



May 31, 2013

Submitted via email: director@fasb.org

Technical Director
Financial Accounting Standards Board (FASB)
P.O. Box 5116
Norwalk, CT 06856-5166

RE: File Reference No. 2012-260

Proposed ASU, Financial Instruments – Credit Losses (Subtopic 825-15)

Dear Director:

Thank you for the opportunity to comment on the recent Exposure Draft *Financial Instruments – Credit Losses*. As the Credit Risk Officer of a growing community bank with a long history of strong performance, I appreciate the chance to comment on this pending change and its effects, from a ground-floor perspective. Specifically, my comments relate to operational, recognition, and capital impact.

Operational Impact: Challenging and Costly

A substantial change is the proposed shift away from an annualized historical loss basis to one that is loan-vintage driven. In order to capture the data to measure and assess loan vintage behavior through the last economic cycle requires, at a bare minimum, a complete dissection and month-by-month rebuilding of 8 to 10 years of loan losses. For many small to mid-sized banks this effort will necessarily be a manual one. It is a monumental and cost-prohibitive undertaking made even more so when one factors in the investment in extensive systems upgrades, human resources, and outsourcing that new model development, testing, and sustainability will require.

Recognition: Forecasting issues and Mismatching

The proposed change in recognition from “incurred” to “expected” losses calls into question the reliability of forecasts and problems arising from mismatching of income and expenses. An expected loss methodology requires institutions to predict economic cycles as well as the extent and timing of future losses. While using Q-factors to adjust losses to the current economic cycle is not a new exercise, evaluating and applying them to loan-vintage losses is. Institutions will then need to forecast from that point forward remaining “life of loan” losses in the context of future economic cycles. Forecasting of this type requires an extensive amount of consistent, reliable, and readily-available data on many levels. The impact of international, national and regional economies and trends, as well as specific institution and loan-level data would need to be considered. Finding such data sources is problematic, time consuming, and costly. Within our own state, for example, type, method, and periods of data collection vary significantly over time, impacting reliability, results assessment, and forecasting effectiveness. Alternatively, reliance upon industry or peer “averages” would skew an institution’s results, and the creation or compilation of raw data adds significant cost and time. Finally, the recognition of “life of loan”

losses up-front, ahead of income off-set, will result in mismatching and is likely to increase the level of reserves.

Capital: Negative Impact

Throughout the comment period, I have participated in a number of sessions focused on the potential impact of the proposal. It has been estimated that current allowance reserves would increase by a factor of 3-5 times, depleting capital even more rapidly as banks simultaneously prepare to meet elevated ratios under Basel. To date, however, it appears that a system-wide financial impact analysis of the changes on banks' reserves and capital structure has not yet been derived. Without this analysis, it is difficult to assess the empirical basis on which the risk-benefit impact of the changes has been measured.

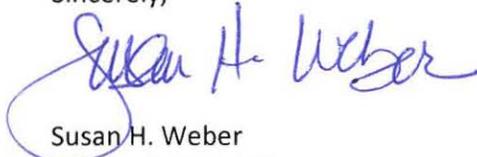
Benefit: Acquired loan reserves

A proposed change that could be viewed as an enhancement to the existing methodology is the ability for banks to include a loss provision against acquired loans. Understanding that a value mark is a point-in-time estimate of the fair value of the purchased loans, perfect knowledge does not exist at acquisition. Developing a methodology for on-going loss reserves after acquisition enables banks to more accurately reflect and report loss experience on acquired portfolios.

Conclusion

In closing, it seems an empirical assessment of the overall impact of these changes is needed. That assessment may highlight aspects of the methodology or underlying calculations that require adjustments. Given significant operational and cost challenges, the creation of a structured and tiered adoption timeline regarding historical loan-vintage losses would be beneficial. Finally, from an overall risk, cost and operational perspective, it seems appropriate to evaluate and develop performance and size-based exemptions for banks from the proposed change in methodology.

Sincerely,



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