



April 1, 2011

Financial Accounting Standards Board
401 Merritt 7
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By Email: director@fasb.org

RE: File Ref. No. 2011-150
Financial Instruments: Impairment

Members of the Board:

On behalf of Merrick Bank Corporation (“Merrick” or “we”) I am commenting on the Board’s Supplementary Document, *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities: Impairment* (“the Proposal”). We appreciate the opportunity to comment on the Proposal. We also appreciate the considerable effort FASB and IASB staff has expended to produce this Proposal. As will be noted below, however, we don’t agree with certain aspects of the Proposal and we urge FASB and IASB to consider these comments and those of other interested parties.

Merrick is an FDIC-insured state-chartered bank with assets of just over \$1 billion. Our primary business is issuing credit card accounts to consumer, generally with credit challenges. We also make loans in the near-prime market to individuals for the purchase of towable boats, camper trailers and motorcycles (our Recreation or installment portfolio).

As we will explain more fully below, we urge the Board not to propose or adopt the joint approach outlined in the Proposal because:

- The joint approach, specifically the use of the “time-proportionate approach” (“TPA”), is too complex and theoretical. We believe it could not be operationalized for revolving credit and it would be very difficult for installment portfolios.
- We have significant concerns about the “foreseeable future” approach, though we generally prefer this to the TPA.
- We believe it would not have helped in the recent financial crisis.
- We believe current accounting principles should be appropriately modified, not discarded.

The Proposal is too Complex and Theoretical

As presented, the Proposal requires two calculations (for the “Good Book”). The first is the TPA, the second is a “foreseeable future” or floor. The TPA requires estimates of the average remaining life of a portfolio and the losses to be realized during that period. Average life can generally be determined for

most installment portfolios. An estimate of the losses to occur during the remaining life of a portfolio, however, is challenging. I assembled the information I would need to make this estimate, and, considering the age of our portfolio and the significantly different behavior between its early years and the last few years, the estimate could differ at the high end by more than two times that at the low end. Such an estimate would be little more than a guess. Also because of the unique nature of this portfolio it would be impossible to find relevant industry comparables.

For a revolving credit portfolio determining the average remaining life is itself a challenging exercise. The average life of an account can be determined. Determining the average life of individual receivables associated with that account is a different matter. We have no system that tracks individual receivables (each a point-of-sale purchase or other debit activity) and the application of payments against those receivables. Of course, estimating the losses to be incurred during the remaining life also remains a challenge. Essentially, for revolving credit portfolios, significant estimates are required in both aspects of the TPA.

We believe the TPA should be discarded. If it cannot be discarded we believe revolving credit portfolios should be exempted from its application.

Concerns with the "Foreseeable Future"

As described the "Foreseeable Future" ("FF") is vaguely defined. On the one hand it seems it could be "too much too soon" on the other hand it could be a horizon of 12 months. We generally believe that the FF approach, or a modification thereto, would be the best outcome as it would be simpler to apply, simpler to understand and promote more comparability between reporting entities.

We are concerned that if not properly defined, it could be interpreted by entities, their accountants or regulators very differently. As this is a time period that should be estimable with some reliability we think it should be generally one year for most consumer loans, and one to 3 years for longer-term loans.

The Financial Crisis

The loss recognition models in use before and during the crisis have been criticized for not recognizing losses soon enough and not incorporating enough forward-looking information. We believe those loss recognition models generally served our financial system well in the many years they were in use. In the revolving credit arena this is particularly true after the banking regulators made a 12-month loss horizon the de-facto standard. By that action they essentially supplanted an incurred loss model with an expected loss model.

It is our belief that no system of loss impairment would have foreseen the magnitude of the coming crisis. If this Proposal had been in place in 2007, few entities would have had expected loss assumptions of the magnitude that actually happened. The result would have been similar - entities caught unprepared and with too many troubled assets would fail. Further, the potentially higher reserve requirements of the Proposal would have had pro-cyclical effects as entities would have been forced to write down assets to a greater extent than under current accounting treatment. It is not improbable to speculate that more failures would have occurred had this Proposal been in place. This crisis was among the greatest in living memory. We urge the Board in this post-crisis scramble to not overreact.

Current Principles Should be Modified, not Discarded

As noted above, current principles have served our financial system well for many years, and through a number of economic cycles. We believe they have generally withstood the test of time. It should not be surprising that given the magnitude of this crisis many firms failed or were driven to the brink of failure. As noted, we don't believe this is due to a failure of accounting principles in the area of loss impairment. However, it is prudent to improve those principles if we can.

One criticism, that allowances for loan loss were not sufficiently forward-looking, can be addressed. We don't, however, believe that the Proposal truly addresses this issue. The Proposal (whether FF or TPA, or both) generally increases the time period included in a forecast of losses. While that may increase reserves generally, it simply establishes a higher benchmark. What is missing is the ability of managers and preparers of financial statements to exercise judgment and to provide for losses in the foreseeable future that perhaps exceed historical trends. As a preparer I can tell you this is very difficult to do, as it is labeled "earnings management." In 2008 many entities believed a recession of some sort was coming, but current principles, whether explicitly or implicitly, discouraged the provision of larger reserves. Guidance that doesn't necessarily expand time horizons but allows for this kind of judgment would address this criticism.

We support those changes to existing principles that allow for loan impairment recognition along the lines of an expected loss as opposed to incurred loss model. We have used this approach practically since our founding in 1997. We believe that most regulated banks use methodologies of this sort. Therefore we urge the FASB and IASB to modestly and appropriately modify existing principles and to refrain from aggressive changes to a model that has generally worked well.

We thank you for your efforts and your desire and willingness to listen to the views of other interested parties. We ask that you consider our comments and those of other parties as you refine your proposal and move to the next step in this process. On the following pages are our responses to the questions posed in the Proposal. We feel that we have not been able to satisfactorily respond to some of the questions, but given the time period available to us we have done the best we can.

If you wish to discuss any of the matters we've presented here, please feel free to contact me (dave.young@merrickbank.com or 801-545-6602).

Sincerely,



David Young

CFO

Merrick Bank Corporation

Responses to the questions posed in the Proposal:

Question 1

Do you believe the proposed approach for recognition of impairment described in this supplementary document deals with this weakness (ie delayed recognition of expected credit losses)? If not, how do you believe the proposed model should be revised and why?

Replacing the incurred loss approach with an expected loss approach significantly accelerates the recognition of losses. With respect to the Proposal, we believe the FF approach adequately addresses any delay in the recognition of losses, and by itself would be more simple and understandable.

Question 2

Is the impairment model proposed in the supplementary document at least as operational for closed portfolios and other instruments as it is for open portfolios? Why or why not?

Given the limited time frame to respond to this Proposal we haven't be able to examine how it might apply to assets other than open portfolios.

Question 3

Do you agree that for financial assets in the "good book" it is appropriate to recognize the impairment allowance using the proposed approach described above [greater of the time-proportional expected losses or losses in the foreseeable future period (not less than 12 months)]? Why or why not?

As we've stated, we believe the TPA is overly complex. We prefer the FF approach, when the future period is of reasonable length, and we believe that by itself it provides a reasonable basis for loss recognition. Therefore, the TPA and the "greater of" concept are unnecessary.

Question 4

Would the proposed approach to determining the impairment allowance on a time-proportional basis be operational? Why or why not?

We believe that the TPA would be very difficult to operationalize. For closed-end loans (installment loans with definite maturities) it would be difficult and, as we've noted above, we don't believe it would produce more reliable or useful financial statements. For revolving credit loans we don't believe it could be operational. The reason is that the TPA requires estimates about the lives of separate receivables (each a separate debit activity of some sort, for example a purchase), and our loan management and accounting systems do not support tracking at that level. Assumptions regarding the application of payments would need to be made. To these assumptions must be added further assumptions regarding losses expected to occur over the remaining life of those receivables. It is difficult for us to estimate losses over a 12-month period. Lengthier periods become little better than guesswork. Stringing together assumptions of these types would result in a flimsy foundation upon which to base financial statements.

Question 5

Would the proposed approach provide information that is useful for decision-making? If not, how would you modify the proposal?

We believe that the proposed approach could have the advantage of establishing greater consistency between reporting entities. However, we don't believe the proposal would be useful for decision making. We believe that because the Proposal requires a more extensive use of estimates of losses over lengthier time periods it will result in more volatile results, making financial results less useful over time.

Question 6

Is the proposed requirement to differentiate between the two groups (ie "good book" and "bad book") for the purpose of determining the impairment allowance clearly described? If not, how could it be described more clearly?

We believe the definition of "bad" book should be as closely related to current guidance (FAS 114) as possible. In this way confusion on the part of preparers, users, accountants and regulators will be diminished.

Question 7

Is the proposed requirement to differentiate between the two groups (ie "good book" and "bad book") for the purpose of determining the impairment allowance operational and/or auditable? If not, how could it be made more operational and/or auditable?

This is an area where we aren't certain. If the definition of "bad book" closely follows FAS 114 then we believe it would generally be operational and auditable.

Question 8

Do you agree with the proposed requirement to differentiate between the two groups (ie "good book" and "bad book") for the purpose of determining the impairment allowance? If not, what requirement would you propose and why?

For our Credit Card portfolio we don't explicitly differentiate between these two groups. In practice our 12-month horizon captures most of the losses in the "bad" book. We don't think this bifurcation need occur with revolving credit portfolios. We divide our installment portfolio between "good" and "bad," and agree with the proposal with respect to installment loan portfolios, as long as the definition of "bad" is well defined.

Question 9

The boards are seeking comment with respect to the minimum allowance amount (floor) that would be required under this proposed model. Specifically, on the following issues:

- (a) Do you agree with the proposal to require a floor for the impairment allowance related to the "good book"? Why or why not?*

We would prefer a model that is simple to use and describe. The TPA is not that. However, if the TPA is ultimately adopted, we believe that may be the more commonly used measure (meaning we believe it would generally be greater than the floor), and for simplicity reasons we would discard the floor so that only one measurement need occur.

- (b) Alternatively, do you believe that an entity should be required to invoke a floor for the impairment allowance related to the "good book" only in circumstances in which there is evidence of an early loss pattern?*

This would introduce a new standard and wrinkle that would only be required in certain circumstances. We believe that would be more confusing to preparers and users of financial statements.

- (c) If you agree with a proposed minimum allowance amount, do you further agree that it should be determined on the basis of losses expected to occur within the foreseeable future (and no less than twelve months)? Why or why not? If you disagree how would you prefer the minimum allowance be determined and why?*

As noted, we prefer a more consistent and simpler standard, generally a 12-month standard, to the TPA with a floor. For us 12 months is the foreseeable period. If this standard were generally adopted it would lead to more consistency among entities. We acknowledge that longer periods may be necessary for longer-term loans.

- (d) For the foreseeable future, would the period considered in developing the expected loss estimate change on the basis of changes in economic conditions?*

As we've noted we believe the foreseeable future could vary by product type. We believe, however, that the standard should not generally fluctuate based on economic conditions. Such conditions would and should affect the amount of a Reserve, but shouldn't change the time frame.

- (e) Do you believe that the foreseeable future period (for purposes of a credit impairment model) is typically a period greater than twelve months? Why or why not? Please provide data to support your response, including details of particular portfolios for which you believe this will be the case.*

We believe the foreseeable future period should generally be 12 months. We acknowledge that some long-lived portfolios (possibly certain commercial and industrial loans, or long-lived consumer loans) exhibit characteristics that warrant longer periods. We believe this because (based on our own experience) estimating losses beyond 12 months is unreliable.

- (f) If you agree that the foreseeable future is typically a period greater than twelve months, in order to facilitate comparability, do you believe that a "ceiling" should be established for determining*

the amount of credit impairment to be recognized under the "floor" requirement (for example, no more than three years after an entity's reporting date)? If so, please provide data and/or reasons to support your response.

We believe the general standard should be 12 months. As noted, we believe certain portfolios could have longer foreseeable futures. We have no experience with longer-lived portfolios and therefore cannot comment on the applicability of a ceiling. Theoretically, it seems reasonable to have a ceiling to promote comparability.

Question 10

Do you believe that the floor will typically be equal to or higher than the amount calculated in accordance with paragraph 2(a)(i)? Please provide data and/or reasons to support your response, including details of particular portfolios for which you believe this will be the case.

This question is difficult to answer. For the various reasons noted, we believe revolving credit products should generally be exempted from this Proposal. For our installment portfolio we would continue to use a 12-month horizon as our foreseeable future period. This is the foreseeable future we can estimate with some reliability. We believe that estimates beyond that period of time would be unreliable. Without more time to test this Proposal we don't know if the "floor" would typically exceed a TPA amount. We suspect the numbers would be similar.

Question 11

The boards are seeking comment with respect to the flexibility related to using discount amounts. Specifically, on the following issues:

- (a) Do you agree with the flexibility permitted to use either a discounted or undiscounted estimate when applying the proposed approach described in paragraph B8(a)? Why or why not?*
- (b) Do you agree with permitting flexibility in the selection of a discount rate when using a discounted expected loss amount? Why or why not?*

We believe that this kind of flexibility should not be allowed so that there is more consistency between reporting entities.

Question 12

Would you prefer the IASB's approach for open portfolios of financial assets measured at amortized cost to the common proposal in this document? Why or why not? If you would prefer this specific approach, do you prefer the general concept of the IASB's approach (ie to recognize expected credit losses over the life of the assets)? Why or why not?

We strongly agree that losses should be recognized over the lives of the assets. As IASB has stated, among other things, this matches expenses and revenues. Without this matching, carrying value is completely disconnected from economic reality. However, we believe the IASB approach is overly cumbersome. For reasons stated above, we believe that a reasonable foreseeable future period would accomplish 90% of the goals of the IASB's approach with 10% of the complexity.

Question 13

Would you prefer the FASB's approach for assets in the scope of this document to the common proposal in this document? Why or why not? If you would not prefer this specific approach, do you prefer the general concept of the FASB's approach (ie to recognize currently credit losses expected to occur in the foreseeable future? Why or why not?

We believe that the appropriate loss model is one that recognizes currently credit losses that will occur in the foreseeable future. Depending on the definition of "foreseeable future," we prefer the directness and simplicity of the FASB approach. However, we believe any loss model that requires an entity to recognize losses now (on the "good" book) that won't occur in the next 12 months (generally, depending on portfolio characteristics) is inappropriate, for reasons previously stated.