Comerica Incorporated

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Muneera S. Carr
Executive Vice President and
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July 20th, 2016

Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116
Attention: Ms. Susan Cosper, Technical Director


Dear Ms. Cosper:

Comerica Incorporated (“Comerica” or “we”) appreciates the opportunity to comment on the Financial Accounting Standards Board’s (the “Board”) Exposure Draft of the Proposed Accounting Standards Update – Intangibles – Goodwill and Other (Topic 350): Simplifying the Accounting for Goodwill Impairment, issued May 12, 2016 (the “Exposure Draft”). Comerica is a financial services company headquartered in Dallas, Texas. As of June 30, 2016, we were among the 50 largest U.S. banking companies, with total assets of approximately $71 billion, total deposits of approximately $56 billion, total loans of approximately $50 billion, and total shareholders’ equity of approximately $8 billion. As of the same date, Comerica reported approximately $635 million in goodwill. We perform the two step test on at least an annual basis and perform the qualitative assessment when certain events occur that may be indicative of impairment.

Comerica appreciates the Board’s efforts to continuously improve accounting standards and supports the current project to explore ways to enhance the goodwill accounting model and the financial information it provides. We are pleased to comment on this matter and encourage the Board to explore Phase 2 of the project by further developing different alternatives for improving the current model, evaluating the relative benefits and costs of each alternative and seeking feedback from preparers and users of financial information.

General Observations

The Harvard Business Review article¹, “What’s the True Value of an Acquisition?” provides a good overview of pricing for acquisitions and how acquirers determine the value of a target and the control

1 https://hbr.org/1999/07/are-you-paying-too-much-for-that-acquisition
premium they are willing to pay. This article is consistent with our experience from our last acquisition, including how management analyzed the transaction and the questions we received from our investors. We cite this article because we believe that it highlights the differences between the view investors, markets and management teams have of an acquisition when compared to the accounting representation of the same transaction. The difference is not just in how the value of the transaction is initially measured but also in the timeframe of the perceived benefit of the transaction.

Under normal circumstances, the purchase price of an acquisition will nearly always be higher than the intrinsic value of the target company. Accounting guidance views an acquisition as the purchase of assets and assumption of liabilities with determinable fair values on the date of the acquisition. The difference between the transaction price and the fair value of the acquired assets and assumed liabilities is recorded as goodwill, which is subsequently evaluated for impairment. On the other hand, management teams, investors and analysts focus more on the underlying business, related cost savings, revenue opportunities, overall synergies and economic impact of the transaction. As stated in the article, “Acquirers generally base their calculations on five types of synergies: cost savings, revenue enhancements, process improvements, financial engineering, and tax benefits.” The value of the target reflected in the control premium is based on the overall value paid for these synergies as opposed to a static fair value of the balance sheet on the date of acquisition.

Similarly, to compare the price of the acquisition relative to other acquisitions in the market, most stakeholders gravitate to the price paid as a percentage of tangible book value. While this is a point in time measure, it is based on the acquiree’s tangible book value, not on fair value assigned by the acquirer. These examples illustrate what key stakeholders consider to be useful information, and do not incorporate goodwill. In fact, during its recent deliberations, the Board noted that goodwill is often disregarded by financial statement users.

Regarding timeframe, in our experience, the success of an acquisition depends upon how long it takes for the acquisition to become accretive to earnings per share; that is, the time it takes for additional income generated by the acquisition to outpace the dilutive effect of shares (or other value) issued as part of the transaction. Deals that become accretive within 3 years are generally viewed favorably when compared to deals that require more time to do so. In the accounting world, goodwill may continue to be viewed as an indefinite-lived intangible long after the benefits of the transaction are fully reflected in the earnings power and stock price of the acquirer.

**Stakeholders’ view of subsequent measurement**

Not only do analysts and other stakeholders not find the goodwill measurement useful at acquisition, it is also not essential to their view of ongoing valuations of companies. This fact was noted in the Board’s recent deliberations. Analysts and other stakeholders evaluate entities using discounted cash flows, earnings multiples or residual income and do not incorporate goodwill into those models. From a regulatory perspective, goodwill is subtracted from a bank’s regulatory capital and capital adequacy calculations. Like analysts, regulators do not assign much value to goodwill, as indicated by the fact that regulatory capital ratios, which are key indicators of an institution’s financial health, disregard it. This is further evidence that key stakeholders do not place importance on goodwill in their assessment of value and financial health.
Accounting model inconsistencies

We observe certain inconsistencies with the current accounting model that may contribute to its lack of usefulness to users of financial information. For example, most other assets acquired in a business combination have finite lives and GAAP prescribes methodologies for derecognizing them as they are consumed by the acquirer. However, goodwill, a residual asset whose initial value is derived from the fair value of all other assets, can only be derecognized through impairment of the entire reporting unit. As a result, goodwill often continues to be recognized on the balance sheet well after the acquired assets that originated it have been consumed. As the target is fully integrated into the acquirer over time, it becomes difficult for stakeholders to ascertain how the remaining goodwill on the balance sheet will generate value for the entity.

Further, certain aspects of the current model may delay the timing of impairment recognition because impairment from unsuccessful acquisitions may be disguised by more successful acquisitions or strong general financial performance of the acquirer. This is because the basis for measurement of goodwill changes from the acquisition date (where it is based on the fair value of the acquired assets related to the transaction price) to subsequent calculations for impairment purposes (where measurement is based on total economics of the reporting unit). Given the change in the unit of account to measure goodwill from the target to the reporting unit, a subsequent impairment of goodwill may not accurately measure the success or failure of an acquisition, or whether or not the value paid for the acquisition was appropriate. Lastly, the change in the unit of account also results in a possible recognition lag and may be a contributor to the perception by stakeholders that impairment is not a leading indicator to the market that the entity may be undergoing financial difficulties, but instead is a confirmation that financial difficulties were already present.

One final accounting model inconsistency that exists today is the difference between the treatment of goodwill post acquisition by private companies and public companies. Under the recently issued Accounting Standards Update (ASU) No. 2014-02, Accounting for Goodwill, private companies may elect to both amortize goodwill and apply a simplified goodwill impairment test. We understand the need the Board and the Private Company Council were addressing in issuing this update and are supportive of the outcome for private companies. However, we believe it is worth considering whether the accounting models for private and public entities should be aligned or whether there is sufficient merit in maintaining two different models.

Limitations and Challenges with Step 1

Evaluating goodwill for impairment is a complex exercise involving numerous assumptions with high degrees of estimation uncertainty that require extensive analysis, review and documentation. Assumptions that are basic to any valuation require a significant amount of judgment and can produce vastly different results. For example, the income approach (also referred to as the discounted cash flow model) uses long-term forecasts that include an estimation of value into perpetuity. These forecasts rely on underlying economic assumptions projected far into the future (often five years or longer), reducing their reliability. The current economic environment is a prime example. Interest rates have been at historic lows since the
latest recession. However, it is likely that most valuation models over the last 8 years incorporated some estimate for a rate increase in their forecasted periods. This example illustrates how unreliable long-term economic projections are, yet management teams are asked to make these estimates at least annually to defend an accounting measurement that, for the most part, appears to be overlooked. On different topics, such as impairment of financial instruments under the recently issued ASU 2016-13, *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*, where the Board has acknowledged that there is a limit to “foreseeable future” and made provisions for the uncertainty in the estimate accordingly.

In the case of the market approach, there is significant judgement that can impact the outcome of a valuation. Typically, the market approach requires the use of comparable measurements to peer or guideline companies within the industry. Many companies are diversified in their business lines and finding an appropriate guideline or peer company that is similar to a single reporting unit and not the full company can be a challenge. For example, finding a company that specializes only in wealth management or retail banking and that does not include commercial banking can be difficult.

With the background of perceived minimal use of goodwill by key stakeholders and inconsistencies within the model, we struggle to understand the burden placed upon preparers such as Comerica to periodically evaluate goodwill for impairment. In all, performing Step 1 of the goodwill impairment analysis is an exercise that spans over several weeks and requires resources from Finance, Treasury, Accounting, Forecasting, Economics and Corporate Valuation. It also requires significant involvement from our auditors, increasing the cost of our audits. Local audit engagement teams must often involve valuation experts, further increasing the cost and time consumed by the exercise. Hence, it is discouraging, if not frustrating, to think that the only users who are interested in the goodwill process are accountants. In light of this, we urge the Board to proceed with Phase 2 of this project with the goal of a better alignment between accounting requirements and the needs of users of the financial statements.

**Specific Observations on the Exposure Draft**

We strongly encourage the Board to proceed to Phase 2 of the project before concluding on Phase 1. As the scope of the second phase appears to be broader than the first phase, we do not think that it is appropriate to remove Step 2 from the valuation model at this time. However, if the Board chooses to conclude on Phase 1 prior to commencing Phase 2 of the project, we have included below our observations on specific aspects of the Exposure Draft for the Board’s consideration.

**Proposed amendments to Step 2 of the goodwill impairment test**

Step 2 of the goodwill analysis provides for a more clear measurement of the fair value of goodwill than the first step as it contemplates fair value for all assets of a segment, both tangible and intangible. In this manner, it provides a more precise measurement that companies would want to consider, instead of estimating potential impairment based on the Step 1 analysis of goodwill. Further, the second step more closely aligns the subsequent measurement of goodwill to its initial measurement, providing more
consistent measurement between the methodology to initially recognize goodwill and subsequently impair it. It is our opinion that Step 2 provides a better estimate of impairment.

Although removing Step 2 in theory may decrease the complexity or cost of the goodwill analysis, it could also result in greater scrutiny to Step 1 of the analysis. In this sense the burden will simply be shifted from one methodology to the next. We understand that completing Step 2 of the analysis is often a complex and costly exercise for financial statement prepares, but removing it may result in a similar amount of work and a less precise estimate.

Providing users with an option to bypass or perform Step 2 of the goodwill analysis would allow entities to determine for themselves whether performing Step 2 is beneficial or not, and would provide prepares with more flexibility in applying the model. Although this would cause some incongruences between impairment measurements across the market, this can be mitigated by requiring entities to make a policy election at the entity level on whether to utilize the Step 2 option, and also require this election to be properly disclosed.

Additional recommendations on the model

We would like the Board to consider a model in which goodwill is amortized over time in conjunction with a periodic impairment test as a potential alternative to the current accounting model. This approach would alleviate many of the accounting inconsistencies inherent in the existing methodology as it recognizes that goodwill has a finite life and applies a systematic methodology for de-recognizing it over a period of time. Analysts and other stakeholders may appreciate removing an asset that they do not truly value. This view would also be more cost effective, as amortizing goodwill over time would simplify the model and decrease the emphasis on the impairment analysis. De-emphasizing the impairment analysis could cause users to employ more simplified impairment analyses, or increase the use of the qualitative analysis. This view would also more closely align GAAP to bank regulatory capital guidance.

Alternatively, the Board could consider a direct write-down of goodwill against equity at the acquisition date. This would be consistent with how analysts view goodwill in their valuations, and would make GAAP consistent with regulatory capital treatment for banks. Lastly, this would greatly reduce the cost of accounting for goodwill and simplify the overall model.

As noted above, we encourage the Board to debate the merits and challenges of the different approaches and look forward to Phase 2 of this project.

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We thank you for the opportunity to express our support for the project and recommendations regarding this proposal, and we respectfully request that the Board consider the points we have raised. Should you require further information or have any questions, please do not hesitate to contact me (telephone 214-462-6684;
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July 20, 2016
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e-mail address mscarr@comerica.com) or Mauricio Ortiz, Senior Vice President – Assistant Controller (telephone 214-462-6757; e-mail address maortiz@comerica.com).

Sincerely,

Muneera S. Carr
Executive Vice President and Chief Accounting Officer

c: David Dupree, Executive Vice President and Chief Financial Officer
Mauricio Ortiz, Senior Vice President and Assistant Controller