

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES EXCHANGE ACT OF 1934**  
**Release No. 52041 / July 15, 2005**

**ACCOUNTING AND AUDITING ENFORCEMENT**  
**Release No. 2278 / July 15, 2005**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-11984**

**In the Matter of**  
  
**Comerica, Inc.,**  
  
**Respondent.**

**ORDER INSTITUTING CEASE-AND-  
DESIST PROCEEDINGS, MAKING  
FINDINGS, AND IMPOSING A CEASE-  
AND-DESIST ORDER PURSUANT TO  
SECTION 21C OF THE SECURITIES  
EXCHANGE ACT OF 1934**

**I.**

The Securities and Exchange Commission (“Commission”) deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 (“Exchange Act”), against Comerica, Inc. (“Comerica” or “Respondent”).

**II.**

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the “Offer”) which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission’s jurisdiction over Respondent and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Cease-and-Desist Proceedings, Making Findings, and Imposing a Cease-and-Desist Order Pursuant to Section 21C of the Securities Exchange Act of 1934 (“Order”), as set forth below.

### **III.**

On the basis of this Order and Respondent's Offer, the Commission finds that:

#### **A. Facts**

##### **1. Summary**

This matter involves the filing of an inaccurate quarterly report with the Commission by Comerica. During the quarter ended June 30, 2002, Comerica failed to establish an appropriate allowance for loan and lease losses ("ALLL") for its subsidiary Comerica Bank-California. This failure stemmed from the flawed methodology that Comerica used for determining the ALLL. As a consequence of understating the ALLL, Comerica's net income was materially overstated for the quarter ended June 30, 2002 and not in accordance with Generally Accepted Accounting Principles ("GAAP"). Accordingly, on October 2, 2002, Comerica restated the financial statements included in its Form 10-Q for the period ended June 30, 2002. The restatement reflected that Comerica's second quarter income before income taxes had been overstated by approximately 14.8%. Following the announcement of the restatement and two larger unrelated charges being taken in the third quarter, the closing price of Comerica's stock fell 20% from the previous day's close. Accordingly, Comerica violated the reporting provisions of the Exchange Act. Moreover, by failing to document the ALLL in accordance with GAAP, Comerica violated the recordkeeping and internal controls provisions of the Exchange Act.

##### **2. Respondent**

Comerica is a Delaware corporation headquartered in Detroit, Michigan. Comerica is a holding company for business, consumer, and investment banks with operations in the United States, Canada, and Mexico. During the relevant period, Comerica had three primary U.S. subsidiary banks: (1) Comerica Bank-Michigan; (2) Comerica Bank-Texas; and (3) Comerica Bank-California. Comerica's common stock is registered with the Commission pursuant to Section 12(b) of the Exchange Act and is listed for trading on the New York Stock Exchange under the stock symbol "CMA."

##### **3. General Description of ALLL**

Regardless of how well a bank's lending is done, the bank will have loan and lease losses. To absorb these losses, banks are required to maintain an ALLL, which is also referred to as an "allowance for credit losses" or "loan-loss reserve." The ALLL represents the bank's assessment of probable credit losses inherent in its loan portfolio as of a specific balance sheet date, whether related to specifically identified loans or not.

The ALLL is established and adjusted by charges against the bank's operating income. The ALLL is presented on the balance sheet as a contra-asset account that reduces the amount of the loan portfolio reported on the balance sheet. The ALLL must be adjusted to reflect the current

level of probable estimated credit losses through a provision for loan and lease losses. This provision appears as an expense item on the bank's income statement and decreases the net income for that period.

#### **4. Comerica's Methodology for Determining its ALLL**

Comerica's ALLL was comprised of the loan loss reserves for its three U.S. subsidiary banks. Each subsidiary bank's ALLL was comprised of standard, specific, and unallocated reserves.

Every commercial loan made by a Comerica subsidiary bank was rated by the subsidiary's credit officers on a scale from 1 to 8 based on risk characteristics. A loan rated 1 (called a "grade 1 loan") had little or no risk and a loan rated 8 was a non-performing loan that was a confirmed loss requiring a charge off.<sup>1</sup> Standard reserves for all loans were determined by grouping together loans with the same loan grades, then applying to each loan grade projected loss ratios set by Comerica based on numerous factors.

As to specific reserves, every quarter Credit Quality Review ("CQR") meetings were convened at each subsidiary to review the subsidiary's loan portfolio. The attendees of these meetings were known as the "CQR committee." The committee would review the bank's large grade 5, 6, and 7 loans for individual impairment every quarter to determine whether they required a specific reserve as opposed to the standard reserve allocation. The CQR committee's determination of the reserve amount for a specific loan was recorded in a one or two page summary called the "CQR report." These reports include a short synopsis of the borrower, the loan, the loan grade, action plans to reduce the risk of the bank, and developments at the borrower. However, the CQR reports often did not provide any narrative explanation for why the CQR committee assigned a particular loan grade or specific reserve allocation to a certain loan. The CQR committee would also review the loan grades for the large grade 5, 6, and 7 loans in Comerica Bank-California's loan portfolio and, as necessary, revise the grade and recommend charge-offs.

Unallocated reserves were intended to cover potential losses on categories of loan portfolios that had been identified as having specific loss characteristics that had not otherwise been considered. Comerica determined its unallocated reserve by first setting a separate range of minimum and maximum reserve percentages for each portfolio category, based on industry, geographic, and economic factors. Comerica used the same percentages for all three of its subsidiaries, notwithstanding the different factors that might have applied to the loan portfolios of Comerica Bank-Texas, Comerica Bank-Michigan, and Comerica Bank-California.

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<sup>1</sup> Comerica used a separate methodology for determining its reserves for retail loans. For the period ended June 30, 2002, the reserves for retail loans accounted for less than 2% of Comerica's entire ALLL.

For each subsidiary, the uniform minimum and maximum percentages for each portfolio category were multiplied by the aggregate loan amounts in each portfolio category. The minimum and maximum figures for each portfolio category at each subsidiary were then added together to create the total minimum and maximum limit for each subsidiary's unallocated reserve. This process created three separate minimum and maximum ranges corresponding to the three subsidiaries. Comerica's chief credit officer would then select a number within the minimum and maximum range for each subsidiary bank to be the preliminary unallocated reserve for that subsidiary. The unallocated reserve figures for all three subsidiary banks were then totaled to form Comerica's preliminary unallocated reserve. That was the final component to determining Comerica's preliminary ALLL. Later, Comerica's management would either accept that preliminary figure as the final unallocated reserve for all three subsidiary banks, or decrease or increase it, to determine Comerica's final ALLL.

The calculation of Comerica's ALLL was partially documented each quarter in a binder titled "Credit Loss Reserve Analysis" ("Credit Loss Reserve binder"). First, a preliminary version of the binder was prepared by Comerica's credit department. It set forth the results of the above-described quarterly procedure through the determination of the preliminary ALLL. Within a few days after the end of each quarter, a group of Comerica's senior officers would meet to review the adequacy of the ALLL, as reflected in the preliminary Credit Loss Reserve binder. At this meeting, Comerica's management would, as described above, determine the final unallocated reserve and the final quarterly ALLL figure. The results of the quarterly meeting were reflected in the final Credit Loss Reserve binder, but meeting minutes were not maintained.

## **5. Problems Relating to Comerica Bank-California's ALLL**

Comerica Bank-California's ALLL process was not properly documented and there was an insufficient link between the CQR process and the quarterly ALLL figure recorded in the Call Report.<sup>2</sup> Furthermore, Comerica Bank-California's methodology was not sufficiently auditable, allocated losses were not representative of current conditions, the documentation of unallocated reserves was inadequate, and recognition of loan losses, and downgrades were delayed. With respect to this last point, Comerica Bank-California's CQR committee meetings were held during the second month of each financial quarter. At those meetings, certain incremental probable credit losses were measured, but Comerica Bank-California did not always reflect the incremental losses in its Call Report for that quarter.

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<sup>2</sup> Federal law requires all banks to file quarterly with the appropriate federal banking agency a Report of Condition and Income (or "Call Report"). See 12 U.S.C. §161 (National banks), 12 U.S.C. §324 (State member banks), and 12 U.S.C. §1817 (State nonmember banks). This report collects basic financial data from banks in the form of a balance sheet, an income statement, and supporting schedules. It is a primary source of financial data used for the supervision and regulation of banks.

In late 2001 and early 2002, the Federal Reserve Bank of San Francisco (“Federal Reserve-San Francisco”) expressed concerns regarding Comerica Bank-California’s increased credit risk profile and that the methodology used by Comerica Bank-California appeared inadequate to ensure that the ALLL kept pace with the deterioration of the bank’s loan portfolio. At a preliminary meeting held on July 31, 2002, during a regularly scheduled examination, Federal Reserve-San Francisco examiners told Comerica Bank-California’s management and Comerica’s chief credit officer that they had preliminarily identified an addition to the provision for loan losses relating to specifically identified loans and additional charge-offs that were required for the period ended June 30, 2002. The Federal Reserve-San Francisco examiners and Comerica Bank-California management agreed to discuss the issues further.

On or about August 5, 2002, at a meeting of Comerica’s senior management, Comerica’s chief credit officer reported that discussions with the Federal Reserve-San Francisco concerning additional provisions and charge-offs were ongoing.

**6. Comerica Files a Form 10-Q for the Period Ended June 30, 2002 Containing a Materially Understated ALLL**

On the evening of August 12, 2002, Comerica filed its second quarter Form 10-Q, which reported a materially understated ALLL and overstated net income figures for the period ended June 30, 2002. Comerica did not disclose in the Management’s Discussion and Analysis of Financial Condition and Results of Operations (MD&A) section of the Form 10-Q any information concerning Comerica Bank-California’s increased risk profile.

**7. Restatement of the Second Quarter 2002 Comerica Bank-California Call Report**

After several additional communications between Comerica and the Federal Reserve-San Francisco examiners, the Federal Reserve-San Francisco and Comerica Bank-California met on September 18, 2002. The regulators directed Comerica Bank-California to restate the June 30, 2002 Call Report to reflect an incremental \$40 million provision for credit losses, which included \$22 million in charge-offs.

**8. Restatement of the Financial Statements Contained in Comerica’s June 30, 2002 Form 10-Q**

Comerica restated the Call Report as directed. As a result of restating the Call Report, on October 2, 2002, Comerica filed an amended quarterly report on Form 10-Q/A for the period ended June 30, 2002. Comerica restated its second quarter income before income taxes from \$272 million to \$237 million, reflecting an overstatement of about 14.8%, and its second quarter diluted net income per share from \$1.03 to \$0.90, reflecting an overstatement of about 14.4%. The overstatements in income before income taxes and diluted net income per share were caused primarily by Comerica’s failure to make the incremental credit loss provision of \$40 million.

The day before the amended filing, on October 1, 2002, Comerica's stock price had closed at \$50.19 per share. After the press release on the morning of October 2, 2002 announcing the restatement and two larger unrelated charges taken in the third quarter, Comerica's stock traded as low as \$39.11 per share and closed the day at \$40.00 per share, a decrease of about 20% from the previous day's closing price. Trading volume increased from 903,300 shares on October 1 to 10,855,200 on October 2 and market capitalization decreased from \$8,767,685,629 on October 1 to \$6,987,595,640 on October 2.

## **B. Legal Analysis**

### **1. Violations of the Reporting Provisions of the Exchange Act**

Section 13(a) of the Exchange Act and Rule 13a-13 thereunder require issuers with securities registered under Section 12 of the Securities Act of 1933 to file quarterly reports with the Commission. The obligation to file such reports embodies the requirement that they be true and correct. See SEC v. Savoy Indus., Inc., 587 F.2d 1149, 1165 (D.C. Cir. 1978), cert. denied sub nom. Zimmerman v. SEC, 440 U.S. 913 (1979). Article 4 of Regulation S-X requires that financial statements filed with the Commission pursuant to Section 13(a) of the Exchange Act be prepared in accordance with GAAP or such statements will be presumed to be misleading or inaccurate. 17 CFR § 210.4-01(a)(1). Furthermore, Articles 9 and 10 of Regulation S-X require creditors to disclose their ALLL in the interim financial statements included in their quarterly reports. 17 CFR §§ 210.9-03(7) & 210.10-01(a). Therefore, banks filing quarterly reports with the Commission must disclose their ALLL in the interim financial statements and the ALLL must be calculated in accordance with GAAP.

Guidance under GAAP for recognition of loan losses is provided by Statement of Financial Accounting Standards No. 5, Accounting for Contingencies (FAS 5), and Statement of Accounting Standards No. 114, Accounting by Creditors for Impairment of a Loan (FAS 114). See SEC Staff Accounting Bulletin 102 ("SAB 102"). FAS 5 provides that an estimated loss from the collectibility of a loan should be accrued when, based on information available prior to the issuance of the financial statements, it is probable the loan has been impaired at the date of the financial statements and the amount of the loss can be reasonably estimated. FAS 114 provides specific guidance on the measurement of loan impairment and related disclosures, but does not change the fundamental recognition criteria for loan losses provided by FAS 5.

On July 6, 2001, the Commission staff issued interpretive guidance on FAS 5 and 114 in the form of SAB 102. In SAB 102, the staff expressed the view that it normally would expect a registrant that engages in lending activities to develop a systematic methodology to determine its ALLL in accordance with GAAP as of each financial reporting date. Comerica failed to develop a systematic methodology for determining the ALLL in accordance with GAAP. Under GAAP, if an issuer can measure a reasonably estimable and incremental probable credit loss in a particular financial quarter, the issuer must recognize the loss in that same quarter. See FAS 5, ¶ 8. Although Comerica's loan review process measured incremental probable credit losses in the second month of a financial quarter, Comerica sometimes did not recognize those incremental

probable credit losses until the following quarter. This practice contradicts FAS 5, FAS 114, and Commission staff guidance. The failure to recognize incremental probable credit losses inherent in Comerica Bank-California's loan portfolio in a timely manner resulted in Comerica's filing of financial statements with the Commission that contained material departures from GAAP. By understating its ALLL in the Form 10-Q for the period ended June 30, 2002, Comerica materially overstated its income before income taxes by \$35 million and diluted net income per share by \$0.13. In percentage terms, Comerica overstated its income before income taxes and diluted net income per share by 14.8% and 14.4%, respectively.

In addition to the above reporting requirements, Item 303 of Regulation S-K requires a registrant to describe in the MD&A section of the Form 10-Q any known uncertainties that it reasonably expects will have a materially unfavorable impact on revenues or income from continuing operations. Comerica failed to comply with the disclosure requirements contained in Item 303 by failing to disclose in the MD&A section of its Form 10-Q for the period ended June 30, 2002 the known uncertainty associated with Comerica Bank-California's increased risk profile (specifically, the deteriorating trend of the subsidiary bank's loan portfolio), which should have been expected by Comerica to have a materially unfavorable impact on income.<sup>3</sup>

Furthermore, Exchange Act Rule 12b-20 provides: "In addition to the information expressly required to be included in a statement or report, there shall be added such further material information, if any, as may be necessary to make the required statements, in light of the circumstances under which they are made not misleading." Comerica failed to comply with this rule by failing to add material information necessary to make the financial statements included in its Form 10-Q for the period ended June 30, 2002 not misleading.

Accordingly, Comerica violated Section 13(a) of the Exchange Act and Exchange Act Rules 12b-20 and 13a-13.

## **2. Violations of the Recordkeeping Provisions of the Exchange Act**

Section 13(b)(2)(A) of the Exchange Act requires issuers to make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and

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<sup>3</sup> This Order does not address whether Comerica, as a bank holding company supervised and regulated by the Federal Reserve Board, was required by Item 303 to disclose "confidential supervisory information" as defined in 12 CFR § 261.2(c). The Commission understands that the Board considers documentation obtained from financial institutions during the course of examinations or inspections, as well as examiner workpapers, memoranda, and reports of examination or inspection, to be confidential supervisory information, and that it is the Board's practice to protect confidential supervisory information from disclosure to third parties to the greatest extent possible consistent with applicable law and the public interest. *See, e.g.*, SR 97-17 (SUP) (June 6, 1997) (Access to Books and Records of Financial Institutions During Examinations and Inspections).

dispositions of the assets of the issuer. Comerica's filing of an inaccurate Form 10-Q on August 12, 2002 evidenced a failure to maintain books and records that accurately and fairly reflected the ALLL, income before income taxes, and diluted net income per share figures for the period ended June 30, 2002. Accordingly, Comerica violated Section 13(b)(2)(A) of the Exchange Act.

### **3. Violations of the Internal Controls Provisions of the Exchange Act**

Section 13(b)(2)(B) of the Exchange Act requires issuers to devise and maintain a system of internal controls sufficient to provide reasonable assurances that, among other things, transactions are recorded as necessary to permit preparation of financial statements in conformity with GAAP and to maintain the accountability of assets. Pursuant to SAB 102, a registrant is expected to maintain documentation of the rationale supporting each period's determination that the reported ALLL figures were adequate. A financial institution is expected to maintain documentation supporting its ALLL policies and procedures, the loan grading system or process, the summary or consolidation of the ALLL balance, the validation of the ALLL methodology, and the periodic adjustments to the ALLL process. See SAB 102.

Comerica failed to adequately document the underlying rationale for making adjustments to the ALLL. Moreover, Comerica did not maintain documentation that linked the components of the loan review process to the final ALLL reported in the financial statements. As a consequence of these practices, Comerica recorded its June 30, 2002 ALLL, income before income taxes, and diluted net income per share in a manner that was not in conformity with GAAP. Based on the foregoing conduct, Comerica violated Section 13(b)(2)(B) of the Exchange Act.

### **IV.**

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent Comerica's Offer.



Accordingly, it is hereby ORDERED that:

Respondent Comerica cease and desist from committing or causing any violations and any future violations of Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act, and Rules 12b-20 and 13a-13 thereunder.

By the Commission.

Jonathan G. Katz  
Secretary