American Bankers Association

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Leslie Seidman, Chairman
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116
Via email: director@fasb.org

RE: File Reference No. EITF-12C: *Subsequent Accounting for an Indemnification Asset Recognized at the Acquisition Date as a Result of a Government-Assisted Acquisition of a Financial Institution*

Dear Chairman Seidman:

The American Bankers Association (ABA) appreciates the opportunity to comment on the Exposure Draft: *Subsequent Accounting for an Indemnification Asset Recognized at the Acquisition Date as a Result of a Government-Assisted Acquisition of a Financial Institution* (ED). ABA brings together banks of all sizes and charters into one association. ABA represents banks of all sizes and charters and is the voice for our nation’s $13 trillion banking industry and its two million employees. The majority of ABA’s members are banks with less than $165 million in assets. ABA’s extensive resources enhance the success of the nation’s banks and strengthen America’s economy and communities.

The ED seeks to resolve current diversity in practice by clarifying the guidance for subsequently measuring an indemnification asset (IA) that is recognized as a result of a government-assisted acquisition of a financial institution. It is proposed that in those circumstances in which the recognized indemnification asset should be amortized, the amortization period is to be the lesser of the contractual term of the indemnification or the remaining life of the indemnified assets.

This issue has an impact on only a tiny percentage of the over 6,000 banks in the United States. Further, only a small portion of those banks hold amounts of indemnification assets that are significant to their balance sheets and this number is not expected to increase, as the structure of recent federally-assisted transactions has evolved and federal indemnification has been deemphasized. Therefore, understanding the limited impact of this project, we question the need for this project. We recognize the importance of clear, concise, and consistent guidance on indemnification assets related to a business combination. However, we question whether consistent accounting treatment will be valued by investors at a level that makes the changes cost-effective for banks to produce. In addition, the accounting for the related indemnified assets could change significantly under the Boards’ financial instruments project, which would require yet another change in accounting for this very specific and narrow transaction fact-pattern. The costs of making two sets of changes to systems and financial reporting processes would outweigh its benefits.

We recommend that any decision on the accounting be deferred. Instead, the focus should be on enhancing disclosures related to the accounting and reporting of indemnification asset balances. Such decision-useful information would not burden preparers with the cost of two sets of system changes.

If the Board determines the guidance as provided in the ED is necessary, we believe that this specific issue can be addressed comprehensively, as noted below in our recommendations, within both the current accounting models for financial instruments and for business combinations, and also within the accounting models being considered within FASB's joint financial instruments project with the International Accounting Standards Board (IASB).

Therefore, we have the following recommendations:

- Indemnification asset accounting for business consolidations should be re-evaluated.
- The final guidance should apply to any third-party indemnification.
- Transition to a new method should be executed prospectively.

Indemnification asset accounting for business consolidations should be re-evaluated.

Topic 805 (Business Combinations) of the Accounting Standards Codification (ASC) specifically addresses accounting for an indemnification agreement, both at acquisition and in subsequent accounting. Topic 805 generally requires the indemnification asset to be recorded at fair value at acquisition and then treated subsequently on the same basis as the indemnified liability or asset. Within our working group organized to review the ED, of the four options reviewed by the EITF related to measuring the IA, support was generally split between those who support amortizing the IA over the expected life of the related assets and those who support amortizing the IA over the lesser of the expected life of the related assets or the length of the indemnification agreement.

We believe that both are reasonable interpretations of current GAAP. We also understand that there was not unanimity on the EITF as to the length of the amortization period; however, certain members of the EITF were troubled that if the IA is amortized over a period longer than the indemnification agreement, a residual asset could remain that does not meet the definition of an asset. With that in mind, we believe the root of the issue is not that the amortization period is too long, but that, at acquisition, the IA must be recorded as a stand-alone asset. As it relates to financial instruments, the requirement to separately reflect the IA confuses the financial statement user as to the practical investment in loans, as well as the quality and collectability of the loans.

Government-assisted IAs generally have no value outside the acquiring entity (the related loans can be sold, but without the government indemnification), and the IAs recorded under GAAP may not necessarily reflect actual amounts expected to be reimbursed by the government. For all intents and purposes, after the acquisition date, the IA asset represents a portion of the cost basis of the related acquired loans. The two assets are linked, and management often views them as being one overall set of cash flows. Based on this, separately recording an indemnification asset for loans and debt securities that are held for long-term investment does not seem appropriate in all circumstances. Our position is not to advocate one amortization method over another. However, no concerns related to a residual asset would be needed if the indemnification asset were not treated as a separate asset, but as a part of the indemnified assets themselves.

We know FASB and the IASB are reviewing how purchased loans should be recorded and presented as part of the joint project on Accounting for Financial Instruments. We recommend that appropriate consideration be given to how IAs should likewise be recorded and presented during a business combination.

The final guidance should apply to any third-party indemnification.

While the ED focuses on government-assisted transactions, if the Board proceeds with the project, it may be useful to expand any final guidance to private, third-party indemnifications made during business combinations, so that any similar issues can be considered before issuing further guidance. While few, if any, private indemnifications have been granted thus far, we believe that transactions in the future may include such indemnifications and similar guidance will then be required.

Transition to a new method should be executed prospectively.

We agree with the Board that retrospective application would be unduly burdensome, especially since the amortization methods used are meant to complement the specialized methods required through ASC 310-30 (Loans and Debt Securities Acquired with Deteriorated Credit Quality). Changes in cash flow assumptions are treated asymmetrically within ASC 310-30, meaning that improvements in cash flow assumptions are not treated the same as deteriorations. Therefore, we recommend prospective treatment in transition, as outlined in the ED.

Thank you for your attention to these matters. Please feel free to contact me (mgullette@aba.com; 202-663-4986) if you would like to discuss this.

Sincerely,

Michael L. Gullette