May 30, 2013

Via electronic mail

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


Exposure Draft ED/2013/3, Financial Instruments: Expected Credit Losses

Dear Ms. Seidman and Mr. Hoogervorst:

Wells Fargo & Company is a diversified financial services company with over $1.4 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 two exposure drafts, (1) Proposed Accounting Standards Update, Financial Instruments-Credit Losses (Subtopic 825-15) issued by the FASB (the “FASB Proposal”) and (2) Exposure Draft ED/2013/3, Financial Instruments: Expected Credit Losses issued by the IASB (the “IASB Proposal”) (collectively, the Proposed Guidance). We acknowledge the FASB and IASB (collectively, the “Boards”) have separate proposals, but believe there are benefits to providing a single comment letter given the common history in development of the proposals and in an effort to communicate with both Boards on their proposed guidance.

Executive Summary
Wells Fargo supports the efforts of the Boards on the development of a credit loss approach that addresses concerns raised during the recent global economic crisis which highlighted potential shortcomings with the existing credit loss frameworks under U.S. generally accepted accounting principles (“GAAP”) and International Financial Reporting Standards (“IFRS”). The Boards are now at an important juncture, having each proposed significantly different credit loss accounting for those financial instruments which do not yet reflect any indication of credit deterioration – i.e., the “good book”. We believe that it is critical for the Boards to reach a fully converged standard on this issue. Credit loss recognition is a fundamental area of accounting for financial institutions world-wide. It is too important to have diverged
accounting, especially when substantially all financial instruments are in the “good book”. We strongly urge the Boards to find a joint path forward. Our recommendation for achieving convergence is to measure expected credit losses for the “good book” utilizing the greater of 12 months or, if applicable, a longer period which is reliably estimable.

We do not agree with either the recognition of lifetime expected credit losses for good financial assets at the point of inception or the arbitrary limitation on the recognition of only 12 months of expected losses. We believe the foundational principles of the existing credit loss model are conceptually sound and preparers and users can most benefit from targeted refinements rather than replacing the existing model with a new unprincipled model that is incompatible with the accounting framework for other loss contingencies. Rather than a fatal flaw in the existing credit loss recognition framework, the “too-little-too-late” outcome experienced during the recent economic crisis was a product of the application of an overly narrow interpretation of the existing credit impairment accounting standards. We believe this outcome, at least in the U.S., was exacerbated by previously required credit-related loan loss reserve restatements mandated by the U.S. Securities and Exchange Commission (“SEC”). More recently, auditors and the SEC have worked more closely with U.S. banking regulators to avoid any confusion on the recognition of credit losses.

Subsequent to the recent economic recession, financial institutions have refined credit loss estimation processes and enhanced their forecasting capabilities to more fully consider credit quality indicators and environmental factors beyond delinquency information and other loan specific confirming loss events. These improvements have resulted in loss estimates with a reasonable degree of confidence using longer loss estimation periods and a more macro assessment of the likelihood of confirming loss events. We believe strongly that an appropriate accounting principle for recognition of credit losses must continue to be event driven but with more sensitivity to changes in environmental and economic factors. We believe a single fundamental change will address many of the core concerns with the competing proposals of the Boards and maintain the integrity of the conceptual framework of an event driven model for the recognition of loss contingencies. Rather than measuring expected credit losses over the next 12 months or over the remaining contractual life, we recommend that the Boards amend their respective expected loss measurement period to be the greater of 12 months or the period that is reliably estimable and predictable.

This recommendation was included in a letter recently submitted to the Boards by certain members of the U.S. banking industry discussing the importance of the project and further deliberations of the Boards, including our encouragement that the Boards more closely converge on this critical joint project. We recognize a need for compromise between the Boards given the benefits for the marketplace, market participants, users, preparers and prudential regulators. The benefits include improved consistency when comparing the financial results globally without the need for adjustments to normalize different accounting frameworks used to estimate credit losses. In addition, many preparers operate in multiple jurisdictions and a compromise would simplify their accounting and reporting, as well as reduce the overall costs necessary for implementation of multiple new accounting standards.

We have included the U.S. banking industry letter in the attached Appendix A. We strongly urge both Boards to consider this recommendation, along with our additional recommendations in our response, as a basis to improve the existing credit impairment framework.
Specific Comments on the FASB Proposal:
We have the following additional comments for the FASB to consider:

- **Cumulative expected credit loss measurement:** We have the following concerns with the expected credit loss calculation:

  - The FASB proposal undermines the long-standing conceptual framework: The proposed guidance represents a significant change from existing guidance for contingent liabilities. A change to a non-event driven, lifetime expected credit loss impairment framework must be justified on a principled basis. Yet, we do not understand how the FASB is justifying its proposed change without properly articulating the underlying principle or rationale for the unique treatment of financial assets compared to all other loss contingencies. We regard the introduction of a results-oriented accounting standard which lacks any principle based justification, the primary purpose of which is to facilitate earlier and increased loss recognition at initial recognition of a financial instrument, as ill conceived. In addition, the FASB has not satisfactorily addressed why it is abandoning the existing loss model which we believe may just need refinement. In its support for the principles for accounting for contingencies, the FASB asserted that “accounting accruals do not provide protection against losses”\textsuperscript{1}. We agree and are concerned the FASB proposal compromises the fundamental accounting principle that losses are recorded when incurred, rather than when they are estimated to occur in the future. We strongly encourage the FASB to fully explain the principles for credit loss recognition and how different models for recognition of loss contingences are supported by the conceptual framework.

  - The consideration of credit quality is integral to any impairment model: Recognition of credit losses should consider the credit quality of financial assets at each reporting date. The FASB proposal represents a speculative measurement of credit losses that does not consider the credit quality of financial assets at the reporting date. Accordingly, credit provisioning will not be aligned with the underlying credit performance of financial assets. In addition, users will have difficulty understanding portfolio credit quality issues and overall entity performance metrics. While we acknowledge that the IASB proposal does consider changes in credit risk in the determination of the allowance, we do not support limiting to 12 month the loss estimation period for all “good” financial assets if there is a reasonable and supportable basis to utilize a longer period. We are also concerned that the transfer principle is not sufficiently defined to determine when assets that do not exhibit observable evidence of impairment require a lifetime expected loss estimate.

We believe the assessment of credit quality is inherent in effective credit risk management. Credit risk managers are adept at assessing credit quality using common credit risk indicators and portfolio or product characteristics, combined with appropriate loss estimation periods that contemplate expectations regarding current and future economic conditions, to measure expected credit losses that are appropriate based on the point in the credit cycle of a particular asset or portfolio. We believe that a model that measures expected credit losses based on credit quality over the period that is reliably estimable and predictable is superior to either of the proposals as “good” assets would not require immediate recognition of an unreliable estimate of expected lifetime credit loss content.

\textsuperscript{1} FASB Statement No. 5, *Accounting for Contingencies*, basis of conclusions
The FASB proposal may produce a wide range of outcomes: While it is positive that the FASB proposal permits a significant amount of flexibility, attempts by preparers to satisfy the objective of a lifetime loss estimate will likely yield a wide range of potential loan loss allowance estimates. For example, some financial institutions may employ a mean reversion approach that assumes credit losses will never exceed historical loss experience while other institutions may employ a more sophisticated path dependent approach that incorporates different economic assumptions during the remaining contractual life of a financial asset or portfolio of financial assets. Given the significant judgment involved in selecting the methodologies and assumptions to measure lifetime credit losses for assets that do not exhibit signs of impairment, we expect a significant amount of diversity in the application of the proposed guidance that will ultimately inhibit comparability among peers and impair the usefulness of financial information.

While we expect that loan loss allowances under both Board’s proposals to be higher than current levels, we do not believe the proposals will be effective at limiting the pro-cyclicality experienced during the most recent credit crisis. In fact, notwithstanding the protection offered by having a larger base allowance, we believe volatility will still occur and will be exacerbated given the uncertainty inherent in long-term expected credit loss estimates for “good” assets. To avoid this outcome, we are concerned that preparers may be inclined to recognize a large allowance at the transition date that will be adjusted subsequently based on a mean reversion technique rather than a more dynamic estimation of credit losses. We do not believe an impairment framework that exacerbates volatility, inhibits comparability, is not capable of successful back testing and may be subject to abuse due to the wide range of acceptable outcomes represents an improvement.

Credit loss measurement must leverage existing loss estimation practices: Although the FASB expects that financial institutions may continue to leverage existing loss estimation practices, many of these practices are not suitable for long-term expected credit loss estimates. Our loss forecasting models must satisfy rigorous internal and regulatory modeling standards, including demonstrated accuracy in back testing to historical results. As a consequence, our prudential regulators do not support the use of certain models, such as roll-rate models, for lifetime loss estimates. Moreover, given the limitations of certain existing practices relative to a lifetime expected credit loss framework, preparers may struggle to adequately support lifetime loss estimates to the satisfaction of auditors and regulators. Accordingly, in order to meet the lifetime expected credit loss objective of the proposed framework, significant costs will be incurred to develop new models, accompanied by new policies, procedures and applicable controls. We do not believe such costs are justified for a credit impairment framework that will yield less reliable and more volatile results that will be difficult to back test in accordance with internal and regulatory modeling standards.

Income statement presentation does not provide accurate picture of earnings performance: Under the proposed model, all expected loss content will be recognized immediately while interest income will be recognized prospectively. Although there can never be perfect matching of credit losses and interest income, we believe a framework that attempts to match interest income with credit losses is superior to the FASB proposal. Such a framework has been effective because it reflects how risk managers, investors and other users evaluate the lending and investing activities of financial institutions. The vast majority of requests we receive from investors and analysts relate to near-term loss estimates and we rarely receive inquiries related to lifetime expected credit loss estimates. While we acknowledge that information about expected credit losses may be useful on a supplemental basis, we believe users will likely have to adjust historical earnings

- **The use of a best estimate should be permitted:** We apply sound judgment to establish a best estimate based on economic scenarios and assumptions that are used to estimate credit losses. These economic scenarios and assumptions inherently consider scenarios whereby certain assets within a portfolio experience a loss and certain other assets do not. It is unclear whether such a best estimate approach is consistent with the proposed guidance that requires the inclusion of two scenarios; one scenario with a loss and one scenario without a loss. We acknowledge that the FASB incorporated this dual scenario approach to ensure that all financial assets subject to a credit impairment assessment have an allowance; however, we do not believe there is a conceptual basis to support the dual scenario approach nor do we believe that a dual scenario approach is inherently more precise than a best estimate approach. We encourage the FASB to reconsider the decision to prohibit the use of a best estimate or further clarify the guidance to indicate that a best estimate is appropriate if the assumptions and economic scenarios used to calculate the best estimate implicitly consider scenarios with a loss and without a loss.

- **Retain and refine the current impairment model for debt securities:** We believe that the current FASB other-than-temporary impairment (“OTTI”) model for debt securities is functioning well, is widely understood and accepted by financial statement users, and should be retained. In response to user concerns, the OTTI model has undergone several refinements\(^2\) that permit the disaggregation of credit risk separately from non-credit risk and provide greater transparency to the credit impairment process for debt securities. In addition, existing disclosures for impairment measurement and unrealized gains and losses have been well received by users and have been effective tools for providing sufficient risk information related to debt securities. To enhance the existing OTTI model, we encourage the Boards to consider the following modest refinements:
  - Align the credit impairment model with the classification categories defined in the recent classification and measurement exposure draft\(^3\) such that all financial assets measured at fair value through other comprehensive income (“OCI”) would be subject to the OTTI model;
  - Permit the assessment of OTTI on a homogenous pool basis as well as on an individual asset basis;
  - OTTI estimates should be recorded through a valuation allowance rather than a basis adjustment; and
  - Both favorable and adverse changes in OTTI estimates should be immediately recognized in earnings.

These suggested modifications will reduce complexity of the model, yield substantially similar impairment results compared to the current model and provide consistency with respect to the recognition of changes in credit loss estimates with the impairment model for loans.

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\(^2\) Most recently, FASB Staff Position FAS 115-2, *Recognition and Presentation of Other-Than-Temporary Impairments* and FASB Staff Position FAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability has Significantly Decreased and Identifying Transactions that are Not Orderly*

\(^3\) FASB Proposed Standards Update, *Financial Instruments – Overall (Subtopic 825-10), Recognition and Measurement of Financial Assets and Financial Liabilities*
 practical expedient related to financial assets measured at fair value through OCI: We believe the practical expedient proposed by the FASB is too narrow in scope and will ultimately require preparers to quantitatively estimate impairment for a significant number of financial assets, even though they exhibit little or no sign of credit deterioration. Financial institutions typically have investment portfolios that contain a significant amount of available-for-sale debt securities. We are concerned that the practical expedient, as proposed, will result in the asymmetrical treatment of similar instruments, increase the cost and burden to produce expected loss estimates that are insignificant and will generate misleading financial results.

For example, consider identical securities purchased on different dates at different prices. One security may be eligible for the practical expedient while the other security may not simply due to a difference in purchase price rather than fundamental credit factors. Likewise, during a rising interest rate environment, high quality financial assets may not be eligible for the practical expedient due to changes in fair value related to non-credit factors. Accordingly, we encourage the Board to revise the practical expedient to eliminate the requirement that fair value of an individual financial asset exceed its amortized cost. This modification would exclude financial assets in an unrealized loss position due solely or primarily to non-credit related factors from the assessment of impairment. This change would allow preparers to dedicate time and resources on evaluating financial assets with credit losses that are expected to be more than insignificant, while providing users with decision useful information on financial assets that could potentially experience significant credit losses in the future.

Alternatively, if the FASB does not wish to exclude all financial assets in an unrealized loss position due solely or primarily to non-credit factors, we recommend permitting the application of the practical expedient to all “high quality” financial assets. Existing SEC guidance defines high quality debt securities as debt securities with credit ratings of “AA” or higher. If this definition is incorporated into the proposed guidance, we believe the practical expedient could be applied to all “high quality” financial assets, regardless of whether fair value exceeds amortized cost. Accordingly, the practical expedient would include a rebuttable presumption that any changes in fair value of high quality financial assets are related to non-credit factors, which more closely aligns with current OTTI model.

Purchased credit-impaired (“PCI”) financial asset: We support the proposed improvements to the PCI model that require (i) the establishment of an allowance for credit loss at acquisition and (ii) the immediate recognition in earnings of both favorable and adverse changes in expected credit losses. However, we do not support the application of the PCI model to debt securities, which should retain the existing OTTI model, as potentially modified by our suggested refinements. Also, we believe the definition of PCI should be modified to remove the requirement for significant deterioration, which would make the definition consistent with current accounting. The inclusion of the significant threshold would unnecessarily limit the number of loans qualifying for this proposed guidance.

The historically different models for PCI loans and non-PCI loans inhibit comparability and have been a source of confusion for analysts and investors. For example, portfolios of similar credit quality may have very different allowance profiles simply because they were acquired rather than

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4 Speech given by John M. James, Professional Accounting Fellow, Office of the Chief Accountant, U.S. Securities and Exchange Commission, at the 2003 AICPA National Conference on Current SEC Developments in Washington, DC
originated. Accordingly, we encourage the FASB to expand the PCI accounting model to apply to all loan acquisitions, including non-PCI loans, whether loans are acquired individually or in a business combination. The application of the proposed PCI accounting model to all loans would eliminate this confusion and provide a uniform accounting framework for all loans.

- **Nonaccrual principle:** Nonaccrual accounting principles are not articulated in the current GAAP codification, but instead are included in guidance issued by prudential regulators. This regulatory guidance requires the placement of loans on nonaccrual status when payment in full of principal and interest is not expected. The FASB proposal contains similar concepts to the current regulatory guidance but instead requires the placement of loans on nonaccrual status if it is probable that an entity will not receive substantially all of the principal or interest. Accordingly, under the FASB proposal, if a creditor expects to collect substantially all, but not the entire loan principal balance, it would not be necessary to place the loan on nonaccrual status. However, regulatory guidance would require placement of the loan on nonaccrual if any amount of principal or interest was not expected, thus creating a potential difference between regulatory accounting principles and GAAP.

These proposed changes would be significant particularly in the area of credit card loans which are charged off in their entirety, at either 120 days past due for closed-end loans or 180 days past due for open-end loans. As existing regulatory nonaccrual principles are generally well understood by both preparers and investors, we do not believe the effort and costs to modify loan accounting systems and processes to maintain two sets of books in order to comply with two different sets of non-accrual principles can be justified. We request that the FASB more closely align their proposal with current regulatory guidance, so as not to conflict or create changes to these principles and interpretive guidance.

In addition, the interest income recognition guidance related to PCI assets proposed by the FASB does not address whether nonaccrual treatment applies to such assets. As discussed above, the proposed changes on nonaccrual status include expectations regarding principal collection, but the FASB proposal does not address whether the definition of principal is (a) original principal, (b) remaining principal at time of nonaccrual consideration or (c) for PCI assets, principal expected to be collected at acquisition. We believe PCI assets should be placed on accruing status at acquisition because the acquisition price already excludes the amount of principal that is not expected to be collected. The FASB should clarify their proposal related to interest income recognition on PCI assets.

Impairment for many financial instruments, such as debt securities and modified impaired loans, is generally measured based on the present value of expected cash flows, discounted at the effective interest rate. Recognition of interest income is necessary in order to accrete the amortized cost basis of the instrument to the cash flows expected to be collected. The impairment measurement already excludes the contractual cash flows that an entity does not expect to collect. Placing these instruments on non-accrual status would inappropriately defer interest income until sale or maturity, or result in recognition of interest at a rate that differs from the effective interest rate of the instruments. We encourage the FASB to exclude financial instruments for which impairment is measured using a discounted cash flow approach from the proposed nonaccrual guidance.
Troubled debt restructurings (“TDR’s”): We do not believe the TDR designation provides decision useful information to investors, analysts, or creditors. We believe that robust disclosures relating to significant loan modifications are more useful than focusing on a specified group of loan modifications. Accordingly, we encourage the FASB to replace the existing TDR designation and related disclosures with disclosures of significant loan modifications, i.e., principal or interest reductions. With the addition of credit quality disclosures in recent years, we believe that investors and analysts have necessary information to assess the risk and quality of the loan portfolio. Removal of the TDR designation would more closely align the FASB disclosures with IFRS loan modification disclosures, where the TDR designation does not exist.

If the FASB retains the TDR designation, we recommend that the FASB include clear guidance on when a TDR can be removed from that classification. The “once a TDR, always a TDR” accounting principle may no longer reflect the current credit quality of a loan and/or the financial condition of the borrower. If the intent of the TDR designation is to focus on loans which have a higher probability of default in the near term, the inclusion of loans with sustained periods of performance dilutes that focus.

The FASB proposal requires a write-off of the adjustment between the amortized cost basis of the investment and the present value of the newly expected cash flows. This is a significant change from current U.S. GAAP which permits the use of a valuation allowance for any amounts between the recorded investment of the asset and the present value of expected cash flows. Accordingly, we are concerned that the FASB proposal will preclude the recovery of prior write-downs until the resolution of the financial asset. Under current practice, charge-offs are typically recorded when troubled borrowers are offered concessions such as principal forgiveness, as the concessions represent amounts that will not be collected. However, in many other situations, the allowance for credit loss is simply dependent on assumptions that estimate the timing and amount of expected cash flows, in which case the use of a valuation allowance appropriately permits the immediate recognition of favorable changes in expected cash flows in subsequent reporting periods. Additionally, the proposed guidance may be difficult to apply as it is often difficult to estimate a write-off at the individual loan level for loans aggregated in pools. As the rules that govern the recognition of a charge-off or charge-down of loan principal are already addressed by regulatory accounting principles, we encourage the FASB to eliminate the requirement to write-off the adjustment between the amortized cost basis of the investment and the present value of the newly expected cash flows.

Collateral dependent financial assets: We believe the FASB proposal would significantly expand the amount of collateral dependent assets based on the revised definition. Currently, GAAP and regulatory principles are generally aligned which allows an option to estimate credit losses using the value of the underlying collateral if repayment is expected to be provided solely by such collateral. The FASB proposal permits the use of collateral value as a practical expedient to calculating expected credit losses when repayment of the asset is expected to be made primarily or substantially through the operation (by the lender) or sale of the collateral. Given the fact that many borrowers will continue to make payments even when collateral is in place to support their loans, there are limited situations where the underlying collateral is the sole method of repayment until a borrower is delinquent and the loan is progressing toward foreclosure. An expansion of the definition would significantly increase the number of collateral dependent loans where there is consistent payment performance. We do not understand the reason for the proposed change to current guidance and

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5 Paragraph 310-40-35-10, as further explained in BC 45-47
practice and thus, we believe that the FASB should retain the existing definition of collateral dependent loans.

- **Credit card and other revolving loans:** The proposed guidance requires entities to estimate expected credit losses over the full contractual period over which the entity is exposed to credit risk. This can be a complex undertaking for instruments such as credit card and other revolving loans. Credit card loans often do not have expiration dates and borrower behavior adds complexity to the analysis. Transactors repay their outstanding balance in full on a monthly basis and these borrowers have a shorter average life. Revolving borrowers maintain a balance, which normally generates a longer loan life. However, many borrowers are inconsistent in their behavior, and may transact for many months, but periodically revolve. Accordingly, these two borrower segments are not static or consistent even in a stable economic environment.

  The estimation process is further complicated by the fact that during periods of economic stress, transactors may become revolvers and revolvers may reach loss more quickly, thus reducing their average life. For these reasons, we believe it is difficult to estimate credit losses over a long period of time for evergreen these types of products. In addition, many revolving commercial loans have shorter-term maturities (1 to 2 years) with automatic or expected renewal options. It is unclear how the proposed guidance should be applied in these situations as the actual contractual life of the instrument may be shorter than the expected “lifetime” of the lending relationship with the customer. The implementation issues associated with the calculation of lifetime expected losses for credit card and other loans should be addressed in supplemental implementation guidance, in order to ensure consistent application among financial institutions.

- **Time value of money:** We do not support the inclusion of a time value of money (“TVM”) principle in the FASB proposal. While we agree that TVM is inherent in the original amortized cost measurement and that estimating a loss by referencing the amortized cost measurement may inherently reflect some discounting, since timing of expected losses is not always built into current credit loss estimation models, we are concerned that the inclusion of the TVM principle will result in interpretive risk to preparers without providing real practical benefit to the financial statement users. Accordingly, we believe the FASB should characterize current credit loss estimation methods as “acceptable alternatives” to approximate the present value under a discounted cash flow model, rather than as methods that implicitly reflect the time value of money. We acknowledge the clarification of the Board in the recently issued Q&A document\(^6\) which explains that an entity would not be required to prove that a method that implicitly reflects the time value of money provides the same result as (or reconciles with) a method that explicitly reflects the time value of money and encourage the FASB to include this clarification in the final guidance. Since the inclusion of TVM makes several assumptions that may not be present in current credit loss estimation processes, we are concerned that without this clarification, auditors will require preparers to substantiate the assertion of the Board that current methodologies implicitly reflect TVM.

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\(^6\) Proposed Accounting Standards Update, *Financial Instruments—Credit Losses (Subtopic 825-15)-Frequently Asked Questions, March 25, 2013, Question No. 16*
Specific Comments on the IASB Proposal:
We have the following additional comments for the IASB to consider:

- **12 Month expected credit loss calculation:** We have the following concerns with the 12 month expected credit loss calculation:
  
  - **Conceptual basis for limiting expected losses to 12 months:** While we are supportive of a floor equal to 12 months of expected credit losses for “good” assets, we do not believe there is a conceptual basis to limit the allowance measurement to 12 months of expected credit losses, particularly when confirming loss events can be estimated with reasonable confidence. Because U.S. financial institutions often utilize longer loss emergence periods for commercial loans and certain consumer loans, the IASB Proposal may result in lower loan loss allowance balances for certain portfolios than management believes are prudent. Accordingly, we do not believe the IASB proposal represents an improvement over the current incurred loss model.

  - **Definition of default:** The IASB proposal does not define the term “default” beyond stating that an entity must have a consistent definition of default. Consequently, different definitions of default may be used among entities or among asset classes. For example, the definition of default could be based on a payment default (contractually due payment is not made) or a technical default (contractual payments may have been made, but a contractual provision has been breached), which will likely yield different loss estimates. For “good” assets, U.S. financial institutions estimate losses based on future charge-offs which can be reliably estimated over appropriate loss emergence periods that consider credit quality and environmental factors beyond just delinquency information. We are concerned that without a consistent definition of default, credit loss estimates will lack comparability among institutions and asset classes and delay the timely recognition of credit losses.

  - **Measurement of 12 months of expected losses:** Existing loss estimation techniques commonly used by U.S financial institutions for “good” assets are not consistent with a lifetime probability of default expected over the next 12 months. In addition, we are concerned with the operational complexity of ensuring the estimate of 12 month expected credit losses only includes losses that result from a default in the next 12 months and also excludes losses that result from any subsequent defaults outside of the same 12 month period. U.S. financial institutions do not utilize a combined 12 month probability of default and lifetime loss given default methodology. Imposing this new approach will be costly for U.S. preparers without any measurable improvement compared to existing methodologies.

- **Transfer principle:** Notwithstanding the lack of definitions for default and a significant deterioration in credit risk, we believe credit deterioration needs to be interpreted more broadly, such that any event with an impact on credit risk should be viewed as sufficient to require the transfer to stage 2 for impairment measurement. In that case, we question the need for a differentiation between stages 1 and 2 if expected losses are measured based on the period that is reliably estimable and predictable. This is because this period would consider the credit quality of financial assets at the reporting date, along with reasonable and supportable assumptions regarding current and forecasted events and conditions. Accordingly, the credit loss estimate would capture expected credit losses for stage 1 and stage 2 assets and all of the expected credit losses for stage 3 assets as loss content tends to materialize earlier rather than later in the life of a financial asset.
Assessment of a significant increase in credit risk: The current incurred loss model has often been criticized as many believe the rigid assessment of probability prevents the timely recognition of inherent credit losses. We are concerned that the concept of “a significant increase in credit risk” will perpetuate this problem. The proposed guidance, which requires an assessment of the relative change in probability of default from initial recognition to the reporting date, does not clearly define what qualifies as a significant change. Consequently, preparers will need to develop their own definitions of significant as the recognition threshold for lifetime credit losses. This ambiguity may lead to different interpretations among institutions, adversely impacting consistency and comparability, as well as a potential delay in the timely recognition of credit losses. To mitigate these risks, it is likely that prudential regulators will narrowly define a significant increase in credit risk.

Tracking credit deterioration: The proposed guidance does not permit an absolute evaluation of credit risk as of the reporting date. Consequently, it is possible that financial instruments with higher credit risk may carry an allowance based on 12 months of expected losses, while other financial instruments with lower credit risk may carry an allowance based on lifetime expected credit losses. Moreover, the requirement to track credit deterioration since the period of inception elicits concern that this evaluation must be performed on an asset-by-asset basis. Such an assessment would be operationally challenging and will likely require costly updates to risk management systems. We believe the most appropriate and operational solution for any transfer requirement would be to align it as closely as possible with current credit risk management practices and systems.

Practical expedient for assets with low credit risk: We believe it will be difficult to conclude that a financial asset has low credit risk in order to avoid the transfer to a lifetime expected loss measurement. The second criterion requires an evaluation of any adverse economic condition or change in circumstances that would lead to at most, a weakened capacity of the borrower to meet its obligations. Given the most recent economic crisis, it would not be unreasonable to envision extreme scenarios where even the best-quality borrower would fail to meet its obligations.

Selection of discount rate: We do not support the ability to choose any reasonable discount rate between and including the risk-free rate and the effective interest rate. We believe use of the effective interest rate most appropriately isolates changes in credit risk when the time value of money is explicitly considered in the impairment measurement. The ability to choose the discount rate will cause the size of the allowance to be sensitive to non-credit related factors.

Interest income recognition: The IASB proposal requires a different interest income recognition method, which is based on the net carrying value, for stage 3 assets. We do not understand the rationale for this treatment or how this approach would be applied to stage 3 assets when the impairment measurement is based on the present value of expected cash flows, which by definition, already excludes cash flows that are not expected to be collected. We believe interest income recognition should be based on contractual interest income, adjusted for deferred fees and costs, coupled with a nonaccrual principle when relevant. Because the IASB Proposal does not include a nonaccrual principle, we are concerned about differences in reporting that may exist between financial reporting to investors and reporting to prudential regulators that establish existing nonaccrual guidance. While we understand that there are multiple regulatory jurisdictions that may be subject to the IASB proposal, we ask that the IASB consider aligning their proposal with relevant jurisdictional regulatory guidance.
Other matters: The following comments relate to similar concerns expressed on the FASB proposal. Please refer to the related comments in the section entitled Specific Comments on the FASB Proposal for more detailed description of our concerns.

- **Impairment model for debt securities:** We believe that the existing FASB OTTI model, with our suggested modifications, is the most appropriate methodology to assess the impairment of debt securities. We encourage the IASB to adopt the FASB OTTI model with our suggested improvements.

- **PCI assets:** We strongly support the FASB proposal to establish an allowance for credit loss at initial recognition. Based on our experience with PCI assets, the IASB proposal to net the initially expected credit losses against the carrying value will perpetuate investor confusion regarding the inherent credit risk associated with PCI assets relative to non-PCI assets. The FASB proposal would reduce the complexity of disclosures and improve user understanding of PCI assets. We have also noted that the PCI model should not be applied to debt securities and we recommend changes to the PCI definitions for consistency of application to existing accounting guidance.

- **Time value of money:** The IASB Proposal requires an explicit reflection of TVM in the credit loss measurement. However, the FASB Proposal permits the use of estimation methods that implicitly consider TVM, which permits entities to leverage existing credit loss models. We recommend that the IASB permit preparers more flexibility the consideration of TVM, and to the extent implicit consideration is allowed, clarify in the final guidance that preparers would not be required to prove that a loss estimate that implicitly considers TVM will not produce the same result as a loss estimate that explicitly considers TVM.

- **Use of a best estimate:** While the IASB requires the usage of the best available information in estimating credit losses, there is a specific prohibition against a single estimate based on the judgment of management. We believe the IASB should re-consider or clarify that management may use a single estimate if the assumptions and economic scenarios used to calculate such an estimate implicitly consider scenarios with a loss and without a loss.

**Specific Comments Related to Both Proposals:**
We have the following additional comments for each of the Boards to consider:

- **Presentation and disclosures:** We agree that the financial statements should include information that enables users to understand the credit risk and how that risk is managed. However, we are concerned that many of the proposed disclosures exceed this objective and may duplicate existing disclosures. We believe that the best way to provide investors with relevant and reliable information is to base the disclosures on information used by management to manage credit risk that is tailored to the nature of the portfolios of debt instruments, including distinguishing between loans and debt securities.

The roll forwards of debt instruments measured at amortized cost and fair value through OCI are examples of disclosures which would be extremely burdensome to prepare with little additional value to users. While we agree that a debt instrument roll forward would provide some limited information as to volumes of new loans and prepayments, most of this information is already available in the cash flow statement and in the year-end and quarter-end balances, as well as disclosures that have been
added over the years such as those which require disclosure of significant sales, purchases or reclassifications of financing receivables.

We agree with a recent industry article\textsuperscript{7} that raised concerns over the quantity and complexity of financial disclosures. Both Boards are engaged in separate projects to evaluate the quality and complexity of disclosures. Although reducing the volume of the disclosures in the notes to the financial statements is not the primary focus of the projects, the Boards believe a sharper focus on important information will result in a reduced volume of disclosures. With that in mind, we believe that the any additional credit disclosures should be postponed until such disclosures are evaluated in connection with the respective disclosure framework projects of each Board. As part of this evaluation, we recommend that the Boards consult with its constituents for input as to which disclosures provide the most value. Representatives from the regulatory agencies, financial institutions, investors, and analysts should be invited to participate in these roundtable discussions. After these discussions, the Boards will be able to craft disclosures which balance the value of the disclosures against their cost.

- **Effective date and transition:** Given the complex and pervasive nature of the proposed guidance we request a 3 year transition period from the effective date to implement the final guidance and should be aligned with the effective date of the proposed guidance on classification and measurement. This time frame is necessary to allow for development of credit loss forecasting models to comply with the proposed guidance as well as the accumulation of historical and other data for use in the loss estimation process. In addition, this time frame would allow for creation of new financial reporting processes to generate the required presentation and disclosures.

We agree with the transition provision in the FASB proposal that would require a cumulative-effect adjustment to the statement of financial position as of the beginning of the first reporting period in which the guidance becomes effective. We believe a cumulative-effect adjustment is preferable as it does not require institutions to incur significant costs or deploy additional resources to restate prior periods. In addition, for guidance that relates to a highly subjective area such as the estimation of expected credit losses, we believe that there is the potential for actual experience and hindsight to taint the expectations that would have been developed for those prior periods. We believe that specific transition guidance should be given in the following areas:
- Whether a loan can be removed from PCI classification given the revised definition in the proposed guidance or based on the performance of the PCI loan since acquisition;
- Whether any remaining nonaccretable difference amounts transfer directly to the new allowance for PCI loans (FASB) or recognized as a basis adjustment to the carrying value (IASB);
- Whether previously recorded OTTI should be reversed to OCI to establish a valuation allowance at transition, and
- Whether existing valuation allowances for TDRs should be charged-off at transition (FASB specific).

- **Interaction with prudential regulators:** We believe more dialogue with prudential regulators and other policy makers is necessary given the current rulemaking activities related to Basel 3. We are concerned with the overall implications to regulatory capital and related financial ratios of financial institutions broadly, as well as the potential disparate impacts to domestic and international financial institutions subject to very different credit loss models. We encourage the Boards to more fully

\textsuperscript{7} 2011 KPMG article, *Disclosure Overload and Complexity, Hidden in Plain Sight*
evaluate the impacts of the proposed guidance with the prudential banking regulators in connection with the deliberations to more closely converge the proposed credit loss frameworks.

**Conclusion**
We are concerned that the Boards have proposed very significant and fundamental changes to the accounting credit impairment for financial instruments that undermine the conceptual framework for loss contingencies and which are not consistent with the economic characteristics of the underlying financial instruments and related risk management practices. We continue to believe convergence in this area is critically important to maintain consistency and comparability among financial institutions globally. Accordingly, we strongly encourage the Boards to renew their cooperation and incorporate the banking industry recommendation, along with our additional recommendations in this letter, into their respective proposals.

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We appreciate the opportunity to comment on the issues contained in the proposed guidance. 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: Paul Beswick – 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
David Wagner – The Clearing House
May 10, 2013

Via electronic mail

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:

In an increasingly global financial marketplace, market participants, users and prudential regulators all recognize the need for a common set of high quality accounting standards related to credit impairment. While we acknowledge the difficulty inherent in reconciling disparate points of view, we strongly encourage the Boards to achieve convergence on what we believe is the most important MOU project. Although we continue to support an event-driven accounting framework for recognizing credit losses consistent with the proposal previously provided by members of the U.S. banking industry, we acknowledge the need for a balanced approach that will broadly appeal to numerous constituents. While a converged standard may not necessarily lead to fully comparable results in practice, the differences between the models proposed by the Boards are far too great and will generate vastly different results. Ultimately, we believe compromise will be necessary by both Boards in order to achieve a converged credit impairment standard. We strongly encourage the Boards to renew their cooperation on this critically important matter.

There are several differences between the proposed models and we have several concerns with each of the proposed models. However, we believe a single fundamental change will help facilitate a compromise between the two Boards while simultaneously addressing many of the core concerns with the proposed models. Rather than measuring expected losses over the next 12 months or over the remaining contractual life, we recommend that the Boards amend the expected loss measurement period to the greater of 12 months or the period that is reliably estimable and predictable. Such a compromise will have the following benefits:

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8 In April of 2011, Several members of the US banking industry proposed an alternative credit impairment model in response to the Supplementary Document: Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities: Impairment
The conceptual basis for the recognition of credit losses would be maintained as credit quality would be more fully considered in the determination of the estimate of credit losses. Credit quality can be evaluated with commonly used credit quality indicators and portfolio and product characteristics, combined with appropriate loss estimation periods that contemplate expectations regarding current and future economic conditions. As a result, performing assets would not require immediate recognition of a less reliable estimate of expected lifetime credit loss content.

The period that is reliably estimable and predictable would capture a substantial portion of expected credit losses for performing assets and all of the expected credit losses for non-performing assets as loss content tends to materialize earlier rather than later in the life of a financial asset. Moreover, during stressed economic environments, allowance levels would not be adversely impacted as expected credit losses should emerge more quickly and would already be reflected in the allowance, supplemented by oversight provided by internal risk management and prudential regulators.

The reliability of expected credit loss estimates would be improved, particularly for long tenor and evergreen assets. Credit risk managers would be better able to validate and back test estimates to their satisfaction and to the satisfaction of banking regulators and auditors. Loss forecasting models must satisfy rigorous internal and regulatory modeling standards, including demonstrated accuracy in back testing to historical results. Accordingly, reliable and predictable credit loss estimates would be measured in a well-controlled environment with a reasonable level of confidence.

Existing loss estimation techniques could be leveraged. Many existing loss estimation methodologies are not suitable for long-term loss estimates and would not satisfy prudent model risk and validation requirements. Limiting the loss estimation period to the period of time which is reliably estimable and predictable would retain the ability of financial institutions to utilize many existing methodologies and retain the ability to capture all or a substantial portion of the expected loss content. Moreover, this would allow smaller, or less sophisticated, institutions to develop and implement loss estimation techniques that meet the standard.

The measurement of losses over the remaining contractual life may adversely impact lending and directly inhibit long-term investment, which is an explicit factor that will be critically evaluated by the Financial Stability Board in their assessment of the implications of accounting standard setting. We believe this compromise will resolve this potential unintended consequence.

The reliably estimable period will allay concerns that limiting measurement of expected credit losses to just 12 months would perpetuate the “too-little-too-late” concerns associated with the incurred loss model.

An explicit transfer principle, as proposed by the IASB, would not be necessary as the period that is reliably estimable and predictable would, as noted above, consider the credit quality of financial assets at the reporting date, along with reasonable and supportable assumptions regarding current and forecasted events and conditions.

The ability to scrutinize the judgments of management through transparent disclosure of the assumptions used to measure expected losses, including the period that is reliably estimable and predictable, by asset class, will allay concerns related to earnings management and ultimately promote and improve comparability and consistency among preparers.

All parties agree that convergence on credit impairment is critically important. Accordingly, we encourage the Boards to renew their cooperation and consider incorporating our recommendation into their respective proposals. We acknowledge that no accounting model will completely resolve pro-
cyclical reserving concerns and loss estimates and estimation periods may vary, by product and across organizations. However, we believe that consistent practice will develop quickly through robust disclosure, coupled with the existence of proper risk governance and regulatory oversight. We believe our recommendation has a solid foundation in existing credit risk management practices in our industry, will more reliably reflect credit losses expected in the portfolio, better align recognition of credit losses to those periods where credit losses are expected in the portfolio, and provide more decision useful information about expected credit losses for investors and other users.

Sincerely,

Ally Financial Inc. RBS Citizens Financial Group, Inc.
Bank of America Corporation Regions Financial Corporation
Capital One Financial Corporation State Street Corporation
Citigroup Inc. SunTrust Banks, Inc.
Comerica Incorporated The PNC Financial Services Group, Inc.
JPMorgan Chase & Co. Wells Fargo & Company
KeyCorp Zions Bancorporation

Morgan Stanley

cc: Paul Beswick – 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
David Wagner – The Clearing House