



April 1, 2011

Ms. Leslie Seidman
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**Re: IASB File: Supplement to Financial Instruments: Impairment ED/2009/12;
FASB 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:

The Clearing House Association L.L.C. (“The Clearing House”),¹ an association of major commercial banks, appreciates the opportunity to comment on the above-referenced Supplementary Document (the “Proposal”).

¹ Established in 1853, The Clearing House is the nation’s oldest banking association and payments company. It is owned by the world’s largest commercial banks, which collectively employ 1.4 million people in the United States and hold more than half of all U.S. deposits. The Clearing House Association is a nonpartisan advocacy organization representing – through regulatory comment letters, amicus briefs and white papers – the interests of its owner banks on a variety of systemically important banking issues. Its affiliate, The Clearing House Payments Company L.L.C., provides payment, clearing and settlement services to its member banks and other financial institutions, clearing almost \$2 trillion daily and representing nearly half of the automated-clearing-house, funds-transfer and check-image payments made in the U.S. See The Clearing House’s web page at www.theclearinghouse.org.

Executive Summary

The Clearing House supports the efforts of the Financial Accounting Standards Board (the “FASB”) and the International Accounting Standards Board (the “IASB”) (collectively, the “Boards”) to improve the quality and comparability of financial statements. In particular, we appreciate the efforts of the Boards to work together to produce a converged and revised proposal that addresses certain aspects of the loan impairment model, an issue that is of vital importance to our members. At the same time, we are concerned that our members have not had sufficient time to properly evaluate the Proposal, given the timing of its release, the lack of clarity on certain key aspects of the Proposal and the narrow scope of the Proposal. As our members are currently in different stages of evaluating the impact and developing their positions, their additional views will be reflected in their individual comment letters to the Boards. Accordingly, we are able to provide only preliminary comments on the Proposal at this time.

In summary, The Clearing House:

- *Strongly recommends* that the Boards develop a full scope impairment model and expose it for comment, as it is difficult for our members to fully evaluate the Proposal given its narrow scope and the insufficient time afforded to field test it;
- *Recognizes* that there is a need for a more forward-looking provisioning approach, and *believes* that it is very important that the new approach be a conceptually sound model that also acknowledges the need for the application of significant judgment on the part of management;
- *Recommends* that the definition of the bad book be based on the current U.S. GAAP definition of an impaired loan;² and
- *Recommends* that the Boards develop a single impairment model for both originated and purchased loans, including purchased credit-impaired loans, and eliminate specific guidance for troubled debt restructurings.

We elaborate on these points below.

A. The Boards should develop and expose a full scope impairment proposal.

We note that the Proposal will likely require substantial changes to financial reporting. We are concerned that constituents may not have had sufficient time to develop their views on

² Accounting Standards Code 310-10-35-16, SFAS 114-paragraph 8 states in relevant part that “a loan is impaired when, based on current information and events, it is probable that a creditor will be unable to collect all amounts due according to the contractual terms of the loan agreement.”

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the issues addressed in the Exposure Draft as the comment period has coincided with year-end and first quarter reporting deadlines along with the recent comment deadlines for other major proposals such as the IASB's Hedge Accounting proposal.

In particular, the time proportional approach to recognition is very new and has the potential to be operationally complex. Our members need sufficient time to field test this model to see what problems might be encountered in practice. At the same time, efforts to do so have been hampered by a lack of clarity on several key aspects of the Proposal. Accordingly, we believe that further Board discussion and deliberation is required to provide greater clarity on how certain aspects of the Proposal are intended to be interpreted and applied, such as the meaning of the terms "expected credit losses" and "foreseeable future," and the definition of both the "good book" and the "bad book", where a potentially wide range of interpretations on all these matters is possible. For example, regarding the good book and bad book distinction, the interaction of these two portfolios is of critical importance, given the difference in how losses are recognized. Notwithstanding these differences, however, numerous issues are not clearly defined, such as, inter alia, how and when an asset can be transferred from the bad book to the good book; how the allowance would be adjusted when a good book loan is transferred to the bad book, and vice versa; and how the allowance would be calculated for the bad book.

Further, our members are unable to evaluate this Proposal without further guidance as to how it will integrate with the rest of the impairment model as well as the FASB's larger projects on the classification and measurement of financial instruments. We therefore strongly encourage the Boards to develop a "full scope" impairment proposal, which would address, inter alia, financial assets that are not part of open portfolios or are evaluated individually; other problem loans; purchased loans, including purchased credit-impaired loans; loans modified in troubled debt restructurings; the proposed definitions of "writeoff" and "nonperforming/nonaccrual" loans; unfunded commitments, guarantees, and investments in debt securities; the methods for measuring credit losses (e.g., whether to use discounted or undiscounted amounts and whether the credit loss estimate should be an expected value); and the method of income recognition. Once a full-scope proposal has been developed, the Boards should expose it for public comment, allowing for sufficient time such that constituents can field test the proposal and provide meaningful feedback to the Boards.

If the Boards were to decide not to re-expose a full scope impairment proposal, we would be very concerned that the final standards would be fatally flawed, or at the very least, would result in unintended consequences. Given the importance of this Proposal to our members, as well as to the financial markets as a whole, we believe that this is too great of a risk. Understanding the systematic and systemic consequences of the proposed guidance is paramount to effective standard setting and high quality financial reporting.

We overwhelmingly support the Boards' premise of the importance of adopting one set of high quality global accounting standards that can be interpreted and applied consistently.

Furthermore, given the fact that many of our members conduct business outside the U.S. and are international in scope, we prefer a single model that can be easily explained to investors as we are concerned that running two systems in parallel will be operationally burdensome, as well as potentially confusing to investors, who may inevitably wonder which is the “right” impairment amount. At the same time, we firmly believe that quality should not be sacrificed for speed. Accordingly, we strongly encourage the Boards to proceed in a thoughtful manner and fully deliberate these important issues so as to produce a new impairment model that is truly an improvement over the existing one, rather than merely compromising on an approach for the sake of convergence and in order to meet the IASB’s June 30th deadline.

B. The new model must have a solid conceptual foundation for it to be successful and the Boards must acknowledge that significant judgment will be required.

We note that the current incurred loss model, while it has some acknowledged drawbacks, is at the same time based on a clearly articulated concept that is consistent with how other loss contingencies are recognized for U.S. GAAP. We support in principle the need for a more forward-looking provisioning approach; however, it is critical that the new model also be conceptually sound, and that the conceptual basis be clearly articulated. In our experience, only accounting standards that are grounded in a solid conceptual foundation prove to be robust enough to be interpreted and applied in a consistent manner and easily explained to and understood by investors.

Regardless of the model that is proposed, significant judgment will be required in applying the model, as is the case today under the incurred loss model. For example, as the Boards have noted in their deliberations, the definition of “foreseeable future” will vary by the type of loan. Along these same lines, we recommend that in determining the expected loss amount, entities should be given the flexibility to determine when the application of a discounted or an undiscounted amount is most appropriate for the portfolio in question. At the same time, we acknowledge that the more judgment that is permitted in the application of the standard, the more disclosure will be needed to explain the alternatives selected and the impact of those choices.

C. The definition of the bad book should be based on the current definition of an impaired loan.

The bad book should be defined consistent with current accounting guidance (under FAS 114/Topic 310) wherein a loan is considered impaired 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.³ Although this definition does not currently apply to large groups of smaller-balance homogeneous loans that are collectively evaluated for impairment, such as credit card,

³ See definition in footnote 2 above.

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residential mortgage, and consumer installment loans, we propose that the bad book definition would apply to all loans, without any scope exclusions. We prefer this definition as it is based on the characteristics of the asset, rather than on management's intention as to how it will manage the asset, as is currently proposed in paragraphs B2-B4 of the Proposal.

In particular, we believe that the intent-based approach proposed is potentially problematic in that the credit deterioration indicators in B3 are alternatively either "too late" or "too early" to define when an asset should be transferred from the good book to the bad book. Examples of indicators that we believe would be too late are the enforcement of security interests (e.g., foreclosure or seizing of collateral); debt restructuring; the exercise of a call option; and the breach of debt covenants. An example of an indicator that we believe is too early is contacting the debtor by mail, phone or other methods. In these instances, the entity's credit risk management objective may not have changed from receiving payments of principal and interest to recovery of the asset principal. Accordingly, we recommend that the Boards refrain from providing specific indicators of credit deterioration and instead provide a principles-based definition of the bad book similar to the current U.S. GAAP accounting definition of an impaired loan.

D. The Boards should develop a single model for both originated and purchased loans and eliminate specific guidance for troubled debt restructurings.

The current model under U.S. GAAP for purchased credit-impaired loans is operationally complex and not easily understood by investors. Conceptually, we see no need for a distinction between originated and purchased loans and recommend that the existing U.S. GAAP guidance for purchased loans be eliminated. Purchased loans, including purchased credit-impaired loans, could instead be integrated into other open portfolios within the good book or bad book, as appropriate.

In addition, we believe that separate accounting guidance is not required for troubled debt restructurings, as more fully articulated in our previous comment letter on this issue.⁴ Restructured loans should be addressed within the overall framework of impairment measurement, and information regarding loan modifications could be provided in disclosures using credit quality indicators.

Finally, we believe that nonaccrual loans should be defined as impaired loans in accordance with the current U.S. GAAP definition of an impaired loan,⁵ such that nonaccrual loans would then be incorporated into the bad book.

⁴ Please refer to our letter to the FASB dated December 13, 2010, File Reference No. 1880-100, Proposed Accounting Standards Update, Receivables (Topic 310), *Clarification to Accounting for Troubled Debt Restructurings by Creditors*.

⁵ See definition in footnote 2 above.

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Thank you for considering the comments provided in this letter. If you have any questions or are in need of any further information, please contact me at (212) 613-9883 (email: david.wagner@theclearinghouse.org) or Gail Haas at (212) 612-9233 (email: gail.haas@theclearinghouse.org)

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