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Mr. Russell G. Golden Technical Director Financial Accounting Standards Board 401 Merritt 7 P.O. Box 5116 Norwalk, CT 06856-5116

File Reference No: 1810-100 By email to: <u>director@fasb.org</u>

Dear Mr. Golden:

We are pleased to have the opportunity to comment on FASB's proposed Accounting Standards Update Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities (the "proposed ASU"). We welcome the Board's effort to improve accounting for financial instruments and support the stated objectives of providing financial statement users with more timely and relevant information about an entity's financial instruments. While we think that the proposed ASU offers some progress towards the goals of consistency and convergence with international standards, we feel that the proposal does not achieve the stated goal of reducing excessive complexity in the accounting for financial instruments. Accordingly, we do not support the issuance of the proposed ASU as a final standard, but would like to offer some suggestions for a less far-reaching proposal that could offer both preparers and users improvements in relevance, reliability and clarity.

We would first like to comment on the proposal overall and then address a few of the stated questions specifically. Our comments are formed from the perspective we gain from working with financial statement preparers and users as well as auditors and examiners of financial institutions. We provide assistance to financial institutions on management of investments, interest rate risk and overall balance sheet management. Preparers and users alike complain that accounting standards as written are confusing, overly complex and often result in information that is neither useful nor relevant to the business model of the typical community financial institution. Particularly smaller, non-public entities struggle to comply with standards that result in pages and pages of disclosures that may never be used by anyone and increasingly larger accounting and audit bills to produce those disclosures.

Overall, we feel that this proposed standard goes too far in applying fair value to too many parts of the balance sheet where the concepts simply do not have relevance to the business models of most of these entities. Particularly in the area of loans and deposits, fair value measurements provide little useful information to users when there are no robust markets in these types of instruments. Additionally, the incremental costs (both in terms of increased audit bills and the

additional time and attention of management) to produce these theoretical measurements can be astronomical.

For example, a typical small community bank of about \$300 million in assets would be required under the proposed new standards to compute fair values for much of the asset and liability sides of the balance sheet where no real market exists. This would create the need for investments in software, additional personnel, subscriptions to databases and then ultimately increased audit costs to review and verify all of the data and calculations performed. These additional costs could easily top \$200,000 per year even for a small institution. For this typical \$300 million bank, that would translate into about 15% of the year's profits, or about 8 bp off of ROA. Additionally, this would result in capital that is unavailable for lending in the community. The additional information would have little or no value to the bank, its customers, investors, regulators or the community.

Although many investors do express a desire for information on discounted cash flow values, most say that having the information in a separate disclosure would be acceptable and that the reliability, or standardization of the methodology, is more important than having fair values on the face of the financial statements. We think that a proposed standard with a requirement for a disclosure of fair values (perhaps as a replacement for the old FAS 107 disclosures) with some of the methodologies described in the current proposed ASU would be more useful for investors and would leave the financial statements on a mixed measurement basis, as they are now, that is more relevant to the business model of the entity.

The following comments relate to specific questions in the proposed ASU:

Question 14: The proposed guidance would require that interest income or expense, credit impairments and reversals (for financial assets), and realized gains and losses be recognized in net income for financial instruments that meet the criteria for qualifying changes in fair value to be recognized in other comprehensive income. Do you believe that any other fair value changes should be recognized in net income for these financial instruments? If yes, which changes in fair value should be separately recognized in net income? Why?

Answer: We agree generally with the income treatment for items where changes in fair value are recognized in other comprehensive income. We would suggest an additional clarification for a problematic income recognition item that is an issue for most financial institutions. Current accounting guidance in ASC 310-20-35-33 prohibits amortization of premium on a bond to a call date earlier than the maturity date. This provision was not in the original FAS 91 but was included in the codification from a later staff interpretation. We feel that this provision is contrary to the overriding principal of conservatism in that it requires investors to amortize premium over a longer period of time (to maturity) even when a bond is highly likely (or in many cases almost certain) to be called at an earlier date. In fact, many investors purchase bonds at premiums that carry a much higher than market coupons specifically because they are almost certain to be called.

In practice, most investors follow the principle of conservatism and amortize premiums to call date and accrete discount to maturity. We think this should be clarified in the codification.

Question 15: Do you believe that the subsequent measurement principles should be the same for financial assets and financial liabilities? If not, why?

Answer: The measurement of any liabilities at fair value provides little decision-useful information to investors because most liabilities on the balance sheet of the typical financial institution cannot be settled at any amount other than the face value. Additionally, the measurement of the fair value of deposits brings into question the franchise value of those deposits to an institution which is not addressed in the methodology recommended.

Question 16: The proposed guidance would require an entity to decide whether to measure a financial instrument at fair value with all changes in fair value recognized in net income, at fair value with qualifying changes in fair value recognized in other comprehensive income, or at amortized cost (for certain financial liabilities) at initial recognition. The proposed guidance would prohibit an entity from subsequently changing that decision. Do you agree that reclassifications should be prohibited? If not, in which circumstances do you believe that reclassifications should be permitted or required? Why?

Answer: Just as with the original FAS 115, reclassifications of assets from one category to another will be problematic because it will be difficult to capture the vast array of circumstances under which an entity might change its plans for a particular asset. We believe that there should be allowances for a change in categories. Although most financial institutions carry the majority of their assets for collection of principal and interest, there do arise from time to time situations that necessitate the sale or settlement of an item before its scheduled maturity. It is necessary that institutions be able to manage their assets without being handcuffed by accounting standards. The standards should allow for a change in circumstances such as liquidity needs, redeployment to alternative investments, changes in credit quality, changes in regulatory treatments, etc.

Additionally, the criteria for measuring fair value with changes through OCI versus income should be clarified. As currently stated, the entity would have to prove that items are generally held for a majority of their terms or infrequently sold. These terms are vague and, as we've seen with previous standards, will probably give rise to arbitrary guidelines being used in practice in the absence of more clarifying language.

Question 17: The proposed guidance would require an entity to measure its core deposit liabilities at the present value of the average core deposit amount discounted at the difference between the alternative funds rate and the all-in cost-to-service rate over the implied maturity of the deposits. Do you believe that this remeasurement approach is appropriate? If not, why? Do you believe that the remeasurement amount should be disclosed in the notes to the financial statements rather than presented on the face of the financial statements? Why or why not?

While the basic methodology of the remeasurement approach is appealing, we feel that the basic problems with presenting a "fair value" for core deposits are:

- 1. Lack of recognition of franchise value or core deposit intangible.
- 2. Misunderstanding of users as to what the value really represents
- 3. Inability of the institution to settle the liability at any value other than face amount.

Accordingly, we feel that there should not be presentation of the remeasurement amount on the face of the financial statements, but perhaps in the disclosures.

Question 38: Do you believe that an entity should immediately recognize a credit impairment in net income when an entity does not expect to collect all contractual amounts due for originated financial asset(s) and all amounts originally expected to be collected for purchased financial asset(s) as proposed in this Update, or do you believe that an entity should recognize initially expected credit losses over the life of the financial instrument as a reduction in interest income, as proposed in the IASB Exposure Draft on impairment?

We agree with the premise of the proposed ASU that there should be a single model for measuring impairment for all assets. We also agree that likely credit losses should be recognized when the entity does not expect to receive all contractual amounts due. We do not agree, however, with the treatment of using a credit loss-adjusted amortized cost balance for items where FV adjustments go through income. This approach would require major retooling of system for most institutions and would not result in relevant income measurements. We also agree that credit impairments should be able to be reversed for all assets when circumstances change.

Question 46: Do you agree that an entity should assume that economic conditions existing at the reporting date would remain unchanged in determining whether a credit impairment exists, or do you believe that an expected loss approach that would include forecasting future events or economic conditions that did not exist at the end of the reporting period would be more appropriate? Are both methods operational? If not, why?

We agree with the premise of the proposed ASU that assessments of credit impairment should be based on conditions that exist as of the reporting date. As we saw in the recent economic downturn, future projections of economic activity can vary widely particularly during times of rapid change. This can lead to turmoil in some markets as preparers and auditors are forced to use overly pessimistic projections to avoid liability issues. A financial statement is meant to measure financial condition as of a certain reporting date, not a "worst case" projection of future events.

Question 53: The method of recognizing interest income will result in the allowance for credit impairments presented in the statement of financial position not equaling cumulative credit impairments recognized in net income because a portion of the allowance will reflect the excess of the amount of interest contractually due over interest income recognized. Do you believe that this is understandable and will provide decision-useful information? If yes, how will the information provided be used? If not, why?

This methodology will not result in useful information and may be misleading. Users and preparers alike want to be able to easily see the amount of cumulative credit impairments separate from income.

Question 55: Do you agree that an entity should cease accruing interest on a financial asset measured at fair value with qualifying changes in fair value recognized in other comprehensive income if the entity's expectations about cash flows expected to be collected indicate that the overall yield on the financial asset will be negative? If not, why?

We agree that there should be a clear and consistent methodology for determining when an asset should be placed on non-accrual. In practice, this is an area where many users and auditors disagree and implementation is not uniform. Users are often confused about the meaning of non-accrual and the comparability of amounts between entities.

The standard as stated, however, will be difficult and complex for most preparers and may result in situations where an item would be placed on non-accrual even though all contractual interest is expected to be received (e.g., where faster than expected premium amortization would create a negative yield for a short period of time).

Question 68 and 69: Do you agree with the transition provision in this proposed Update? If not, why? Do you agree with the proposed delayed effective date for certain aspects of the proposed guidance for nonpublic entities with less than \$1 billion in total consolidated assets? If not, why?

As stated in the earlier par of this comment letter, we believe that most of the proposed Update relating to measurement of the vast majority of the balance sheet at fair value is simply too complex and not useful for most users and thus should not be implemented in its current form. However, if these provisions are enacted, we do agree that a delay of at least five years would be appropriate for smaller institutions. We believe that this delay should be stated as "entities that are either non-public and/or less than \$1 billion in assets". We believe that a smaller proposal aimed at some of the suggested changes such making credit impairment methods consistent, making credit impairments reversible and certain income recognition clarifications could be made effective sooner. The provisions for simplification of hedge accounting could also be made effective for all entities sooner.

FTN Financial appreciates the opportunity to participate in this process and to submit comments on this proposal that has the potential to impact our institution as well as our clients. If you have any questions concerning these comments, please direct them to me at the number or email address below.

Regards,

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