

Bryn Mawr Bank Corporation

March 26, 2009



LETTER OF COMMENT NO. 120

VIA EMAIL TO: director@fasb.org

Mr. Russell Golden
Technical Director
Financial Accounting Standards Board
301 Merritt 7
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RE: Proposed FAIR VALUE FSP FAS 157-e, *Determining Whether a Market Is Not Active and a Transaction Is Not Distressed*

Dear Mr. Golden:

Bryn Mawr Bank Corporation ("BMBC")¹ appreciates the opportunity to comment on Proposed FAIR VALUE FSP FAS 157-e, *Determining Whether a Market Is Not Active and a Transaction Is Not Distressed* ("Proposed Fair Value FSP"). Current accounting is resulting in financial statements for banks that are not transparent and are misleading to users of financial statements. BMBC unequivocally supports transparency in financial reporting, both as preparers of financial statements and users of others' financial statements. Therefore, we believe it is critical to make improvements to financial reporting – in this case, improvements to fair value accounting. So, we commend the staff's efforts to better address this key issue, considering that many, if not most, of the markets for mortgage and other asset-backed securities, are currently dysfunctional and illiquid.

BMBC believes that Fair Value FSP accounting (mark to market accounting, or MTM) for banking institutions often provides misleading information to users of the financial statements, and the current market has clearly demonstrated this. Although SFAS 157 required no additional use of fair values, it resulted in a new definition of fair value that has not worked effectively. Some believe the problem is the standard itself, while others point to a litigious environment that forces reliance on the lowest tangible quotes. In any case, we appreciate the FASB's efforts to make improvements to the guidance for estimating market values in illiquid markets.

¹ Bryn Mawr Bank Corporation is a \$1.1 billion community bank established in 1889 that operates in the western suburbs of Philadelphia, PA.

MTM is not as simple as it sounds -- nor is it simple to apply. Many questions arise. For example,

- If a true “market value” does not exist, then how should one estimate market value?
- Does an estimate provide useful information?
- What is the proper framework for estimating market value among a range of possible market value estimates?
- How does one know when an active or dislocated market does or does not exist?
- Can entities whose business models are not based on MTM prepare their own financial statements, or must they buy programs or hire outside vendors to develop the information?

These questions, so vital to the basic financial accounting concepts of reliability and relevance, could have been true under the former definitions of fair value in this current market. However, the use of “exit” price and the application of the three “levels” of inputs as a hierarchy have resulted in much debate and research relating to individual securities, and have contributed to what we believe to be overstatements of losses for over a year. Enormous amounts of time have been spent on substantiating and documenting MTM estimates. Our hope is that the FASB will bear in mind that the proposed Fair Value FSP needs to not only help improve the definition of fair value, but also streamline the work that is currently required. To help ensure this, it is critical that the FASB, PCAOB, and preparers are in agreement about what is required and expected in the application of this and other fair value guidance.

We support the Proposed Fair Value FSP because it is a significant step in the right direction in helping preparers understand the concepts for estimating fair value in illiquid markets. Unfortunately, as the Proposed Fair Value FSP is written, we believe confusion will remain and there may continue to be widespread misapplication of SFAS 157. The following comments will help reduce that confusion. In summary, they are:

- Guidance must be changed to differentiate between normally inactive markets and dislocated markets. This will change how bid prices are used in a Level 3 valuation technique. Further, it should also provide an entity with flexibility to determine whether, even in an inactive market, reliance on market quotes is appropriate.
- The description of an “orderly transaction” must be modified to ensure that risk premiums used in Level 3 valuation techniques reflect those of a normally active and functioning market. Without such language, the abnormal liquidity risks in the current market will unintentionally remain as a significant factor within these model valuations.

- The FASB should provide additional guidance in the proposed Fair Value FSP regarding what is a quoted price. Financial institutions often obtain values for its investment securities from third party sources including, but not limited to: market transactions, broker quotes, and pricing services. It would be helpful if FASB specifically provided a definition of what constitutes a quoted price, and how those third party pricing sources fit into that definition.

Differentiation is needed between inactive markets vs. dislocated markets.

Quotes received in dislocated markets should often be disregarded in Fair Value FSP models.

The Proposed Fair Value FSP introduces a two-step process to determine (1) whether the market is inactive, and (2) whether the quoted price is related with a distressed transaction. Seven factors are listed that should be evaluated under step 1, three of which are new to SFAS 157 and are indicative not of a market that is necessarily inactive, but of a market that is dislocated.

There is a difference between a market for a security that is **normally inactive** (that is, it is the sort of security for which trades are infrequent under any market conditions) and one that is **abnormally inactive** or **dislocated**, and there is a difference on how you would make use of broker quotes in these markets for the purposes of estimating fair values. In many normally inactive markets (such as during the infant stages of a new derivative product), broker quotes may have large bid-ask spreads.

However, those bid prices would likely be appropriately used as a point of reference when using a modeled valuation technique.

In abnormally inactive or dislocated markets, however, those bid prices generally have no relation to the economic value to a market participant who is a long-term holder of the security. They make sense only for dealers who are trading for profit. These quotes should be totally disregarded when using modeled valuation techniques. However, the example provided in the Proposed Fair Value FSP to assist preparers in using valuation techniques (paragraph A32A-G), even after noting that quoted prices cannot be used as inputs, uses the inherent yield of bid prices as a basis to calculate a midpoint discount rate. This creates the mistaken impression that bid prices should automatically be considered in the valuation model, virtually replicating the same confusion caused by FSP 157-3.

Non-dislocated inactive markets should not be presumed to require Level 3 inputs

With the specific criteria provided in paragraph 29A, most debt markets today will be considered inactive, though there are some that may be operating relatively effectively. Because of the *relative difficulty in obtaining information regarding specific transactions that form broker/pricing service quotes*, the two-step process might require the majority of debt securities to now needlessly undergo Level 3 modeling. This would obviously result in an administrative burden that most companies (banks, brokers, trust and investment companies, and pricing firms, to name a few) will be unable to bear. In these cases, Level 3 inputs are both unnecessary and burdensome.

Recommendations

We reiterate that normally inactive markets operate very differently from abnormally inactive or dislocated markets. With that in mind, we recommend the following:

- Revise proposed paragraph 29A
 - To differentiate between normally inactive markets and abnormally inactive or dislocated markets. As long as the two are left together, inappropriate reliance on, or consideration of, unreasonable broker quotes will continue. We believe that transactions in an abnormally inactive or dislocated market need no test to *determine whether the transaction is distressed*.
 - To provide the flexibility of the entity to determine, even in an inactive market, whether quoted prices are appropriate or not. We believe that, without further differentiation, in practice, securities in non-dislocated markets will unnecessarily require Level 3 inputs.
- Revise the example in paragraph A32F to exclude consideration of “bid-level yields”, since this can be interpreted to use bid prices as a legitimate starting point in the modeling process within a dislocated market.

Reasonable Risk Premiums should reflect Normal Active Markets.

The objectives of the various market participants in the debt securities (and, namely, asset-backed securities) markets are varied. Long term investors, such as commercial banks, will normally have lower risk premium requirements than other market participants. Banks are normally buy-and-hold investors who are interested solely in the contractual cash flows over time, whereas dealers and traders often strive for short-term profit or price speculation. The amount of risk each assumes differs significantly because their objectives are different.

The FASB staff appears to recognize this, as the example in paragraph 32 details assumed discount rates that range from 7 percent to 15 percent. In other words, they realize various market participants will have different required rates of return – one more than twice the other in this case. With that in mind, unless more guidance is provided, we believe that there will continue to be widespread confusion in setting discount rates based on an “orderly transaction”. This is because the term “reasonable risk premium for bearing uncertainty that would be considered by market participants” (as noted in paragraph 29A) may be interpreted differently based on which kind of market participants are considered and the illiquidity in the market.

In an active market, banks are selling to banks or other institutions with similar investment objectives and risk premiums (with dealers passing through the security). However, the fact is that transactions are primarily made through broker/dealers who also trade for profit and often increase their risk premium because of their intent to sell in the short term. So, in this dislocated market, the risk premiums will vary significantly.

Recommendation

Therefore, we recommend that the description in paragraph 29A of an “orderly transaction” be modified as follows:

“An orderly transaction would reflect all risks inherent in the asset, including a reasonable risk premium for bearing uncertainty that would be considered by market participants (that is, willing buyers and willing sellers) in pricing the asset in a non-distressed transaction *in a normally active and functioning market.*” (Inserted words are italicized)

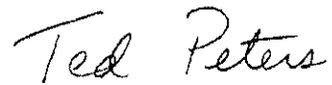
Inserting such wording will reduce the confusion that arises during a dislocated market because of risk premiums required by certain market participants.

Note: BMBC supports FASB’s efforts as reflected in the Proposed Fair Value FSP. **However, it is our opinion** that the Public Company Accounting Oversight Board (“PCAOB”), in their oversight role over the major accounting firms, also needs to get on board with these proposed changes and not indirectly influence the accounting firms into extreme conservative interpretations of current Fair Value and OTTI Standards.

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Thank you for your attention to these matters and for considering our views.

Sincerely,



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