August 10, 2010

Technical Director
Financial Accounting Standards Board
401 Merritt, P.O. Box 5116
Norwalk, CT 06856-5116

Re: Exposure draft comment
File reference 1810-100
Accounting for Financial Instruments
Views of Users of Community Bank financial statements

Dear Sir or Madam:

Sunflower Bank, N.A. is a regional bank with $1.7 billion in assets, headquartered in Salina, Kansas. To assist them with their liquidity requirements, we provide an unsecured "federal funds" line of credit to several smaller community banks in our market area. In addition, on occasion, we make loans to individuals secured by the stock of privately held community banks. Our initial underwriting standards and subsequent credit monitoring policies require that we read and analyze the financial statements of these banks. Because the fed funds lines are unsecured, **the banks' financial statements are the single most critical piece of information that we utilize.** Thus, we feel that we have a genuine interest and qualification on which to comment about the exposure draft regarding proposed mark to market accounting for loans and deposits:

Scope – Question 1: Do you agree with the scope of financial instruments included in this proposed Update…?

No, we believe that assets and liabilities that are intended to be held to maturity/collection in the normal course of business should not be included in the scope of this proposed guidance. Investments held to maturity are appropriately addressed by ASC 820; loans (not held for sale) are appropriately addressed by ASC 310; and core deposit liabilities are appropriately accounted for at expected settlement amounts. Marking these financial instruments to market in the basic financial statements is inconsistent with the business strategy of the reporting entity, which creates mis-information that is confusing to users of community bank financial statements.

Initial Measurement – Question 12: For financial instruments initially measured at the transaction price, do you believe that the proposed guidance is operational to determine whether there is a significant difference between the transaction price and fair value? If not, why?

No, the guidance provided in paragraphs 14 through 17 of the ED, in tandem with relevant literature on determining "fair value" and adjusting for liquidity risk, **is not operational.** In many circumstances, this underscores the concerns that users of community bank financial statements have about "mark to market" reporting of assets that are not intended to be sold at market; they are intended to be held to maturity, but may be "marked to market" despite the long-term intentions and nature of the asset.

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Informed users have a concern that the current guidance will result in "day 2" losses being recognized in net income because of loans being made at market rates and terms but made in an illiquid market. For example, a community bank makes a loan in its rural community at market rates and terms. The business strategy is to hold the loan to maturity and the expectation is that the loan will be collected in full as the borrower has a stellar credit history and excellent collateral. However, the market for such a rural community loan is illiquid, requiring the use of level 3 pricing under current fair value accounting (ASC 820). When following the guidance of ASC 820 with respect to the discount rate, the illiquid market condition requires a higher adjusted discount rate resulting in a "fair value" that is below the transaction cost. Under the guidance at paragraph 17 of the ED, this difference would immediately be charged against earnings, and the carrying value of the loan reduced when the underlying facts are that no credit loss is expected and the loan terms are at market rates.

This would appear to be an **unintended consequence which not only results in financial reporting that is inconsistent with the underlying economic reality, but which could also have a negative effect on lending (restrictions on the bank's ability to lend to small businesses or possible higher-than-market rates in order to create more liquidity).**

<u>Subsequent Measurement – Question 22</u>: *Do you believe that the recognition of qualifying changes in fair value in other comprehensive income (OCI) (measuring the effects of subsequent changes in interest rates on fair value as well as reflecting differences between management's and the market's expectations about credit impairment) will provide decision-useful information for financial instruments an entity intends to hold for collection or payments…?*

No, users of community bank financial statements **do not believe that reporting these subjective changes in fair value in OCI or elsewhere in the basic financial statements serves a useful purpose or provides useful information because of the absence of a ready market for the loans and the inherent subjectivity in measuring the change in value.**

This question automatically assumes that the recognition of qualifying changes in fair value in OCI will be attributable solely to the effects of subsequent changes in interest rates or reflect differences between management's and the market's expectations about credit impairments. Such matters will not be the only qualifying changes in fair value of OCI; most of those changes will be related to liquidity of the after-market for loans made by community banks and judgments made by bank personnel regarding perceived credit risk, because there is no active market for individual community bank loans.

Further, users are concerned that if such market adjustments are eventually accepted by regulators, the measurement of bank capital will become more volatile and will discourage lending by community banks.

Measuring and reporting long-term assets at short-term exit values does not provide useful information upon which to make decisions by users. For example, this is not useful information to a Board of Directors in determining acceptable loan-to-capital ratios or the balance of lending and investment activity. **Quite the contrary; measuring and reporting long-term assets at short-term exit values are counter-productive to assessing capital adequacy and business risk assessment.**

<u>Subsequent Measurement - Question 17</u>: Do you believe that the measurement approach...for core deposit liabilities... is appropriate?

As indicated previously, we believe that core deposit liabilities should be exempt from the scope of the ED. However, if held to maturity loans remain included within the scope, we agree that core deposit liabilities should be reflected using a present value approach.

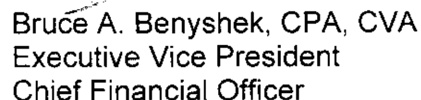
Conclusion: Relationship to Statement of Financial Accounting Concepts

Statement of Financial Accounting Concept No. 5, which has withstood the test of time, reminds us of the following with respect to "fair value" accounting (taken from the "Highlights" section):

"Information based on current prices should be recognized if it is sufficiently relevant and reliable to justify the costs involved and more relevant than alternative information."

The ED proposes to utilize fair value in lieu of the current cost basis in cases where "current prices" are completely unavailable and "fair value" is to be determined based on estimates and judgments that, by their nature, are subjective. More importantly, the **short-term fair values of long-term assets and liabilities are, quite simply, not relevant to financial statement users focused on long-term results. Such information is not only less reliable, it is less relevant to users of community banks with respect to long-term assets and liabilities.**

Respectfully,



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