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April 1, 2011

Via email

Leslie F. Seidman, Chairman
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Norwalk, Connecticut 06856-5116

Sir David Tweedie, Chairman
International Accounting Standards Board
30 Cannon Street, First Floor
London, EC4M 6XH
United Kingdom

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

Dear Ms Seidman and Sir David:

Wells Fargo & Company (Wells Fargo) is a diversified financial services company with over \$1.3 trillion in assets providing banking, insurance, trust and investments, mortgage banking, investment banking, retail banking, and consumer finance services. We appreciate the opportunity to comment on the joint Supplementary Document, *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities: Impairment*.

Executive Summary

We do not support the jointly proposed FASB/IASB credit impairment model (the “Joint Proposal”) as it requires the use of an eclectic set of mechanical calculations which lack any cohesive underlying accounting principles applicable to financial instruments. In order to accommodate an arbitrary convergence timeline, it appears that the Boards have “stitched together” their disparate proposals on credit impairment. Unfortunately, the Joint Proposal does not adequately address the underlying cyclical nature of financial instruments, which we believe is the most meaningful improvement opportunity to the current accounting framework. The existing accounting model has been criticized because of concerns about the adequacy of credit loss reserves and the timing of credit loss recognition. To address these criticisms and improve the existing credit impairment framework, we believe financial institutions must be able to more fully consider a broader spectrum of the credit cycle in the development of loss reserves than is permitted currently in order to anticipate unforeseen or rapid and parallel shifts in loss expectations.

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The FASB stated recently that credit impairment is the “single most important issue having to do with financial instruments as it relates to the financial crisis and the criticism of the current accounting mechanisms”¹. We agree. Accordingly, we support a credit impairment model change, but only if it represents an improvement over the existing impairment framework.

Members of the U.S. banking industry have developed an alternative proposal (the “Alternative Proposal”) that we believe effectively addresses the concerns with the existing impairment model while remaining faithful to existing accounting principles and credit risk management practices within the industry. The details of the Alternative Proposal are described in the attached Appendix A. We strongly urge both Boards to consider the Alternative Proposal as a basis to improve the existing credit impairment model.

We also want to express concern about the lack of due process and consideration exercised by the Boards related to the exposure of the Joint Proposal. The comment deadline does not adequately consider year-end and first quarter financial reporting priorities or the fact that we find ourselves in an unprecedented period of standard setting that has necessitated the diversion of additional time and resources that are needed to properly assess the Joint Proposal. Moreover, the Joint Proposal does not address significant categories of financial instruments subject to credit impairment, such as purchased loans, large individually evaluated loans and investment securities. Lastly, the Joint Proposal includes the introduction of new terms and concepts that have not been clearly defined and are therefore subject to interpretation and diversity in practice.

Specific Comments on the Joint Proposal

While we do not support the Joint Proposal, if the Boards decide to proceed with the Joint Proposal, we offer the following additional comments for the Boards’ consideration.

Single Impairment Framework:

- **We strongly encourage the development of a single model for credit impairment:** We do not believe there is a conceptual basis to differentiate between originated and purchased financial instruments, including purchased credit-impaired loans. While additional steps may be required to address purchased instruments when compared to originated instruments, we believe that a universal model should be created. For example, for purchased financial instruments, an allowance for credit impairment could be estimated based on expectations of credit risk at the date of acquisition with that amount separated from the purchased discount and recorded as an allowance for credit losses at that time. After the acquisition, the allowance for credit impairment would be evaluated in a manner consistent with originated instruments. We encourage the FASB and the IASB to consider development of a single model for all financial instruments in an effort to reduce the complexity and the disparate accounting treatment for purchased and originated instruments that exists with current accounting standards.

¹ Statement made by Leslie Seidman, FASB Chairman, at the US Chamber of Commerce Conference on March 10, 2011.

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Time-proportional Method:

- Eliminate the time-proportional method: The time-proportional method as originally proposed by the IASB was principles-based and had technical and economic merit. Adjustments to the original IASB proposal to make it more operational have resulted in an impairment model that is based on an arbitrary formula that no longer has any conceptual basis. Moreover, in order to determine if the use of the time-proportional method is appropriate, the Joint Proposal requires reporting entities to continuously calculate and monitor three separate credit loss estimates. These estimates include the: 1) time-proportional amount, 2) foreseeable future amount, and 3) foreseeable future amount limited to 12 months. Lastly, as we note below, we believe use of the time-proportional method will be limited. For these reasons, we strongly encourage the Boards to eliminate the time-proportional method.
- Use of the time-proportional method would be limited: We do not believe it is likely that the time-proportional method will often be the basis for determining credit reserves. For mature portfolios and during times of economic stress, we believe it is more likely that the allowance for credit losses will be based on the foreseeable future period. Based on internal analysis, we believe a foreseeable future period of approximately 24 months would obviate the use of the time-proportional method.
- The time-proportional method is sensitive to more than credit risk: The weighted average life and weighted average age used in the calculation of time-proportional amount are subject to changes based on movements in interest rates and other market conditions. This is particularly true of longer term loans such as real estate mortgages. While these movements, in many cases, may result in changes to the credit risk of a borrower, it also makes the time-proportional method subject to variations even in cases where credit risk is unchanged. Accordingly, we do not believe that a credit impairment method that is highly dependent on non-credit factors as critical inputs is appropriate. This also introduces another layer of complexity when comparing impairment amounts across institutions. As stated above, generally, we are not supportive of the time-proportional method as currently proposed, but at a minimum, we suggest that the FASB and IASB provide guidance regarding how to consider changes in key inputs that are not credit risk-related.

Foreseeable Future:

- The definition of foreseeable future period must be more clearly defined: The definition provided in the Joint Proposal is based on the “period for which specific projections of events and conditions are possible and the amount of credit losses can be reasonably estimated” which we believe is too broad, vague and open to interpretation. We are concerned that the lack of clarity for this definition will result in reduced comparability between entities and industry regulators may ultimately establish interpretive guidance for U.S. financial institutions.
- The foreseeable future period will perpetuate and exacerbate pro-cyclicality: While it is expected that the foreseeable future approach will result in larger credit loss allowances, we believe that in benign credit environments, these allowances will likely only be marginally larger. Because of the cyclical nature of credit losses, the longer loss emergence periods in the future foreseeable model will further amplify and actually exacerbate the pro-cyclical effects of the existing impairment model. Entities would be subject to the same (or increased) pressure to build reserves only when losses become observable.

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The Bad Book:

- The proposed definition of the bad book is not clearly defined: The definition focuses on when credit management of an asset has changed to a recovery view versus an on-going view for collection of regular payments. However, the indicators provided in the Joint Proposal to perform this assessment are either too early or too late in the life cycle of a loan. For example, basing the assessment on whether a debtor has been contacted by mail, phone, or other methods is typically too early. Similarly, basing the assessment on whether the lender has pursued actions such as enforcement of security interests, debt restructuring or a breach of debt covenants is typically too late. In the absence of more clear guidance, there is risk that consistent application and comparability will be compromised.
- The definition of the bad book should be consistent with the existing accounting definition for impaired loans: Loans should be considered impaired, and thus included in the bad book, when it is probable that a creditor will be unable to collect all amounts due (principal and interest) in accordance with the terms of the loan agreement. While this definition currently does not apply to large groups of smaller-balance homogeneous loans that are collectively evaluated for impairment, such as most consumer loans, we propose that the bad book definition would apply to all loans (or portions of loan pools), without a scope exception. We prefer this definition because it is based on the credit quality of the asset and is well understood within the industry.
- The concept of a troubled debt restructuring (“TDR”) should be eliminated: Restructured loans should be addressed within the overall credit impairment framework. We strongly recommend that the Boards eliminate the concept of a TDR and replace current TDR disclosures with more relevant total loan modification disclosures based on loan credit quality indicators. Loan modification disclosures based on credit quality will be more decision useful and will provide better comparability, consistency and transparency with respect to the allowance for credit losses and loan credit quality among preparers. We previously expressed our concerns related to TDRs more fully in our response to the FASB’s request for comment on the TDR Clarification Guidance in November 2010.
- The definition of non-accrual should be standardized: We believe that non-accrual loans should be considered impaired loans and thus incorporated into the bad book. To better facilitate the identification of non-accrual loans, we recommend conforming the definition of non-accrual loans to existing U.S. banking regulatory guidance.

Discounting:

- We prefer an undiscounted approach to estimating credit losses: The IASB has provided multiple options to calculate the time-proportional expected losses that occur over time. These options include an undiscounted basis, a discounted basis using a straight-line approach or a discounted basis using an annuity approach. We believe that discounting introduces complexity that is not necessary. While discounting may be theoretically appealing, we believe that many entities will not apply discounting in an effort to reduce the number of estimates included in their credit impairment calculations as discounting would require an estimate of both the timing and amount of expected credit losses. Moreover, we believe that in many cases, an undiscounted approach will approximate similar results as a discounting approach. Notwithstanding this view, we acknowledge that discounting may be appropriate in certain situations, such as significant loan modifications. Accordingly, we recommend that the Boards provide additional guidance in this area.

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- Effective interest rate should be used for discounting: If the Boards permit a discounting approach, we believe the options for the discount rate provided in the Joint Proposal, using a range from a risk-free rate to the loan's effective interest rate, create additional unnecessary complexity and diversity. We believe that the use of the loan's original effective interest rate has conceptual basis, is well understood and would provide greater consistency in the measurement of losses.

Disclosure Requirements:

- Evaluation of disclosure requirements is premature: The IASB has deliberated and exposed disclosures for credit impairment. We believe to effectively comment on such disclosures that we need to see the full proposed standard on the Accounting for Financial Instruments. In addition, we have implemented credit quality disclosures based on the recently issued FASB standard and we do not yet know how that standard will interact with the proposed disclosures related to this financial instruments impairment project.

Other Concerns:

- The Boards must adequately consider the role of banking regulators in standard setting: U.S. banking regulators often take on a standard setting role for the industry and "fill in the gaps in GAAP" when accounting standards are not clear. We do not believe the Boards have adequately considered this role as many aspects of the Joint Proposal lack sufficient clarity, which increases the risk that management judgment will be replaced with prescriptive guidance issued by U.S. banking regulators. Regulators regularly assess the adequacy of and provide input on the methodologies used to calculate the allowance for credit losses, as well as issue guidance specifically related to the assessment of credit quality. Without a clearly articulated principle or succinct definitions of the foreseeable future or the composition of the bad book, we are concerned the proposed guidance will not be consistently interpreted and applied across jurisdictions, especially in jurisdictions with less stringent regulatory oversight than the U.S.
- High quality standard setting should take precedence over convergence: The Boards have approached the Financial Instruments Project independently² and we are disappointed that, to date, the Boards have not been able to agree on many aspects of this project. Accounting for financial instruments, particularly credit impairment, is critical to financial institutions. While we believe that a converged credit impairment standard that is applied consistently across all jurisdictions is preferable, it is critical for the Boards to produce an accounting model for financial instruments that is principles-based and faithful to the underlying economics of financial instruments. The timing of convergence is much less important than the production of high quality accounting standards. Most notably, the credit impairment model proposed by the Boards is limited in scope as it only relates to open portfolios. Accordingly, the Board will need to expose yet another impairment proposal prior to June 2011. With all of the competing priorities facing both Boards, it is unrealistic to expect that financial institutions can adequately model and assess or the Boards can adequately re-deliberate their credit impairment proposal. While we are supportive of convergence, we strongly encourage the Boards to prioritize the improvement of existing accounting standards over meeting an arbitrary convergence deadline.
- High quality accounting standards can only be produced with sufficient due process: Proper due process must include constituent outreach, proper field testing, sufficient comment periods that provide for adequate analysis, and re-deliberation. None of the impairment proposals were adequately field tested prior to exposure and the Joint Proposal was stitched together and hastily exposed during a period that coincides with

² The IASB has proposed separate guidance in phases through the issuance of IFRS 9. The FASB issued its proposed guidance in an exposure draft in May 2010.

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earnings season and the preparation of year-end and first quarter financial statements. Moreover, during this time, financial institutions had the additional burden of preparing the newly-required credit quality disclosures and assessing and commenting on the IASB proposal on hedge accounting.

- The Boards need to specifically state a principle for other non-credit-related contingent liabilities: Existing FASB guidance for the allowance for credit losses is based on the principles underlying ASC Topic 450, *Contingencies*³. While the Joint Proposal would establish a new methodology for the recognition and measurement of credit impairment, we do not believe it is the intention of the Boards to extend the concepts and principles of the Joint Proposal to the recognition and measurement of other contingent liabilities. Accordingly, we encourage the Boards to clarify that the concepts in the Joint Proposal will not apply to contingent liabilities that do not relate to the recognition and measurement of credit impairment.

Conclusion

We share the goal of the FASB and IASB to develop high quality, converged accounting standards, but only if achievement of that goal results in improved accounting standards. All parties agree that improvement to the existing credit impairment framework is necessary. Accordingly, we strongly encourage the Boards to discard the Joint Proposal and consider the Alternative Proposal as a basis for improving the credit impairment framework. We encourage the Boards to continue with additional outreach efforts and fully field test the Alternative Proposal as well as any future proposals to ensure that the final standard is of high quality, operational and well understood by standard setters, regulators, users and preparers prior to issuance.

* * * * *

We appreciate the opportunity to comment on the issues contained in the joint Supplementary Document. If you have any questions, please contact me at 415-222-3119.

Sincerely,

/s/ Richard D. Levy

Richard D. Levy
Executive Vice President & Controller

cc: Jim Kroeker – Securities and Exchange Commission
Kathy Murphy – Office of the Comptroller of the Currency
Stephen Merriett – Federal Reserve FASB
Robert Storch – Federal Deposit Insurance Corporation
Donna Fisher – American Bankers Association
Gail Haas – New York Clearing House Association

³ Formerly Statement of Financial Accounting Standards No. 5, *Accounting for Contingencies*

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Appendix A

April 1, 2011

Via email

Leslie F. Seidman, Chairman
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401 Merritt 7
PO Box 5116
Norwalk, Connecticut 06856-5116

Sir David Tweedie, Chairman
International Accounting Standards Board
30 Cannon Street, First Floor
London, EC4M 6XH
United Kingdom

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

Dear Ms Seidman and Sir David:

We understand the difficult issues the FASB and IASB have been dealing with in their efforts to converge the accounting for financial instruments. We applaud the agreement reached regarding the measurement of financial instruments held for the collection of cash flows to account for them on an amortized cost less impairment basis. We also believe the tentative decision to account for impairment separately from the interest yield on loans and debt securities provides better information to both users and preparers of financial statements. These accounting decisions will ensure the financial statements reflect the way such financial instruments are managed.

We also recognize that the two boards had approached the accounting for impairment from two different directions and that the “dual impairment” model represents a significant compromise on the parts of both boards. However, we have concerns with the credit impairment model that has been jointly proposed, the most significant of which is that it does not adequately address the cyclical behavior of financial instruments and the lack of transparency around inherent loss events until such events are observable. Many financial institutions were severely criticized during the recent financial crisis because the limitations of the existing credit impairment accounting framework raised questions about adequacy of credit loss reserves and timing of credit loss recognition. Many believe the limitations of the current framework contributed to the severity and length of the financial crisis.

Members of the U.S. banking industry have developed an alternative proposal that we believe will more effectively address these concerns while expanding upon the existing incurred loss concept. In addition, we believe this approach will not require the significant operational complexity involved in implementing the joint proposal. A description of the alternative proposal is provided in the attached Exhibit A. We strongly encourage

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both Boards to consider this alternative proposal as a basis to improve the existing impairment framework in lieu of the jointly proposed model.

We support the efforts of the Boards to develop a converged and improved accounting standard. All parties agree that improvement to the existing impairment framework is necessary. Accordingly, we encourage the Boards to continue with additional outreach efforts and fully field test any future proposals to ensure that any new standard is of high quality, operational and well understood by standard setters, regulators and preparers prior to issuance. We recognize this may extend beyond the June 30, 2011, MOU target date, but it is critical that the process result in an improved standard. As a group, we offer our assistance in modeling, field testing and developing enhanced disclosures for this proposal.

Sincerely,

Ally Financial Services

Regions Financial Corporation

Bank of America Corp

State Street Corporation

Capital One Financial Corporation

SunTrust Banks, Inc.

Comerica Incorporated

The Bank of New York Mellon Corporation

JPMorgan Chase & Co.

The PNC Financial Services Group

KeyCorp

Wells Fargo & Company

Northern Trust Corporation

Zions Bancorporation

cc: Jim Kroeker – Securities and Exchange Commission
Kathy Murphy – Office of the Comptroller of the Currency
Stephen Merriett – Federal Reserve Board
Robert Storch – Federal Deposit Insurance Corporation
Donna Fisher – American Bankers Association

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Exhibit A

U.S. Banking Industry Proposed Credit Impairment Model

Introduction

The incurred loss model under U.S. GAAP and IFRS that governs credit impairment has been criticized following the recent financial crisis. The two main criticisms raised are: 1) reserve adequacy (i.e., credit reserve levels at the inception of the financial crises were inadequate to absorb the elevated losses that occurred during the crisis and likely substantially existed at the inception of the crisis) and 2) timing of recognition (i.e., increases in realized losses led to a combination of elevated charge-offs and large reserve builds at the peak of the crisis that inappropriately reduced market confidence in the banking sector). Many believe the delayed timing of loss recognition and magnitude of loss, which together reflected a severe and rapid deterioration in credit quality, exacerbated the severity and length of the financial crisis. All parties (standard setters, regulators, investors, and preparers) agree that improvements to the credit impairment guidance are necessary.

We believe that the fundamental principles inherent in the incurred loss model are sound and have served the industry, regulators and financial statement users effectively by providing a well understood framework to determine credit-related allowances. However, over time, the incurred loss model has increasingly been interpreted in a way that has resulted in a significant flaw: allowance calculations based on too narrow a view of the credit cycle. History has shown that the credit profile of financial instruments is highly cyclical, typically with a period of benign loss activity that coincides with the expansion and peak of overall economic activity and credit availability, followed by a shorter and more concentrated period of elevated credit losses. Narrow interpretations and application of the incurred loss model result in the compression of this cycle by considering only losses estimated over an abbreviated loss emergence period and restricting the use of market trends and other data that would indicate changes in the probability or severity of loss until such deterioration is observable.

The events of the recent financial crisis put a spotlight on this weakness in the application of the incurred loss model, resulting in the criticism noted above. Although we believe the fundamental principles of the incurred loss model remain sound, some thoughtful and tailored changes are necessary to incorporate the cyclical behavior of financial instruments and lack of transparency around inherent losses prior to the deterioration of the credit environment.

To date, the independent proposals from the FASB and IASB have focused primarily on only one aspect of the problems with the current model. The FASB's "foreseeable future" model addresses reserve sufficiency through expansion of the loss definition and the time period covered by the forecast by removing the "probable" trigger and expanding the types of inputs that may be considered in a loss forecast. However, the foreseeable future model suffers from the same flaw as the existing model, as it may be narrowly interpreted with a limited view of both the losses within the emergence period and of breadth and depth of the credit cycle. Accordingly, we believe the "foreseeable future" methodology, as originally proposed, may not adequately address the weaknesses in the current model and may perpetuate and exacerbate the pro-cyclicality of results while only modestly increasing the absolute level of credit reserves during extended periods of benign credit activity. Also, recent banking regulator comments lead us to believe this model, if adopted globally would potentially be implemented differently in the U.S. (most likely with longer "foreseeable future" loss forecasting periods) than in other jurisdictions.

In contrast, the IASB attempted to address the relationship between credit losses and loan pricing and income recognition and, therefore, pro-cyclicality, by introducing a time-proportionate spreading of credit losses over the expected life of the portfolio. However, this model does not result in a credit reserve that is sufficient to

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anticipate significant changes in credit loss curves as it also may focus on a narrow view of the credit cycle. Accordingly, the original IASB approach also perpetuates pro-cyclicality as changes to originally anticipated loss estimates would be recognized retroactively for good book assets and immediately in full for bad book assets.

We believe the compromise proposal set forth in the recent Supplementary Document – *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities – Impairment*, issued on January 31, 2011, was an attempt by the two Boards to combine the independent FASB and IASB proposals in a manner that would address both the reserve adequacy and timing of loss recognition issues with the current incurred loss model. For the reasons noted above, we believe the compromise proposal does not adequately address these issues.

We recognize that no impairment model can completely address the cyclical nature of credit risk inherent in financial instruments, and there will always be some level of volatility as we move through the ups and downs of the credit cycle. However, we believe it is possible to modify and enhance the existing incurred loss model to consider the cyclical behavior of financial instruments and lack of transparency around inherent losses in certain periods of the credit cycle in the determination of credit impairment. We believe this proposal would result in a better estimate of credit losses related to loss events inherent in the portfolio at the balance sheet date, effectively address the criticisms regarding the adequacy and timeliness of credit loss recognition and provide financial statement users with a more representative view of an entity's financial condition.

Proposal

Our proposal expands on existing incurred loss practices found within current accounting principles to more effectively estimate inherent credit losses by eliminating the probability threshold, incorporating expected events into the loss forecast and extending the loss emergence period. Under our proposal, inherent credit losses are estimated using a two-step approach. Although described in two steps, these components are interrelated and are each necessary to estimate losses inherent in the portfolio. We have described the components separately and would disclose them separately to provide clarity and transparency of management estimates:

1. A base component (the “Base Component”) that represents the estimate of expected inherent losses in the portfolio that are reasonably predictable;
2. A credit risk adjustment component (the “CRA”) that represents additional credit losses that are not yet reflected in current credit risk metrics used to estimate the Base Component but are estimated using macro-level factors and are expected to emerge with more transparency as the credit cycle unfolds.

Base Component

The Base Component is intended to capture expected inherent losses that are reasonably predictable based upon an assessment of historical and current credit information and expected events and conditions. The Base Component methodology replaces the current incurred loss model with an expected loss concept that incorporates expected events into the loss forecast and extends the loss emergence period to a period over which losses are reasonably predictable. Uncertainty in the forecasting process, changes in loss emergence periods, and other factors are not explicitly or systematically considered in the Base Component, and as such, the Base Component is by itself an incomplete estimate of inherent credit losses. The terms “*Expected Inherent Losses*” and “*Reasonably Predictable*” are defined as follows:

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Expected Inherent Losses are defined as management's best estimate of losses inherent in the loan portfolio based on a company's credit evaluation process taking into account all relevant current and historical information as well as expected events and conditions. This is a change from the existing incurred loss definition as the "probable" threshold has been eliminated and expectations of future events can be fully considered to estimate the severity of losses associated with a loss event. Expected Inherent Losses are pro-cyclical, by nature, and reflect the portion of the total allowance for credit losses that can be reasonably predicted in the current environment based on the available evidence and trends. The elimination of the "probable" trigger in the definition of Expected Inherent Losses is necessary to allow the Base Component to capture a greater portion of the actual losses inherent in a portfolio at any given point in time and align the credit loss recognition methodology with the cyclical nature of the underlying financial instruments. We believe that a company's best estimate of losses, whether probable or not, is the correct starting point for establishing credit impairment as this information is more reflective of loss estimates used in pricing credit. We also believe that this articulation of an expected loss concept is preferable to establishing a "more-likely-than-not" threshold of incurred losses because it is better aligned with risk management, and credit loss estimation practices, which generally do not incorporate a probability weighted analysis or a pre-defined level of precision.

Reasonably Predictable is defined as the period of time that losses can be estimated with reasonable confidence. In estimating the losses that are Reasonably Predictable, several factors should be considered including, the characteristics of the financial instrument or pool of financial instruments, the historical performance of the financial instrument or pool of financial instruments, the current and expected market conditions, and consideration of a company's own credit forecasting processes. The period of time determined to be reasonably predictable will vary by asset class and may change throughout credit cycles, and will not necessarily be consistent across companies.

This methodology is not intended to result in the immediate recognition of a full life-of-instrument loss estimate in most cases because it would be unlikely that the Reasonably Predictable threshold would be satisfied unless there is a specific indication of impairment. For example, if for individual instruments or a specifically identified pools of instruments with specific indications of impairment (e.g., collection of all contractual principal or interest is not expected), all Expected Inherent Losses for that instrument or that portion of the pool of instruments would be considered Reasonably Predictable and the remaining life of loan loss would be immediately recorded similar to current accounting.

Credit Risk Adjustment Component (the "CRA")

The CRA is a separate component of the allowance for credit losses that is established to address the inherent limitations in a company's credit forecasting process and the cyclical nature of macroeconomic conditions. Past credit cycles have seen extended periods of benign activity followed by rapid parallel upward shifts in credit loss estimates. The specific economic and credit conditions that lead to the negative credit shocks often accumulate over a number of years, but often are not readily apparent in the credit metrics commonly used to estimate the Base Component. For example, a) underwriting standards and loan terms may be eased during benign credit environments; b) favorable economic conditions may mask credit weaknesses of the borrower, c) uncertainty regarding the sustainability of the current economic conditions is often high and d) loss emergence periods tend to extend during benign economic periods. Each of these factors suggests that credit losses build even during benign credit environments and these losses later become transparent as the credit cycle deteriorates. Consideration of these factors, therefore, would likely cause the CRA to be highest during these benign credit environments, thus, ensuring that inherent credit losses are appropriately recognized even during such periods. Conversely, the CRA may not be as high during times of increasing loss rates as the portfolio's loss content is reflected or more apparent in current credit quality indicators and therefore would be more fully captured by the Base Component.

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Many critics have concluded that the existing model for credit impairment may not be capable of capturing the portion of losses that have been incurred, but for which, there is no currently observable evidence of credit loss. We believe the CRA concept more effectively addresses this weakness and enhances the existing incurred loss model from both a balance sheet perspective (by capturing estimates of expected inherent losses that are not readily apparent or observable), and an income statement perspective (by appropriately accelerating the recognition of credit losses into the periods in which they are inherent but not readily observable, and not concentrating loss recognition into the later stages of a credit cycle when losses are observable and can be specifically identified).

The CRA is intended to capture those losses that are inherent in the portfolio, but due to the nature of the credit cycle, will not become transparent until credit losses begin to materialize. During the course of a normal credit cycle, the counter-cyclical nature of the CRA will offset some, but not all of the volatility created by uncertainty in the timing and amount of credit losses. For example, no impairment methodology could have fully addressed the dramatic parallel shift in credit loss curves experienced from 2007 to 2009. In periods of extreme credit stress, a company may need to increase the Base Component as losses become observable, but may decide a CRA is also necessary if sufficient uncertainty remains regarding the absolute levels of expected credit losses. In this manner, the CRA addresses both criticisms, reserve adequacy and timing of credit loss recognition, leveled at the existing accounting guidance.

The methodology for establishing the CRA should consider factors including, but not limited to:

- Current credit metrics and forecast;
- Historical credit metrics (including stressed loss rates);
- Management's evaluation of the credit cycle;
- Other important credit indicators such as borrower behavior and collateral values;
- Current underwriting standards, loan covenant terms, and other loan characteristics;
- Recent trends in economic conditions;
- Portfolio performance, concentrations, and deterioration relative to historical ranges;
- Changes in loss emergence patterns over a credit cycle; and
- The level and estimate of imprecision and uncertainty in the factors above.

Many of the factors considered in the CRA would by nature be heavily dependent on management's judgment. These factors should be fully documented and supported by either market data, where possible, or internal data and analysis, and appropriately disclosed in the financial statements.

Conclusion

We believe that a credit impairment methodology that estimates credit losses inherent in the portfolio, comprising both a Base Component and a CRA, will address many of the concerns with the existing impairment model, and is superior to all other models proposed to date. We believe that the application of this methodology will:

- Generally increase the size of existing credit reserves to more accurately reflect inherent losses in the portfolio, including the risk of deteriorating economic conditions on those inherent losses;
- Reduce pro-cyclical volatility in the income statement created under the existing model as inherent losses will be appropriately recognized earlier in the credit cycle;
- Better align recognition of credit losses to those periods where credit losses are inherent in the portfolio, but are latent due to favorable economic conditions; and

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- Provide more useful qualitative and quantitative disclosures to financial statement users through transparent disclosure of the different components of the allowance for credit loss calculation and enhanced information about the key methodologies, assumptions and judgments used in determining those amounts.

We believe that this methodology has a solid foundation in existing accounting principles and credit risk management practices in our industry, and is similar to concepts and practices in analogous circumstances to estimate inherent losses in other industries.