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August 24, 2009

Via email

Russell G. Golden, Technical Director File Reference No. 1700-100 Financial Accounting Standards Board 401 Merritt 7 PO Box 5116 Norwalk, Connecticut 06856-5116

Re: File Reference No. 1700-100– Exposure Draft

Proposed Statement of Financial Accounting Standards (PSFAS), Disclosures about the Credit Quality of Financing Receivables and the

Allowance for Credit Losses

#### Dear Sir:

Wells Fargo & Company (Wells Fargo) is a diversified financial services company with over \$1.3 trillion in assets providing banking, insurance, trust and investments, mortgage banking, investment banking, retail banking, and consumer finance. We appreciate the opportunity to comment on the FASB's File Reference No. 1700-100: Exposure Draft of a Proposed Statement of Accounting Standards: Disclosures related to the Credit Quality of Financing Receivables and the Allowance for Credit Losses ("ED").

#### **General Comments**

We believe that high-quality disclosures about the credit quality of loans and the related allowance for credit losses are critically important for an investor's understanding of financial statements and we agree with the objective of the exposure draft, which is to improve the disclosure of information in order to allow financial statement users to understand:

- The nature of credit risk inherent in the creditor's portfolio of financing receivables;
- How that risk is analyzed and assessed in arriving at the allowance for credit losses; and
- The changes, and reasons for those changes, in both the receivables and the allowance for credit losses.

In order to accomplish these objectives, we believe that the FASB needs to better align the disclosure requirements contained in this ED with its Financial Instruments and Disclosure Framework projects. Specifically, we recommend the following:

1. The FASB and IASB, thru a joint convergence project, are currently analyzing a loan recognition and impairment model as part of its *Financial Instruments: Improvements to Recognition and Measurement* project. It would seem premature to require significant new disclosures for the existing model if it is very likely that the existing model will be replaced in the very near future with a new recognition and measurement model.

2. The significantly increased disclosures required by this ED run counter to the objective of the Disclosure Framework Project, which was added to the FASB's agenda on July 8, 2009, and has as its goal the reduction of "disclosure overload."

Additionally, there are very significant operational matters that need to be addressed prior to finalizing the ED including:

- 1. The proposed new disclosures are not operationally feasible within the time frames established in the exposure draft, and
- 2. Adoption of the ED is cost prohibitive given their pervasive impact. Compliance would require a significant amount of time and resources to be devoted to make changes to loan and credit reporting systems in order to prepare the required disclosures. We believe such costs are disproportionate to the benefit provided, especially if these costs are part of a "throwaway" project that enhances disclosures under existing accounting rules vs. a new accounting model adopted in 2011 under the Financial Instrument project.

We offer the following additional comments in amplification of these points.

## The ED does not cover all Loans and is not aligned with the Goals of the FASB's Financial Instruments Project

The ED is limited in its focus, only providing enhanced disclosures for loans accounted for in accordance with FAS 5 and FAS 114. These disclosures are not relevant for loans accounted for in accordance with:

1) SOP 03-3 or FAS 141R, 2) FAS 65, which has no allowance requirement, or 3) FAS 159, which has no allowance requirement. Also, loan loss reserve coverage ratios for financial institutions with large portfolios of SOP 03-3 loans, loans held for sale and loans carried at fair value may not be comparable to financial institutions that do not have loan accounted for under these methods.

There are currently at least five loan recognition and measurement models embedded in our financial statements. They are:

- 1. An "incurred loss" model for loans recognized in accordance with paragraph 8a of SOP 01-6, Accounting by Certain Entities (Including Entities With Trade Receivables) That Lend to or Finance the Activities of Others ("SOP 01-6")<sup>1</sup> if the allowance for loan loss is based on losses incurred as of the balance sheet date in accordance with FAS 5, Accounting for Contingencies ("FAS 5").
- 2. An "expected loss" model for loans recognized in accordance with paragraph 8a of SOP 01-6, if the allowance for loan loss is based on expected life of loan losses calculated as of the balance sheet date in accordance with FAS 114, *Accounting by Creditors for Impairment of a Loan-an Amendment of FASB Statements No. 5 and 15* ("FAS 114"),
- 3. An "expected loss" model" for purchased loans recognized in accordance with SOP 03-3, *Accounting for Certain Loans or Debt Securities Acquired in a Transfer* ("SOP 03-3"). SOP 03-3 loans are initially recognized at fair value, with ongoing evaluation of expected life of the loan losses with provision of allowance, if necessary. This approach is also followed under FAS 141R for all loans acquired in a business combination.

<sup>&</sup>lt;sup>1</sup> Paragraph 8 a states that, "Loans and trade receivables that management has the intent and ability to hold for the foreseeable future or until maturity or payoff should be reported in the balance sheet at outstanding principal adjusted for any chargeoffs, the allowance for loans losses (or the allowance for doubtful accounts), any deferred fees or costs on originated loans, and any unamortized premiums or discounts on purchased loans."

- 4. A Lower of Cost or Market Value ("LOCOM") model for certain non-mortgage loans held for sale, accounted for by analogy to FAS 65, *Accounting for Certain Mortgage Banking Activities* ("FAS 65").
- 5. A "fair value" model for certain mortgage loans held for sale and which are accounted for in accordance with FAS 159, *The Fair Value Option for Financial Assets and Financial Liabilities, including an amendment of FASB No. 115* ("FAS 159").

Further, as part of the *Financial Instruments: Improvements to Recognition and Measurement* project, the Board is considering significant changes to the accounting for loans and has asked the staff to consider several variations of an "expected loss model" or a "fair value" model. The "incurred loss" model and the FAS 114 expected loss model, which are the basis for the ED disclosures, are only two of the four models which the FASB is addressing. Until the FASB is able to decide on a loan recognition and measurement model, it would not seem worthwhile to address additional disclosures for the current model.

# This Project is Not Consistent with the Goals of the Joint FASB/IASB's Financial Instrument Project

We believe this project is not consistent with the stated FASB and IASB goal of convergence and emphasis on more fair value measurements for financial instruments. In June of 2009, the IASB issued a Request for Information, ("Expected Loss Model"): Impairment of Financial Assets: Expected Cash Flow approach. The Expected Cash Flow model approach, presented in the Request for Information and to be applied to all loans, is similar to an "expected loss-SOP 03-3" model approach. This approach would not require the recognition of an allowance unless there was deterioration in credit subsequent to origination or purchase. We believe that certain aspects of the SOP 03-3 expected loss model provide more meaningful data to investors and may better reflect loan portfolio economics. It is economically irrational to require financial institutions to incur significant costs on "throw away" work. Before the issuance of a new standard that would require financial institutions to significantly modify their existing loan systems, the FASB should insure that these new systems would not be made obsolete within a few years because of the adoption of/transition to an IASB standard with entirely different recognition, measurement and disclosure requirements. We strongly support the FASB goal to converge US standards with International Financial Reporting Standards and believe the joint choice of a consistent loan loss model should demonstrate this commitment.

## The SEC has issued Best Practices guidance on Disclosures for the Provision and Allowance for Loan Losses

On August 18, 2009 the Division of Corporation Finance of the Securities and Exchange Commission issued letters to financial institutions providing best practice disclosure guidance. Specifically, the letter instructs registrants to provide clear and transparent disclosures on how they account for their provision and allowance for loan losses, especially given the current economic environment. The letter further sets forth a number of Management Discussion and Analysis suggestions including extensive disclosures for higher risk loans such as carrying value, allowance data, current loan-to-value ratios, amount/percentage of modifications/refinances, delinquency statistics and charge-off ratios, etc. Additional disclosures are required for changes in practices followed to determine the allowance for loan losses together with explanations on how historical loss data is utilized for estimating current losses, how economic factors are incorporated into allowance estimates, the level and specificity used for grouping loans for purposes of estimating losses, non-accrual loss and charge-off policies, application of loss factors to graded loans, and other estimation methiods and assumptions used. When there has been a decline in the value of assets serving as collateral for loans, registrants should consider disclosing the approximate amount (or

percentage) of residential mortgage loans as of the end of the reporting period with loan-to-value ratios above 100%, how the allowance for loan losses has taken into consideration housing price deterioration and the basis for assumptions about housing price depreciation, the timing and frequency of appraisals, and the sources of appraisals for collateral-dependant loans.

Given this extensive practice guidance issued by the SEC, we question the need for the FASB to "rush out" new disclosure requirements contained in the ED. Rather we encourage the FASB to be thoughtful in its approach and fully integrate this disclosure ED with its other projects on *Financial Instruments: Improvements to Recognition and Measurement* and *Disclosure Framework*.

## This Project is Not Consistent with the Goals of the FASB's Disclosure Framework Project

On July 8, 2009, FASB announced the addition of a new FASB agenda project aimed at establishing an overarching framework intended to make financial statement disclosures more effective, coordinated, and less redundant. In announcing the disclosure framework project, FASB stated that it intends to address "disclosure overload," to enable all entities to focus on making more coherent disclosures in their annual reporting package, and to move away from what some assert has become a compliance exercise. FASB expects to announce its preliminary views during the first half of 2010. The ED contains disclosures that are prescriptive in nature and that we believe would add to the current disclosure overload. Accordingly, we recommend that FASB postpone the ED effective date until the disclosures can be analyzed in light of the proposed disclosure framework project.

## Previous Allowance for Loan Loss Disclosure Projects Have Not Been Successfully Completed

The current proposal is the latest of a series of three proposals to improve the disclosure of loan and allowance for loan loss data. The first project was attempted by the AICPA in June of 2003 with a Proposed Statement of Position on the "Allowance for Credit Losses." This project addressed the classification, measurement and the disclosure of the allowance for loan losses. Numerous comment letters were received by the AICPA addressing the operational difficulties associated with implementing the disclosure recommendations and the project was ultimately terminated without issuing final guidance. Despite the comment letters on the first project, the AICPA returned in 2005 to the FASB with a proposed SOP entitled "Disclosures concerning Credit Losses Related to Loans and Loan Commitments" that focused solely on allowance for loan losses disclosures. It also failed to receive the support of the FASB staff and was eventually dropped from the AICPA agenda. The FASB staff has now generated a third proposal to improve disclosures, which does not differ significantly from its two predecessor projects and we have similar and consistent criticism for this third project. We believe that improvements to the existing loan recognition and measurement model must be made before a disclosure standard can be adopted.

#### **Timing of Adoption**

The implementation of this proposal for fiscal beginning years after December 31, 2009, is not feasible. There are considerable system and process changes required to appropriately comply. The regulatory bodies have not had sufficient time to address this ED. We urge the FASB to either terminate the project or delay implementation of the ED until the FASB, financial institutions and regulators can more fully understand the impacts and consequences of the changes. Because the allowance and credit information required by the ED is pervasive and may have not been historically captured, we believe the earliest meaningful effective date would be the first interim or annual reporting period ending after December 15, 2011.

### Proposed Standard is not operationally feasible in near term

The implementation of the disclosures described in the ED would require a significant amount of time and resources during a time period when financial institutions are heavily preoccupied with other accounting and reporting standards such as FAS 166, *Accounting for Transfers of Financial Assets*, FAS 167, *Amendments to FASB Interpretation No. 46R*, Basel II Reporting Systems, and SOP 03-3. To meet the accounting and reporting requirements of these implementations, significant system and process changes are already required. This is not the time to issue a new standard that creates more operational difficulty in implementation.

The Proposed Standard implicitly assumes that loan loss allowances are established and tracked at the loan level, similar to the accounting for a purchase discount or FAS 91 deferred fee or cost. Thus it assumes that an allowance amount is specifically identified with each loan that was originated or disposed of during the period. It also assumes that the same allowance amount can be tracked from a pool of loans that are current to a pool of loans that is 31-60 days delinquent and can be further tracked as it moves to a 61-90 delinquency pool and ultimately to a greater than 90 days delinquent pool. In fact, this is not correct. Most allowance levels are determined at the end of each month by analyzing the reserve requirements for the loans in that delinquency pool on that date. The allowance requirement would be determined the next month based on the loans in the pool at the end of that month. Allowance flows in and out of a pool are not tracked, only the requirement at the end of the month is recognized. We are not aware of any existing systems that are capable of preparing several reports required by the Proposed Standard and our initial estimate is that it would take at least two years to develop such systems.

Paragraph 9.16 of the AICPA Depository and Lending Institutions Audit Guide indicates that "Management should consider its <u>overall</u> loan loss allowance and liability for other credit exposures to be appropriate in accordance with GAAP only if such amounts are considered appropriate in accordance with GAAP to cover estimated losses inherent in the loan portfolio and the portfolio of other financial instruments, respectively." The entire loan loss allowance is available for all loans in the portfolio. If there is a short fall of the allowance for one loan portfolio, it may be offset with an allowance from another loan portfolio. The proposed disclosures would cause financial institutions to disaggregate the allowance by industry sector, geographic area, category of borrowers, type of collateral levels, etc. This would mislead investors into thinking that only a subset of the reserve is available to the associated loan pool.

#### **Fair Value Disclosures**

Fair value disclosures are not relevant to the users of financial statement when it is the intent and ability of management to hold the loans for the foreseeable future or until maturity or payoff. Management does not consider the fair value of the majority of loans in its day to day management and operations of the company. Additionally, fair values often include a liquidity discount that has no relationship to expected losses. There has been a wide diversity in practice in the determination of fair values for financial instruments. For loans, there are limited pricing services available and the vast majority of loans are traded in inactive markets, which limits the usefulness of the pricing depending on the view of management related to the resolution of the loan. Also, the markets may not appropriately incorporate financial data known only to the lender as part of the underwriting process. We therefore believe that granular market value disclosures required by the ED will be difficult to provide and will be of little value to investors given management's longer term view of these loans.

### **Disclosure of Risk Grading Methodology**

While we support the concept of enhanced disclosure related to the determination of the allowance for credit losses, we do not believe that disclosing internal risk grading scales and methodologies will increase transparency or provide useful information. Each financial institution has a unique scale and process that makes comparisons across firms challenging. Wells Fargo has observed during its extensive acquisition due diligence efforts that there are significant inconsistencies in applying the loan grading system defined by the regulators.

Any disclosures in this area should not compromise borrower privacy and confidentiality and we therefore believe that disclosure could only be made at a level of detail that would not add significant insight for financial statement users. Also, with risk-based loan pricing, financial institutions receive higher returns on the risk associated with their less credit-worthy borrowers. Disclosure of the credit ratings of these assets could create negative perceptions that are not valid given their favorable risk adjusted economic returns.

#### **Regulatory Issues**

Any proposed accounting guidance must acknowledge the regulated environment of financial institutions. This proposed guidance is incremental to the reporting guidance established by the Office of the Comptroller of the Currency in their Call Report instructions. In the regulatory guidance, specific definitions and instructions have been developed by the regulatory agencies to assist in the preparation of their reports. These definitions have been largely ignored in the proposed guidance. For example the term "portfolio segment" or "class of financial receivable" are undefined terms in regulatory reporting structures. The use of specific regulatory defined terms permits financial institutions to uniformly classify all loans and leases, and allows for inter-bank comparability. The lack of specific and commonly accepted definitions of such terms as "portfolio segment" or "class of financial receivable" precludes this comparability. In addition, the lack of commonly accepted definitions in the proposals requires the ongoing maintenance of two entirely different reporting structures, one for regulatory reporting and one for the audited financial statements.

## **Conclusion**

We believe the current disclosure requirements adequately provide informed financial statement users with an understanding of the methodologies used to determine the allowance for credit losses. We do not believe any changes to the current disclosure requirements should be contemplated until the completion of joint FASB and IASB Recognition and Measurement Project.

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We appreciate the opportunity to comment on the issues contained in the FASB's invitation. 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: Financial Accounting Standards Board Members
Kathy Murphy – Office of the Comptroller of the Currency
Art Lindo – Federal Reserve Board
Robert Storch – Federal Deposit Insurance Corporation
Donna Fisher – American Bankers Association
Gail Haas – New York Clearing House Association