May 30, 2013

Technical Director
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

File Reference: No. 2012-260

Dear Board Members and FASB Staff:

Ally Financial Inc. ("Ally") is pleased to comment on the Financial Accounting Standards Board's ("FASB" or the "Board") Proposed Accounting Standard Update, Financial Instruments–Credit Losses (Subtopic 825-15) ("Proposed Update"). Ally is a leading automotive financial services company powered by a top direct banking franchise. Ally's automotive services business offers a full suite of financing products and services, including new and used vehicle inventory and consumer financing, leasing, inventory insurance, commercial loans and vehicle remarketing services. Ally Bank, the company's direct banking subsidiary and member FDIC, offers an array of deposit products, including certificates of deposit, savings accounts, money market accounts, IRA deposit products and interest checking. Ally's Commercial Finance unit provides financing to middle-market companies across a broad range of industries. Ally operates as a bank holding company and reported approximately $182 billion in assets as of December 31, 2012.

Ally understands the importance of the impairment of financial instruments proposal and supports the FASB in its efforts to provide clarification and decision useful information to users, auditors and preparers. Despite the current divergence in this area, above all others, we would like to emphasize that it is vitally important that the FASB and IASB continue to strive for a converged solution in this area. In April 2011, in response to the FASB Supplementary Document, *Accounting for Financial Instruments and Revision to the Accounting for Derivative Instruments and Hedging Activities – Impairment*, we were part of group of banks that provided an alternative for impairment on loans. That proposal builds on the current models for impairment on loans in both US GAAP and IFRS and we still believe it is a better alternative than either of the current proposals by the FASB or IASB. We have attached that proposal to this letter as Appendix B.

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The following sections will provide more specific observations, concerns and insights related to the Proposed Update. In addition, Appendix A includes responses to certain of the specific questions the FASB included in its exposure draft.

General Comments

Recognition related to Loans

While we recognize and understand that the genesis of much of the work related to impairment has come in response to a broad concern in the marketplace that the current application of the accounting model for impairment is providing for impairment "too little, too late" when a credit downturn hits, we feel strongly that the current expected credit loss (CECL) model as proposed will swing the pendulum too far in the opposite direction and will be providing for losses "too much, too soon."

Recognizing full lifetime losses on loans could have significant implications to lending institutions willingness to lend under certain circumstances and to certain types of borrowers. Originating a loan is typically a positive event for a lending institution and drives much of the institution's long term profitability. Under this proposal, having a growing portfolio or originating a significant number of new loans in any period will have a significant negative impact on quarterly profitability due to the requirement to record full lifetime expected losses when the loans are originated. We fundamentally believe that this illustrates the most significant challenge and flaw with this proposal. While there likely is no perfect impairment model that will satisfy all constituencies, we certainly believe that a better model can be put forward that does not penalize lenders with growing portfolios, as we believe the CECL model will, while still meeting the FASB objective of providing for losses earlier in the credit cycle. As previously indicated, we believe the earlier proposal by the banking industry that we included in Appendix B would be such a model.

Applicability to Debt Securities

There are several concerning components within the proposal related to debt securities. First, while we understand the desire to minimize the number of impairment models related to various types of financial instruments, we do not believe that the OTTI model utilized for debt securities in current US GAAP is broken. Subsequent to the changes brought about in FASB Staff Position (FSP) FAS 115-02 and the additional clarity provided by that FSP, we believe that the overall impairment considerations on debt securities are applied consistently and correctly throughout the industry and are not in need of change.

Ally's primary concern as it relates to applying the proposed guidance to debt securities, is the requirement to include at least one scenario which ends in a loss within the measurement of impairment. Such consideration will result in impairment charges for all debt securities, including those that have never experienced a credit loss (e.g. US Government Securities). Further, this will result in taking a charge on such a security early in its lifecycle, only to completely recover that charge as the security approaches maturity. While we understand that any charge under this circumstance is likely to be

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relatively small, we fundamentally disagree with recording a loss where no such loss is likely to ever materialize.

Ally believes the practical expedient on debt securities that indicates that a credit charge need not be taken if both the fair value of the debt security is greater than its cost basis and any credit impairment on the security is insignificant will cause many operational and comparability challenges.

From the perspective of comparability, the ability to utilize the practical expedient will be greatly impacted by the timing of the purchase of the security. For example, a single entity or multiple entities could purchase the exact same security on different dates and due solely to changes in the interest rate environment between the respective purchase dates, each individual security could have a different measurement of impairment. Consider that the fair value at the reporting date is 101, one security could have been purchased when the fair value was 98 and the other when the fair value was 102, assuming insignificant credit impairment, each security would receive different impairment measurements. The item purchased at 98 would have no impairment recorded due to the use of the practical expedient, while the item purchased at 102 would be required to have a recorded impairment.

Furthermore, changes in interest rates could impact the fair value of the security such that the security might move in and out of the ability to utilize the practical expedient from period to period. Operationally, this could pose significant challenges and would also have the effect of causing unwarranted income statement volatility.

Purchased Credit Impaired (PCI) Assets
We applaud the FASB for taking strides to simplify this operationally challenging area of accounting. We agree with the Board's decision to eliminate the nonaccretable yield component of the current US GAAP requirements by replacing it with a model that allows for recording the credit component of a purchase discount as a gross up to loans and the entity's recorded reserves. Further, by allowing for any positive changes in expected cash flows to immediately flow through the income statement via the credit impairment guidance, it essentially eliminates the requirement to capture any positive changes in the expected cash flows as an adjustment to yield over the remaining life of the asset, which is one the most significant operational challenges of today's accounting for PCI assets.

In addition to agreeing with the Board with respect to the changes in PCI accounting, we further believe that this model should be expanded and followed for all purchased loans. Ally would respectfully suggest that splitting out the credit component for all purchased loans and then subsequently applying the credit impairment guidance to the whole asset would significantly simplify the accounting for all purchased loans subsequent to purchase. Under current US GAAP, the loans are recorded at fair value upon acquisition pursuant to the existing fair value and/or business combination guidance. For non-PCI assets, this fair value mark includes consideration for interest changes subsequent to the original issuance of the instrument, anticipated credit losses over the remaining life of the

loan, liquidity considerations, as well as a profit margin. We request the Board to consider expanding the PCI credit component considerations to the accounting for all purchased loans and allow an entity to simply record the credit component as a reserve and gross up the balance of the loan, consistent with the proposed guidance on PCI assets.

TDR Accounting

With respect to the proposed changes to TDR accounting and considerations, Ally respectfully disagrees with the Board's direction in the proposed ASU. The proposed changes take an already challenging area of accounting under current US GAAP and incorporate additional complexity. While we acknowledge and do not fundamentally disagree with the Board's perspective and reason for providing the proposed changes as modifications of troubled loans are typically made as an entity's best effort to collect on the original note, we do not believe that the related accounting should be as complex as proposed.

The proposed guidance would essentially require an entity to record a nonaccretable item similar to the current US GAAP accounting for PCI assets that the Board has proposed amending due to the inherent complexities and operational challenges that it presents. We do not understand why on one hand the Board would eliminate such an operationally burdensome item only to reinstate it elsewhere.

Ally currently provides certain modification programs whereby the interest rate on the note is increased along with a lengthening of the term of the note. This has the effect of reducing the borrower's monthly payments. Because we do not re-underwrite the loan, we cannot definitively indicate that the modification was performed at a market interest rate and therefore we classify the modification as a TDR. Utilizing the initial modification calculation in the proposed update, the result of the present value calculation would exceed the recorded loan amount, thereby improving our overall expected cash flows. The proposed guidance indicates that when discounting the expected cash flows at the original note rate, if there is a shortfall, such a shortfall should be recorded as a charge-off and therefore a realized loss at the time of the modification. However, it does not indicate what should be done in the case of a calculation that results in increased cash flow expectations. Analogizing to the proposed guidance when the cash flows decrease, one could conclude that you would record a gain and increase the carrying value of the note when the cash flows increase. Ally does not believe that to be appropriate and believes that if the Board chooses to go forward with the proposed TDR considerations, guidance should be provided on how to account for such a circumstance.

Ally does recognize the importance of disclosing relevant information related to modifications made to loans and other financial instruments and the related impact of such modifications on our overall operations. As such, we would suggest that in place of the proposed TDR accounting considerations, the Board should consider enhancing disclosure requirements around all modified loans and their respective performance so that the readers of the financial statements receive all of the relevant information needed in order to understand the impact of an entity's modification practices.

Eliminating TDR considerations would result in all modified loans simply following existing US GAAP for modifications to non-troubled borrowers. Under which, an entity must consider whether or not the modification results in a new loan or a modification of an existing loan. We believe that following the non-troubled modification guidance for all modifications, and thereby eliminating the TDR considerations, would benefit both users and preparers by simplifying the overall accounting requirements related to modifications.

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Ally appreciates the opportunity to share our comments with the Board. We urge the FASB staff to consider our aforementioned comments and answers to *Questions for Respondents* when finalizing the Proposed Update. If you have any questions on the comments contained in this letter, please contact me at 215-734-4886.

Sincerely,

Michael Anspach
Executive Director, Global Corporate Accounting Policy and Valuation Governance
Ally Financial, Inc

cc: Mr. David DeBrunner, VP, Controller, and Chief Accounting Officer
Mr. James Mackey, Chief Financial Officer

Appendix A- FASB Questions

Scope

Question 1: Do you agree with the scope of financial assets that are included in this proposed Update? If not, which other financial assets do you believe should be included or excluded? Why?

Ally's Response:
As noted in our general comments, we believe that the current accounting considerations for impairment of debt securities should be maintained and therefore excluded from the scope of this proposal.

Recognition and Measurement

Question 9: The proposed amendments would require that an estimate of expected credit losses be based on relevant information about past events, including historical loss experience with similar assets, current conditions, and reasonable and supportable forecasts that affect the expected collectibility of the financial assets' remaining contractual cash flows. Do you foresee any significant operability or auditing concerns or constraints in basing the estimate of expected credit losses on such information?

Ally's Response:
While much of the information required to perform this calculation is already available and therefore putting this proposal into operation is not likely to pose significant operational challenges, we are concerned that such an approach is not the most representationally faithful approach for measuring credit losses. See our general comments, regarding the impact to growing portfolios.

Question 10: The Board expects that many entities initially will base their estimates on historical loss data for particular types of assets and then will update that historical data to reflect current conditions and reasonable and supportable forecasts of the future. Do entities currently have access to historical loss data and to data to update that historical information to reflect current conditions and reasonable and supportable forecasts of the future? If so, how would this data be utilized in implementing the proposed amendments? If not, is another form of data currently available that may allow the entity to achieve the objective of the proposed amendments until it has access to historical loss data or to specific data that reflects current conditions and reasonable and supportable forecasts?

Ally's Response:
For most asset classes, we believe the data would be available. However, for new products, historical loss rates would take time to establish and therefore any day one loss considerations would likely be based on models for other assets with similar credit risk characteristics.

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Question 11: The proposed amendments would require that an estimate of expected credit losses always reflect both the possibility that a credit loss results and the possibility that no credit loss results. This proposal would prohibit an entity from estimating expected credit losses based solely on the most likely outcome (that is, the statistical mode). As described in the Implementation Guidance and Illustrations Section of Subtopic 825-15, the Board believes that many commonly used methods already implicitly satisfy this requirement. Do you foresee any significant operability or auditing concerns or constraints in having the estimate of expected credit losses always reflect both the possibility that a credit loss results and the possibility that no credit loss results?

Ally's Response:
As noted in our general comments, Ally believes that applying this principle to debt securities will cause unnecessary fluctuations in earnings whereby we would record credit losses on items where no credit loss is ever likely to materialize.

Question 13: For purchased credit-impaired financial assets, the proposed amendments would require that the discount embedded in the purchase price that is attributable to expected credit losses at the date of acquisition not be recognized as interest income. Apart from this proposal, purchased credit-impaired assets would follow the same approach as non-purchased-credit-impaired assets. That is, the allowance for expected credit losses would always be based on management's current estimate of the contractual cash flows that the entity does not expect to collect. Changes in the allowance for expected credit losses (favorable or unfavorable) would be recognized immediately for both purchased credit-impaired assets and non-purchased-credit-impaired assets as bad-debt expense rather than yield. Do you foresee any significant operability or auditing concerns or constraints in determining the discount embedded in the purchase price that is attributable to credit at the date of acquisition?

Ally's Response:
Consistent with our comments above, Ally does not believe that the same accounting result would be achieved for non-PCI assets. As we discussed above, we believe that a portion of the day one fair value of a non-PCI asset is related to the expected credit losses of the instrument and is therefore embedded within the fair value adjustment upon initial recording. Apart from the disconnect on the day one recording of the asset, we believe that it is appropriate and much easier operationally to incorporate the credit component of both PCI and non-PCI assets into the credit allowance and allow any future changes in cash flow expectations, either positive or negative, to be immediately recognized through the related credit reserve.

Question 14: As a practical expedient, the proposed amendments would allow an entity to not recognize expected credit losses for financial assets measured at fair value with qualifying changes in fair value recognized in other comprehensive income when both (a) the fair value of the individual financial asset is greater than (or equal to) the amortized cost basis of the financial asset and (b) the expected credit losses on the individual

financial asset are insignificant. Do you foresee any significant operability or auditing concerns or constraints in determining whether an entity has met the criteria to apply the practical expedient or in applying it?

Ally's Response:
Please see our general comments on this topic.

Question 15: The proposed amendments would require that an entity place a financial asset on nonaccrual status when it is not probable that the entity will receive substantially all of the principal or substantially all of the interest. In such circumstances, the entity would be required to apply either the cost-recovery method or the cash-basis method, as described in paragraph 825-15-25-10. Do you believe that this proposal will change current practice? Do you foresee any significant operability or auditing concerns with this proposed amendment?

Ally's Response:
Ally understands that the spirit of the guidance is meant to be consistent with current bank regulatory requirements and therefore current industry practice in this area. While the wording is not precisely consistent with the bank regulatory guidance, we believe in practice the guidance would be applied consistently with the current practice and therefore do not foresee any significant operability concerns beyond what currently exists.

Question 16: Under existing U.S. GAAP, the accounting by a creditor for a modification to an existing debt instrument depends on whether the modification qualifies as a troubled debt restructuring. As described in paragraphs BC45–BC47 of the basis for conclusions, the Board continues to believe that the economic concession granted by a creditor in a troubled debt restructuring reflects the creditor's effort to maximize its recovery of the original contractual cash flows in a debt instrument. As a result, unlike certain other modifications that do not qualify as troubled debt restructurings, the Board views the modified debt instrument that follows a troubled debt restructuring as a continuation of the original debt instrument. Do you believe that the distinction between troubled debt restructurings and nontroubled debt restructurings continues to be relevant? Why or why not?

Ally's Response:
Ally does not believe that there needs to be a distinction between TDR and non-TDR modifications. Please see our general comments on this topic.

Disclosures

Question 18: Do you foresee any significant operability or auditing concerns or constraints in complying with the disclosure proposals in the proposed Update?

Ally's Response:
For loans, no, the vast majority of the information within the proposed disclosures is information that is already disclosed within the financial statements.

For debt securities, the disclosure requirements are not consistent with the way that we manage our portfolio and currently gather information. As discussed in our general comments, we believe that the current OTTI requirements, including the disclosures, should be maintained for debt securities.

Transition and Effective Date

Question 20: Do you agree with the transition provision in this proposed Update? If not, why?

Ally's Response:
Ally agrees with the cumulative effect adjustment to the beginning of the effective period. While we understand that there will be some comparability issues in the year of adoption, it would be operationally burdensome and require significant hindsight to apply this guidance retrospectively to all periods presented.

Question 21: Do you agree that early adoption should not be permitted? If not, why?

Ally's Response:
Ally agrees that early adoption should not be permitted. For banking institutions, credit impairment is one of the most significant estimates to the financial statements. As such, it is vital that all companies are preparing their credit analyses using a consistent accounting standard and timeline.

Question 22: Do you believe that the effective date should be the same for a public entity as it is for a nonpublic entity? If not, why?

Ally's Response:
Yes

Question 23: Do you believe that the transition provision in this proposed Update is operable? If not, why?

Ally's Response:
Ally believes the transition provision is operable as written.

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Question 24: How much time would be needed to implement the proposed guidance? What type of system and process changes would be necessary to implement the proposed guidance?

Ally's Response:
Due to the wide array of both accounting and regulatory changes that have been and continue to be proliferated subsequent to the Financial Crisis, we believe that there should be a significant transition period to implement any modifications to the impairment guidance when it is finalized. With any modification of this type and magnitude, it requires the design and update of the related internal controls, as well as changes to our reporting protocols and data gathering procedures. We would need time to internally communicate the pending changes, as well as, to consider to what extent we would need to make modifications to any of our related systems. In addition and specific to this proposal, the bank regulators may or may not make changes to the regulatory requirements in this area that would also have to be taken into consideration prior to the effective date. For example, if the regulators do not make any changes to the regulatory considerations around the Allowance for Loan Loss (ALLL) and this guidance has the expected effect of significantly increasing the ALLL, entities may have to make changes to debt covenants, asset mixes, etc. in order to mitigate some of the likely deterioration in certain regulatory ratios. Considering these items, Ally believes an implementation timeframe of at least two years from the release of the final guidance would be required to effectuate these changes.

Appendix B

April 1, 2011

Via email

Leslie F. Seidman, Chairman
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, Connecticut 06856-5116

Sir David Tweedie, Chairman
International Accounting Standards Board
30 Cannon Street, First Floor
London, EC4M 6XH
United Kingdom

Re: File Reference No. 2011-150, Supplementary Document: *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities: Impairment*

Dear Ms Seidman and Sir David:

We understand the difficult issues the FASB and IASB have been dealing with in their efforts to converge the accounting for financial instruments. We applaud the agreement reached regarding the measurement of financial instruments held for the collection of cash flows to account for them on an amortized cost less impairment basis. We also believe the tentative decision to account for impairment separately from the interest yield on loans and debt securities provides better information to both users and preparers of financial statements. These accounting decisions will ensure the financial statements reflect the way such financial instruments are managed.

We also recognize that the two boards had approached the accounting for impairment from two different directions and that the "dual impairment" model represents a significant compromise on the parts of both boards. However, we have concerns with the credit impairment model that has been jointly proposed, the most significant of which is that it does not adequately address the cyclical behavior of financial instruments and the lack of transparency around inherent loss events until such events are observable. Many financial institutions were severely criticized during the recent financial crisis because the limitations of the existing credit impairment accounting framework raised questions about adequacy of credit loss reserves and timing of credit loss recognition. Many believe the limitations of the current framework contributed to the severity and length of the financial crisis.

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Members of the U.S. banking industry have developed an alternative proposal that we believe will more effectively address these concerns while expanding upon the existing incurred loss concept. In addition, we believe this approach will not require the significant operational complexity involved in implementing the joint proposal. A description of the alternative proposal is provided in the attached Exhibit A. We strongly encourage both Boards to consider this alternative proposal as a basis to improve the existing impairment framework in lieu of the jointly proposed model.

We support the efforts of the Boards to develop a converged and improved accounting standard. All parties agree that improvement to the existing impairment framework is necessary. Accordingly, we encourage the Boards to continue with additional outreach efforts and fully field test any future proposals to ensure that any new standard is of high quality, operational and well understood by standard setters, regulators and preparers prior to issuance. We recognize this may extend beyond the June 30, 2011, MOU target date, but it is critical that the process result in an improved standard. As a group, we offer our assistance in modeling, field testing and developing enhanced disclosures for this proposal.

Sincerely,

Ally Financial Services

Bank of America Corp

Capital One Financial Corporation

Comerica Incorporated

JPMorgan Chase & Co.

KeyCorp

Northern Trust Corporation

Regions Financial Corporation

State Street Corporation

SunTrust Banks, Inc.

The Bank of New York Mellon Corporation

The PNC Financial Services Group

Wells Fargo & Company

Zions Bancorporation

cc: Jim Kroeker – 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

Exhibit A

U.S. Banking Industry Proposed Credit Impairment Model

Introduction

The incurred loss model under U.S. GAAP and IFRS that governs credit impairment has been criticized following the recent financial crisis. The two main criticisms raised are: 1) reserve adequacy (i.e., credit reserve levels at the inception of the financial crises were inadequate to absorb the elevated losses that occurred during the crisis and likely substantially existed at the inception of the crisis) and 2) timing of recognition (i.e., increases in realized losses led to a combination of elevated charge-offs and large reserve builds at the peak of the crisis that inappropriately reduced market confidence in the banking sector). Many believe the delayed timing of loss recognition and magnitude of loss, which together reflected a severe and rapid deterioration in credit quality, exacerbated the severity and length of the financial crisis. All parties (standard setters, regulators, investors, and preparers) agree that improvements to the credit impairment guidance are necessary.

We believe that the fundamental principles inherent in the incurred loss model are sound and have served the industry, regulators and financial statement users effectively by providing a well understood framework to determine credit-related allowances. However, over time, the incurred loss model has increasingly been interpreted in a way that has resulted in a significant flaw: allowance calculations based on too narrow a view of the credit cycle. History has shown that the credit profile of financial instruments is highly cyclical, typically with a period of benign loss activity that coincides with the expansion and peak of overall economic activity and credit availability, followed by a shorter and more concentrated period of elevated credit losses. Narrow interpretations and application of the incurred loss model result in the compression of this cycle by considering only losses estimated over an abbreviated loss emergence period and restricting the use of market trends and other data that would indicate changes in the probability or severity of loss until such deterioration is observable.

The events of the recent financial crisis put a spotlight on this weakness in the application of the incurred loss model, resulting in the criticism noted above. Although we believe the fundamental principles of the incurred loss model remain sound, some thoughtful and tailored changes are necessary to incorporate the cyclical behavior of financial instruments and lack of transparency around inherent losses prior to the deterioration of the credit environment.

To date, the independent proposals from the FASB and IASB have focused primarily on only one aspect of the problems with the current model. The FASB's "foreseeable future" model addresses reserve sufficiency through expansion of the loss definition and the time period covered by the forecast by removing the "probable" trigger and expanding the types of inputs that may be considered in a loss forecast. However, the foreseeable future model suffers from the same flaw as the existing model, as it may be

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narrowly interpreted with a limited view of both the losses within the emergence period and of breadth and depth of the credit cycle. Accordingly, we believe the "foreseeable future" methodology, as originally proposed, may not adequately address the weaknesses in the current model and may perpetuate and exacerbate the pro-cyclicality of results while only modestly increasing the absolute level of credit reserves during extended periods of benign credit activity. Also, recent banking regulator comments lead us to believe this model, if adopted globally would potentially be implemented differently in the U.S. (most likely with longer "foreseeable future" loss forecasting periods) than in other jurisdictions.

In contrast, the IASB attempted to address the relationship between credit losses and loan pricing and income recognition and, therefore, pro-cyclicality, by introducing a time-proportionate spreading of credit losses over the expected life of the portfolio. However, this model does not result in a credit reserve that is sufficient to anticipate significant changes in credit loss curves as it also may focus on a narrow view of the credit cycle. Accordingly, the original IASB approach also perpetuates pro-cyclicality as changes to originally anticipated loss estimates would be recognized retroactively for good book assets and immediately in full for bad book assets.

We believe the compromise proposal set forth in the recent Supplementary Document – *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities – Impairment*, issued on January 31, 2011, was an attempt by the two Boards to combine the independent FASB and IASB proposals in a manner that would address both the reserve adequacy and timing of loss recognition issues with the current incurred loss model. For the reasons noted above, we believe the compromise proposal does not adequately address these issues.

We recognize that no impairment model can completely address the cyclical nature of credit risk inherent in financial instruments, and there will always be some level of volatility as we move through the ups and downs of the credit cycle. However, we believe it is possible to modify and enhance the existing incurred loss model to consider the cyclical behavior of financial instruments and lack of transparency around inherent losses in certain periods of the credit cycle in the determination of credit impairment. We believe this proposal would result in a better estimate of credit losses related to loss events inherent in the portfolio at the balance sheet date, effectively address the criticisms regarding the adequacy and timeliness of credit loss recognition and provide financial statement users with a more representative view of an entity's financial condition.

Proposal

Our proposal expands on existing incurred loss practices found within current accounting principles to more effectively estimate inherent credit losses by eliminating the probability threshold, incorporating expected events into the loss forecast and extending the loss emergence period. Under our proposal, inherent credit losses are estimated using a two-step approach. Although described in two steps, these components are interrelated and are each necessary to estimate losses inherent in the portfolio. We have described the

components separately and would disclose them separately to provide clarity and transparency of management estimates:

1. A base component (the "Base Component") that represents the estimate of expected inherent losses in the portfolio that are reasonably predictable;
2. A credit risk adjustment component (the "CRA") that represents additional credit losses that are not yet reflected in current credit risk metrics used to estimate the Base Component but are estimated using macro-level factors and are expected to emerge with more transparency as the credit cycle unfolds.

Base Component
The Base Component is intended to capture expected inherent losses that are reasonably predictable based upon an assessment of historical and current credit information and expected events and conditions. The Base Component methodology replaces the current incurred loss model with an expected loss concept that incorporates expected events into the loss forecast and extends the loss emergence period to a period over which losses are reasonably predictable. Uncertainty in the forecasting process, changes in loss emergence periods, and other factors are not explicitly or systematically considered in the Base Component, and as such, the Base Component is by itself an incomplete estimate of inherent credit losses. The terms "***Expected Inherent Losses***" and "***Reasonably Predictable***" are defined as follows:

Expected Inherent Losses are defined as management's best estimate of losses inherent in the loan portfolio based on a company's credit evaluation process taking into account all relevant current and historical information as well as expected events and conditions. This is a change from the existing incurred loss definition as the "probable" threshold has been eliminated and expectations of future events can be fully considered to estimate the severity of losses associated with a loss event. Expected Inherent Losses are pro-cyclical, by nature, and reflect the portion of the total allowance for credit losses that can be reasonably predicted in the current environment based on the available evidence and trends. The elimination of the "probable" trigger in the definition of Expected Inherent Losses is necessary to allow the Base Component to capture a greater portion of the actual losses inherent in a portfolio at any given point in time and align the credit loss recognition methodology with the cyclical nature of the underlying financial instruments. We believe that a company's best estimate of losses, whether probable or not, is the correct starting point for establishing credit impairment as this information is more reflective of loss estimates used in pricing credit. We also believe that this articulation of an expected loss concept is preferable to establishing a "more-likely-than-not" threshold of incurred losses because it is better aligned with risk management, and credit loss estimation practices, which generally do not incorporate a probability weighted analysis or a pre-defined level of precision.

Reasonably Predictable is defined as the period of time that losses can be estimated with reasonable confidence. In estimating the losses that are Reasonably Predictable, several factors should be considered including, the characteristics of the financial instrument or pool of financial instruments, the historical performance of the financial instrument or

pool of financial instruments, the current and expected market conditions, and consideration of a company's own credit forecasting processes. The period of time determined to be reasonably predictable will vary by asset class and may change throughout credit cycles, and will not necessarily be consistent across companies.

This methodology is not intended to result in the immediate recognition of a full life-of-instrument loss estimate in most cases because it would be unlikely that the Reasonably Predictable threshold would be satisfied unless there is a specific indication of impairment. For example, if for individual instruments or a specifically identified pools of instruments with specific indications of impairment (e.g., collection of all contractual principal or interest is not expected), all Expected Inherent Losses for that instrument or that portion of the pool of instruments would be considered Reasonably Predictable and the remaining life of loan loss would be immediately recorded similar to current accounting.

Credit Risk Adjustment Component (the "CRA")

The CRA is a separate component of the allowance for credit losses that is established to address the inherent limitations in a company's credit forecasting process and the cyclical nature of macroeconomic conditions. Past credit cycles have seen extended periods of benign activity followed by rapid parallel upward shifts in credit loss estimates. The specific economic and credit conditions that lead to the negative credit shocks often accumulate over a number of years, but often are not readily apparent in the credit metrics commonly used to estimate the Base Component. For example, a) underwriting standards and loan terms may be eased during benign credit environments; b) favorable economic conditions may mask credit weaknesses of the borrower, c) uncertainty regarding the sustainability of the current economic conditions is often high and d) loss emergence periods tend to extend during benign economic periods. Each of these factors suggests that credit losses build even during benign credit environments and these losses later become transparent as the credit cycle deteriorates. Consideration of these factors, therefore, would likely cause the CRA to be highest during these benign credit environments, thus, ensuring that inherent credit losses are appropriately recognized even during such periods. Conversely, the CRA may not be as high during times of increasing loss rates as the portfolio's loss content is reflected or more apparent in current credit quality indicators and therefore would be more fully captured by the Base Component.

Many critics have concluded that the existing model for credit impairment may not be capable of capturing the portion of losses that have been incurred, but for which, there is no currently observable evidence of credit loss. We believe the CRA concept more effectively addresses this weakness and enhances the existing incurred loss model from both a balance sheet perspective (by capturing estimates of expected inherent losses that are not readily apparent or observable), and an income statement perspective (by appropriately accelerating the recognition of credit losses into the periods in which they are inherent but not readily observable, and not concentrating loss recognition into the later stages of a credit cycle when losses are observable and can be specifically identified).

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The CRA is intended to capture those losses that are inherent in the portfolio, but due to the nature of the credit cycle, will not become transparent until credit losses begin to materialize. During the course of a normal credit cycle, the counter-cyclical nature of the CRA will offset some, but not all of the volatility created by uncertainty in the timing and amount of credit losses. For example, no impairment methodology could have fully addressed the dramatic parallel shift in credit loss curves experienced from 2007 to 2009. In periods of extreme credit stress, a company may need to increase the Base Component as losses become observable, but may decide a CRA is also necessary if sufficient uncertainty remains regarding the absolute levels of expected credit losses. In this manner, the CRA addresses both criticisms, reserve adequacy and timing of credit loss recognition, leveled at the existing accounting guidance.

The methodology for establishing the CRA should consider factors including, but not limited to:

- Current credit metrics and forecast;
- Historical credit metrics (including stressed loss rates);
- Management's evaluation of the credit cycle;
- Other important credit indicators such as borrower behavior and collateral values;
- Current underwriting standards, loan covenant terms, and other loan characteristics;
- Recent trends in economic conditions;
- Portfolio performance, concentrations, and deterioration relative to historical ranges;
- Changes in loss emergence patterns over a credit cycle; and
- The level and estimate of imprecision and uncertainty in the factors above.

Many of the factors considered in the CRA would by nature be heavily dependent on management's judgment. These factors should be fully documented and supported by either market data, where possible, or internal data and analysis, and appropriately disclosed in the financial statements.

Conclusion

We believe that a credit impairment methodology that estimates credit losses inherent in the portfolio, comprising both a Base Component and a CRA, will address many of the concerns with the existing impairment model, and is superior to all other models proposed to date. We believe that the application of this methodology will:

- Generally increase the size of existing credit reserves to more accurately reflect inherent losses in the portfolio, including the risk of deteriorating economic conditions on those inherent loses;
- Reduce pro-cyclical volatility in the income statement created under the existing model as inherent losses will be appropriately recognized earlier in the credit cycle;

- Better align recognition of credit losses to those periods where credit losses are inherent in the portfolio, but are latent due to favorable economic conditions; and
- Provide more useful qualitative and quantitative disclosures to financial statement users through transparent disclosure of the different components of the allowance for credit loss calculation and enhanced information about the key methodologies, assumptions and judgments used in determining those amounts.

We believe that this methodology has a solid foundation in existing accounting principles and credit risk management practices in our industry, and is similar to concepts and practices in analogous circumstances to estimate inherent losses in other industries.

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