August 5, 2011

Ms. Leslie Seidman
Chairman
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-05116

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

**Re:** The Clearing House Proposed Alternative Approach to Staff Papers on Impairment: Three-bucket approach (IASB Agenda reference 8, FASB Agenda reference 99)

Dear Ms. Seidman and Mr. Hoogervorst:

The Clearing House Association L.L.C. ("The Clearing House"), [1] an association of major commercial banks, has reviewed the Staff Papers on Impairment (the "Staff Papers").[2] We understand that the Staff Papers are preliminary in nature, and that the Financial Accounting Standard Board (the "FASB") and the International Accounting Standards Board (the "IASB" and collectively with the FASB, the "Boards") are requesting feedback from the industry on their

[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.

[2] IASB/FASB Staff Papers on Impairment: Three-bucket approach, IASB/FASB Staff Paper on Financial Instruments: Impairment, Transfer between buckets and IASB/FASB Staff Paper on Impairment, Bucket 1 measurement.

proposed impairment approach. The Clearing House applauds the Boards' efforts to develop a converged impairment model and would appreciate your consideration of our proposed alternative approach (as outlined in the attached document).

In developing our proposal, our overall goal is to produce a model that provides for a balance between a) well-defined criteria regarding what is classified in Bucket 1 vs. Bucket 2 to ensure a broad consistency of approach among financial institutions, and b) management judgment, so that the model is not overly rigid and mechanical in nature. We believe that the proposed approach would both provide useful information for investors to make decisions, as well as be operational for financial institutions.

We would be happy to discuss our proposal with the Boards and/or Staff in further detail at your convenience. We appreciate the opportunity to provide our input and look forward to future opportunities to do so. If you have any questions or if we can facilitate those additional discussions, please contact me at (212) 613-9883 (email: david.wagner@theclearinghouse.org) or Gail Haas at (212) 612-9233 (email: gail.haas@theclearinghouse.org).

Sincerely yours,

David Wagner
Senior Vice President
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cc: Ms. Susan Cosper
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*The Clearing House Association L.L.C.*

**The Clearing House Proposed Alternative Approach to the Staff Papers on Impairment**

1. The Clearing House proposed alternative approach to the Staff Papers on Impairment would provide for 3 buckets as follows:

- Bucket 1: **Unimpaired Loans** (the "Good Book") – Individual loans with no indication of impairment and, in the context of portfolios, financial assets evaluated collectively for impairment that do not meet the criteria for Buckets 2 or 3. The occurrence of broad macroeconomic events that impact the entire portfolio would not necessarily result in these loans being reclassified into Bucket 2.

  *For example*: Assume Bank A originates loans only in the United States. A decline in GDP for the United States would not trigger a reclassification to Bucket 2 for all of Bank A's loans that are currently classified in Bucket 1.

  *Allowance:* For Bucket 1 the allowance amount at each reporting date is equal to 12 months' worth of expected credit losses of the assets in Bucket 1.

- Bucket 2: **Emerging Impaired Loans** – Loans (both individual and pools) with some indication of emerging credit deterioration such that a more extensive loss reserve is warranted.

  Instead of using "observable" macroeconomic events as the trigger for classification as Bucket 2, Bucket 2 loans would generally have one or more of the following characteristics:

  - Obligor faces major ongoing uncertainties and exposure to adverse business, financial or economic conditions which either could lead to (or likely impair) the obligor's capacity to adequately meet its financial commitments;
  - Obligor may be in danger of default because of the relatively high levels of debt that the issuing company has relative to the level of equity;
  - Obligor may be vulnerable to adverse business, financial or economic conditions but currently has the capacity to meet financial commitments, or obligor is currently highly vulnerable in meeting financial commitments;
  - Non-investment grade ratings;
  - Potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may, *at some future date*, result in the deterioration of the repayment prospects for the credit or affect the institution's credit position.

  These loans do not expose an institution to sufficient risk to warrant classification yet as Bucket 3. Loans that might be classified in this bucket include those for which:

  - Questions exist regarding the condition of and/or control over collateral;

- Economic or market conditions may unfavorably affect the obligor in the future;
- A declining trend in the obligor's operations or an imbalanced position in the balance sheet exists, but not to the extent that repayment is jeopardized;
- Delinquency or loan-to-value ratios are increasing;
- Other indications of emerging impairment risk exist; or
- Loans that, although performing, by their nature have higher risk characteristics (e.g., subprime loans).

*For example:* Assume the Housing Price Index (HPI) decreases for a particular region of the United States, such as the Southwest. A financial institution would review its portfolio of mortgage loans in the Southwest, and for those with higher risk characteristics, such as a high loan-to-value ratio, it would move those pools of higher risk loans to Bucket 2. Not all mortgage loans in the Southwest would have to be moved to Bucket 2, however. In addition, loans identified as impaired would be moved to Bucket 3.

*Allowance:* Since there is not yet a clear indication of impairment, it is too early to reserve for the expected losses over the full life of the loan. For Bucket 2, the allowance amount at each reporting date is equal to 24 months' worth of expected credit losses of the assets or more, if warranted by either macroeconomic conditions or economic conditions specific to a particular type or class of loan. This timeframe corresponds to what most credit risk professionals believe they can predict with reasonable assurance and should be responsive to concerns that the existing reserve methodology produces an allowance amount that is "too little, too late".

- Bucket 3: **Impaired Loans** (the "Bad Book") – Individual and homogeneous pools of impaired loans. A loan is considered impaired when it is probable that a creditor will be unable to collect all amounts due according to the contractual terms of the loan agreement.

  *Allowance:* The allowance for Bucket 3 is the full lifetime expected losses for these loans.

2. Loans would be classified into each category (i.e., Bucket 1, 2 or 3) depending on their credit risk at each period-end. The model would not require banks to track the evolution or deterioration of a particular loan or portfolio over time. We believe that the model proposed above would provide more useful information to investors as they are more interested in reserves required for a financial institution's portfolio at a given point in time (i.e., the balance sheet date). This absolute credit risk model provides greater consistency within an entity's balance sheet and comparability among institutions. Further, one of the most significant benefits of the proposed new approach is that it draws upon and enhances current practices within the financial services industry. In addition, The Clearing House continues to believe that a migration model, such as the relative credit risk model currently being considered by the FASB (which requires an institution to track the performance of an individual loan and pools of loans over time), is not operational for financial institutions.

3. In all cases, the credit losses used as a basis for determining the allowance balance would consider both historical and current information including forward-looking information (i.e., all reasonable and supportable information).

4. We believe there should be a single model that applies to both originated and acquired loans.