From:
 Max Arai

 To:
 Director - FASB

Subject: Comment on File Reference: No. 1810-100

Date: Thursday, July 08, 2010 1:21:33 PM

File Reference: No. 1810-100 Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities

Dear Mr. Golden:

As an individual and professional investor, I am delighted to have the opportunity to comment on the exposure draft *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities* ("proposal"). I strongly support mark to market valuations for all financial assets held by banking institutions. Many people, particularly those managing these institutions object to the transparency and potential earnings volatility this reporting would create, but these objections reflect current risk management policies more than they reflect sound banking practice. In particular, the American Banker's Association (ABA) has mounted a letter writing campaign to fend off perceived intrusions into their constituents' business. In this letter, I seek to refute their arguments.

Loans held on a banks book above market value unfairly inflate the true value of the bank's assets at the potential expense of investors. While sophisticated investors may be able to make use of the footnote disclosures to estimate the deterioration in the bank's underlying capital, the bank's management can report earnings (and collect compensation) based on the inflated valuations. Some opponents of this proposal believe that such assets may in fact be held to maturity and therefore should be evaluated solely on the basis of current performance. Book value obscures both positive and negative changes to the value of the underlying assets. Debt restructuring and changes to the terms of outstanding debts can greatly reduce the market value of the debt without changing the book value (par). Conversely, banks with higher coupon performing debt should recognize the increased value rather than simply commingling these interest payments with other perhaps less lucrative assets. More simply, what prudent bank would allow loans to issue against the book value of a client's collateral? Investors should not be subject to an asymmetric information gap imposed structurally through the existing weak accounting treatment.

Book value no longer seems appropriate for financial instruments. The use of book value in accounting is intended to provide an estimate of the value of that asset when liquidated without including discounts for liquidity or distress of the owner (it should reflect distress of the asset as an impairment). For example, plant property and equipment will be carried at original acquisition cost less the accumulated depreciation. The depreciation schedule reflects the expected useful life of the asset and the salvage value at end of life, thereby providing an appropriate discount to the value of the asset. This treatment provides the only fair valuation for highly specific company assets, such as a production line or factory. Financial instruments generally held by banks no longer share these characteristics. Since the advent of securitization, financial instruments such as loans have become far more marketable. Idiosyncratic features of a given debt instrument can be diversified away making portfolios of loans far less illiquid. Recent problems in the securitization markets reflect gaps between prices investors were willing pay for impaired assets versus expectations set by previous investors (perhaps incorrectly informed investors); the increasing bid ask spread in the securitization market greatly reduced their attractiveness to banks, but the mechanism remains financially valid. Systematic impairment of

bank assets, such as has been experienced with real estate mortgages for certain locales, reflects longer term uncertainty regarding the value of these assets. Impairments should be reflected in accounting for the value of these assets. Such impairment may be reversible by selling the loan to a third party for more than book value or by maturing without default. Reversal of impairment would still remain risk, albeit upside risk. The increasing ability of markets to value these assets argues that the need for book value accounting has diminished. Instead, mark to market accounting can provide far greater transparency into the acutal assets held by a bank, thereby enabling investors like myself to adequately guage the health and prospects of these institutions.

The ABA correctly notes that the imposition of this market to market requirement may require some banks to modify their business practices. They correctly note that should the volatility of the actual assets held by banks become more widely and transparently known to investors, such as myself, the markets would impose discipline on those institutions with more volatile asset bases. This outcome may be the strongest argument in favor of these new accounting rules. Effectively, the ABA is arguing that their constituents should be protected from the prying eyes of investors, since increased transparency might impair the stock valuations of banks with risky asset portfolios.

Finally, the ABA letter discusses the potential compliance costs associated with these regulations. All banks will already have systems to monitor the valuations of their portfolios, so any incremental costs must reflect either their uncertainty in the efficacy of these systems to produce auditable valuations, concerns about the potential liability arising from valuation errors, or unwillingness to fully disclose the actual condition of the bank's capital. Conservative asset valuations incorporating mark-to-market values and impairments would surely be less likely to annoy investors than inflated valuations based on outdated historical valuations, although more conservative valuations might limit risk taking by the bank (and profits). In many ways, banks represent a form of asset management not subject to SEC scrutiny. Mark to market accounting would bring bank's net asset valuation methods more in line with those NAV mechanisms used by SEC regulated asset managers.

I thank you for your time and for your consideration of these views. I am happy to discuss these matters in greater detail should you be interested. I look forward to the successful implementation of these improvements to financial reporting.

Gratefully yours, Max Arai, CFA 66 County Road Andover, MA 01810 maxarai@verizon.net