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LETTER OF COMMENT NO. 254

Mr. Russell G. Golden
Technical Director
Financial Accounting Standards Board
401 Merritt 7
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File Reference: Proposed FSP FAS 115-a, 124- LETTER OF COMMENT NO. 293

Dear Mr. Golden:

The Darling Consulting Group, Inc. (DCG) and the attached 79 co-signers appreciate the opportunity to comment on the proposed FASB Staff Position No. FAS 115-a, FAS 124-a, and EITF 99-20-b, "Recognition and Presentation of Other-Than-Temporary Impairments."

We also offer a brief comment at the end regarding FAS 157-e, "Fair Value Measurements."

Proposed FSP Makes Significant Improvement But Stops Short

In the context of existing accounting rules and guidance regarding the impact of the calculation of "fair value" of financial instruments on reported earnings and capital, the proposed FSP provides marked improvement. Specifically, the ability to bifurcate unrealized securities losses due to the deterioration of the underlying credit dynamics of a financial instrument from other loss factors that pose a "less likely" risk of true economic loss over time (e.g. liquidity and interest rate risk) is an important step in the right direction. It has the benefit of allowing for the "recovery" of the capital reduction associated with the non-credit component as market conditions improve.

Conceptually, we disagree with the implied assumption that an other-than-temporary credit driven impairment presumes that the other loss factors are also other-than-temporary.

Accordingly, we oppose the portion of the proposed FSP as it relates to reporting non-credit related unrealized losses for held-to-maturity debt instruments. Existing guidance from FAS 115 appears sufficiently clear regarding an institution that has made the declaration to hold a security to maturity. By virtue of this declaration, an entity has decided to avoid cyclical noise in the capital markets that can impact short-term value but have little impact on the likely realization of contractual cash flows. Therefore, we believe that the non-credit portion for securities deemed to be other than temporarily impaired should be treated the same as non-impaired HTM securities are currently treated (footnote disclosure vs. the current proposal for adjusting capital via OCI).

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We also strongly encourage the FASB to consider granting an ability to record a one-time recapture of OTTI earnings charges from prior reporting periods that would not have occurred based on the guidance this FSP provides. Doing so can have a meaningful positive impact on the capital position for a number of banking institutions at a time when capital is in scarce supply. Allowing this makes good business sense without the burden of completing an earnings restatement.

Issues surrounding OTTI are not new, and had the proposed guidance existed a little over a year ago the impact on earnings and regulatory capital would have been far less for many banking institutions (including the FHLB system, FNMA and FHLMC to name a few).

Quite frankly, this is a time to put politics and egos aside and to do what is simply right. What is right is to unwind much of the unnecessary destruction of reported capital that has occurred throughout the banking industry that resulted directly from the combined application of FAS 157 and OTTI guidance (the former of which is currently under review, and the latter of which lacked meaningful clarity). The fact that these two issues are under a much accelerated review is clear testament to the inherent problems with the to-date implementation of fair value accounting "standards".

A Need for "Recapturing" Portion of OTTI Adjustment

Prospectively, lifting the specter of non-credit related impairment losses will undoubtedly make the non-agency securities market more liquid as investor fears of senseless OTTI charges are eased. In effect, the proposed FSP will help right an accounting standard wrong that contributed to the demise of certain segments of the securities and credit markets.

But is this enough? Had this proposed guidance been in place in 2008 as the credit markets began the historic changes that have reshaped the landscape of the financial system, we feel that the rapid deterioration of capital that was evident among some financial institutions would have been mitigated greatly.

It seems dubious at best that at a time when the government is helping to support the banking industry with access to capital, that inconsistent implementation of incomplete *a priori* fair value related guidance be allowed to destroy more capital on a non-cash basis than has been infused on a cash basis. It is this very scenario which is producing a deeply concerning reality: many banks that are producing meaningful ongoing positive cash flow that contributes real incremental cash to capital reserves are being dangled over the edge of a cliff because of accounting rules that never adequately "allowed" for these very difficult times.

For example, there are many private label whole loan mortgage securities that are "trading" at deep discounts in spite of very strong underlying credit performance characteristics. Many of these have been the source of OTTI write-downs that have resulted from non-functioning markets. If the exact loans underlying these securities were instead held in whole loan form on the balance sheet, they would not be impaired. How does FASB reconcile this substantially

different reporting of carrying values on a bank's balance sheet? If it can not do so with clarity, how can FASB not allow for an appropriate recapturing of the previously, by definition, overstated OTTI earnings losses?

The damage is done; therefore, prospective implementation accomplishes little relative to the very real unintended consequences that have been allowed to transpire. To freeze this damage at a time when a meaningful component of this damage can be reversed with a one-time "extraordinary" adjustment is unconscionable, in our opinion.

Below are two of the many types of examples we have witnessed first hand and very recently that reinforce our concerns with the points above:

1) A multi-billion dollar bank was "forced" at year-end to record a large impairment on a portion of their investment portfolio. They reported a "fair value measurement" of approximately 18 cents on the dollar despite the fact that they continue to receive 98.5 cents of contractual cash flow. The prospective yields on these securities are 35%-45%. Transparency? We think not. Unnecessary destruction of reported capital? Absolutely. Did we happen to "stumble" on the only example? No way; numerous similar examples prevail for banks of all sizes. In fact, in this situation the attempt was made to purchase these same securities in the open market at these "fair values". The result; none could be found for purchase, not even at higher prices.

2) Many similar examples exist where OTTI adjustments result in 20%-70% impairment charges which do not reflect anywhere near fairly on the intrinsic values of the related securities based upon cash flow characteristics. Clearly, he who controls the assumptions can "justify" ANY VALUE. The real question is who does "control" the assumptions? Very few, if any, of the institutions we hear from feel that they have much of a say in this regard; but yet have very little practical "choice" but to "sign-off" on values they believe are incorrectly understated.

In recognition of the above, the implementation of any and all changes as proposed should be done in such a way that OTTI charges recorded in previous periods (e.g. back to the date that the market for non-government securities began to come under non-credit related OTTI pressure; at very least to 12/31/07) be written back up into the carrying value of the security for the non-credit loss component existing at the implementation date of the proposed FSP. This is the quickest way to put much needed capital back into the system that was effectively and inappropriately destroyed over the last 18 months, and can be accomplished without a costly and cumbersome restatement process.

In Closing: A Call to Revisit Fair Value Accounting Entirely and Proceed with Caution

Authors in support of "mark-to-market" accounting and the SEC itself have argued that most banks have a relatively small amount of assets subject to "mark-to-market" accounting. They have used this fact to support their claim that fair value related accounting has had little to do

with the current situation. There are a couple of points which deserve consideration based on the perspective we get from the experiences of the diverse universe of community banks we speak with every quarter.

1) It is the application of "mark-to-market" concepts to the accounting for OTTI (under the guidance within FAS 157) that is the pertinent "mark-to-market" issue at hand.

2) If the "mark-to-market" accounting model has merit then it should hold firm whether a portion of or all financial instruments are carried at Fair Value.

3) The reality is that if all bank loans were subjected to the same litmus test that has been applied to investment portfolios, then the likelihood of a single bank left standing would be minimal at best.

4) To conclude that this is reflective of reality would be difficult to comprehend. To conclude that this is reflective of the fact that the vast majority of banking institutions operate with "illiquid" balance sheets (e.g. local market loans and deposits that cannot be freely traded), and that if forced to liquidate could not do so without incurring unrealistic discounts (exit prices), non-representative of the intrinsic values of the underlying cash flows, and unsupportable by regulatory capital levels, would be an accurate statement.

5) In effect, the application of full mark-to-market accounting to the banking industry guarantees that it ceases to exist. This is not a current phenomenon; it has always been the case. If this is not acceptable, then the accounting model must be revisited.

The debate on mark-to-market accounting also begs a very important question: " Is the purpose of accounting to dictate how entities conduct their business, or is it to reflect how business is actually conducted?"

We believe strongly that Fair Value Accounting (FVA) concepts are not appropriate for financial intermediaries such as the majority of commercial banks, savings banks and credit unions. Most financial intermediaries are balance sheet investors that generate the majority of their earnings from the spread they earn between the income (yield) on assets and the costs of their liabilities. Very little of the earnings for these financial intermediaries results from the sale of assets and liabilities. FVA measurements neither reflect how earnings are created nor capture the true going concern value of this type of financial institution.

To impose a market value concept, that by definition presumes the existence of liquid markets, on business entities that operate primarily in a world of illiquid markets (i.e. community bank business model based upon managing spread vs. price changes), is suspect at best and dangerous at worst.

A Brief Comment on Proposed FAS 157-e

We agree that the proposed two-step process represents a significant enhancement to the existing guidance pertaining to Fair Value Measurements. Notwithstanding, we believe that FASB should provide further guidance regarding the determination of fair values for financial instruments deemed to be part of inactive markets; specifically as it pertains to use of judgment in estimating and discounting cash flows. A particular area of concern relates to the assumptions regarding defaults and loss factors, and the extent to which they should reflect what is currently known vs. the extent to which they should reflect "anyone's guess" as to potential future defaults, delinquencies, deferments, etc.

In theory, FASB can talk about a reporting entity "using its judgment" on certain matters. In reality, many are finding that it is not the "judgment" of those that sign the financial statements that really matters.

In practice, it too often appears that the only opinion or "judgment" that really matters is that of the CPA firm (or regulators); an opinion which we often find is not "free from bias". Candidly, what we hear from bankers is too frequently reflective of what seems to be 3rd party biases towards a more self-serving and often draconian view based more on the covering of their flank than on fair and accurate reporting of the bank's financial position. In addition to the examples noted earlier in our letter, the following serves as a different yet related example of our concern:

- A multi-billion dollar bank was "forced" to lower their reported "fair values" on their FAS 107 footnote disclosures for their performing loan portfolio to a level that was 7-10 points lower than the bank estimated amount. The only opinion that "mattered" was that of the CPA firm that "felt" the loans were worth less. They had a "price" in mind that they were comfortable with; one that had nothing to do with the particular bank portfolio in question, but rather based upon some "studies" they had done relating to prior credit cycles. Fair reporting? For many banks, the risk of such credit related exit pricing disclosures on performing loans is to signal incorrectly that they are technically insolvent.

These realities makes it imperative that FASB carefully craft new guidance and pay due attention to how accounting impacts business practices. This is particularly true in the area of "fair value" where the technicalities of a theoretical valuation exercise often take center stage and more meaning than the intended spirit of the accounting standard when it was first drafted.

We thank you for your time in reading our comments, and appreciate your serious consideration of our thoughts and recommendations. We would be happy to discuss this letter with you.

Sincerely,

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