the loan. Even after taking into account these credit losses, many newly

originated loans, such as those sold issued by mortgage brokers, are sold for more than their face value. However, under this proposal a bank could be forced to mark the loan below both fair value and face value due to the requirement to recognize all expected lifetime credit losses at origination.

The FASB's previous proposal for the fair value method was met with great resistance. Why would the FASB want to propose something that is even more conservative?

4. The impact this proposal could have on lending if the economic outlook worsens and projected credit losses increase is significant.

Banks typically originate a slightly greater amount of loans than those that are maturing each year. If the economy were to worsen and projected credit losses were to increase, most banks would become defensive and take the necessary steps to ensure that they had more than enough capital. Under this proposal, it seems fairly possible that instead of issuing more capital, a bank could conserve capital by just ceasing the origination of new loans.

In addition, if a bank wants to grow its loan portfolio during a recessionary period when expectations regarding future losses for new loans are greater, the bank will likely be required to raise additional capital during a recessionary time when it's often very difficult to raise capital.

Many would argue that it doesn't make sense to have a rule in place that discourages banks from issuing new loans at a time when the economy is starting to struggle. Some would say that this proposal will result in a "self-full filling prophecy". In other words, if you want to start a recession, just have rules in place that encourage banks to stop issuing new loans at the first sign of economic trouble.

In closing, thank you for the opportunity to comment on this matter. Please consider the points raised in this letter.

Sincerely,

John Montgomery, CFA, CPA
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