1810-100
Comment Letter No. 1316

Pentagon Federal Credit Union

Superior Rates. Proven Service.

PO Box 1432, Alexandria, VA 22313-2032 1-800-247-5626 www.PenFed.org

September 29, 2010

Mr. R. Golden-- Technical Director
File Reference No. 1810-100
Financial Accounting Standards Board
401 Merritt 7, P.O. Box 5116
Norwalk, CT 06856-5166

RE: Proposed Accounting Standards Update-- *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities Financial Instruments (Topic 825) and Derivatives and Hedging (Topic 815)*

Dear Mr. Golden:

In review of the proposed accounting standards update, Pentagon Federal Credit Union (PenFed) greatly appreciates the opportunity to comment on the Proposed Accounting Standards Update--*Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities Financial Instruments (Topic 825) and Derivatives and Hedging (Topic 815)*. The comments herein are balanced between issues and observations relative to the financial industry as a whole, as well as comments particular to the organization, structure and operations of PenFed and of the Credit Union industry.

General Comments

Unlike many of our fellow financial industry practitioners, we greatly support the key premise of this Exposure Draft (ED) for clear and sound disclosure of financial instruments through improved timing, clarity and usefulness of financial statements disclosures.

As a $14 billion asset-based mutual institution with 1 million members/owners, our mission is to provide safe and sound lending and depository products and services that meet the needs and expectations of our members/owners. Importantly, we have grown over the past 75 years by continuing to meet and exceed the expectations of our members/owners while growing our operations in a prudent, conservative and sound manner. Our operations and cost structure are straight-forward and efficient, and our losses on our members assets are among the lowest in the mutual and retail banking industries.

General Comments, Continued

Overall, as detailed below, there are several aspects of this ED that are not conceptually aligned with the operations of a mutual institution such as PenFed. In summary, the most significant concerns are as follows—

-- the requirement to measure all financial assets at fair value on the balance sheet with offsetting adjustments to equity/earnings,

-- the requirement to combine interest income recognition relative to contractual interest income and credit impairment assumptions, and

-- the requirement to measure core deposits, as well as other deposit and debt-related liabilities, at a measurement other than their contractual terms and conditions.

Simply put, the impact of these proposed requirements on financial institutions in general, and even more so to mutual operations such as ourselves, could include potential outcomes such as--

-- unprecedented volatility in earnings and equity, resulting in unstable capital levels and inconsistent key management and industry performance metrics and assessments,

-- mutual members/owners- the key users of the financial reporting process- will find that the fair valued-based financial statements clearly undermine the confidence and stability of such reporting entities, the result of reporting based-on current market conditions and fluctuations, which are not in any way indicative of the long-term performance (cash flows) of the contractual assets and liabilities of these institutions, and

-- undue pressure and influence to change the operations of mutual institutions to increase operating costs (to both institutions and members/owners) with added layers of assets/complexity to manage the volatile market fluctuations-- while continuing to offer the needed longer term products and services for its members/owners; or possibly worse, the potential elimination of many of the longer term products and services currently offered to mutual members/owners.

Classification and Measurement

Being an institution that has over 80% of its assets in long-term consumer/retail loans originated from and for its members/owners that are carried at amortized cost, PenFed agrees that providing on the face of the balance sheet the disclosure of fair value of said assets to be a purposeful and transparent update within PenFed's financial reporting. However, the recognition of the month-by-month and year-by-year fluctuations in said fair value as a component of earnings and/or other comprehensive income will bring unprecedented volatility to the earnings and members' equity of institutions such as PenFed. A better presentation would be a significant expansion within the existing notes of those statements.

Importantly, PenFed's historical growth in members' equity has maturated from two key sources: growth in its membership base together with its prudent and solid financial performance. These have been the paramount foundation under which this institution has grown and prospered for the past 75 years.

In consideration that a hypothetical/future debt crisis in other regions of the world could impact pricing in the U.S. bond market and therein bring volatility to the fair value measurements of PenFed's member assets, such an event could result in a single period end fair value adjustment that would significantly impair the equity strength of an institution like PenFed. In truth, any external event that would significantly impact the current/near-term financial markets would suffice by way of example. And therefore, such an outcome would be unconscionable to the members of PenFed, and would be ill-reflective of not only the performance and value of said member assets, but also of the value and strength of the members that contributed, own and trust in this institution.

This disconnect in measuring the value of member assets at a given financial reporting date is not unique to PenFed, and thus an unintended outcome may be a resurgence of the so-called "non-GAAP" structure for financial reporting – such as "core earnings" financial reporting. Having experienced the days of divergence between core earnings financial reporting vs. U.S. GAAP reporting, it is with much reluctance and concern that not only could our industry turn to "unwind" the impact of the proposed fair value measurements, but that our members will place their reliance and confidence in such non-GAAP financials, and hence disregard the U.S. GAAP financial statements as "unreliable."

Classification and Measurement, Continued

With that said, externally audited financial statements are a key component of a safe and sound institution/reporting process, and hence in the long term, the financial performance under U.S. GAAP guidelines could place an influence and pressure on institutions to reduce their exposure and investment in long-term assets and liabilities, in order to minimize the impact and divergence of fair value reporting vs. amortized cost reporting.

This migration, whether it is instantaneous with the adoption of this ED, or over a decade in time, would significantly reduce the value that PenFed could offer to its members though its longer term loan and share/deposit products. In response, PenFed would likely have to augment its cost structure within its products and services to meet the needs of its members, and at the same time reduce the duration of its assets and liabilities. This demand will likely lead to highly more complex transactions and "layers" of assets and liabilities that are counter-intuitive to the goal of this ED for clear and sound disclosure and usefulness of financial statement disclosures, while significantly reducing the benefit and value returned to PenFed's members.

Clearly, PenFed's members look to PenFed for availability of straight-forward loans and share deposit products, at competitive pricing, built on a foundation of PenFed being a stable, safe and sound institution that is focused on achieving true value for its members. Financial reporting on a periodic basis, which includes a short-term focus on market fluctuations, is the exact opposite stance for measuring and reporting for PenFed and its members, with the outcome undermining the confidence and strength that has lead to the highly successful stance that PenFed has achieved over the past 75 years.

Credit Impairment and Interest Income Recognition

Consistent with PenFed's asset structure and lending characteristics, PenFed finds that impairment of assets should be recognized over the life of the asset (and re-measured on a periodic basis) and not exclusively to the origination of the asset or any particular period end valuation. In addition, the migration to an "expected loss" methodology should be based on disclosed assumptions on future economic trends and market conditions vs. reliance on period end reporting trends and conditions, which will again lead to unwarranted volatility in the assessment of credit impairment. Entities should evaluate and disclose the credit review of assets on a pooled or loan-by-loan basis, with the designation of pooled vs. loan-by-loan being applied on a consistent basis.

Contractual interest income and losses on loans/credit should be reported separately, as the commingling of these two distinctive events will add unwarranted complexity to the measurement and reporting of financial assets. The concept that contractual interest income received would not be recognized when earned within a framework of a "credit loss adjusted" recognition methodology is too complicated of a framework to be practically implemented and measured. Further, this item in particular would not provide full transparency for our members. PenFed supports the earlier recognition of credit losses; however, this is better achieved through a viable and studied approach to the expected losses of an asset or group of assets.

Core Deposits and Financial Liabilities

PenFed has not been a significant participant in the acquiring or purchasing of deposit accounts, in that the growth of PenFed's share/deposit portfolio has been through its growth in membership and the deposit products available to its new and existing members.

PenFed does not believe it should measure an intangible asset related to the value of its core deposits relationships which are internally created, as PenFed believes the liability/deposit balance that should be reflected in its balance sheet is the balance held for its members' (stated amount or book balance) as of that particular reporting date. In a comparable view, PenFed does not find that it would be meaningful to report its financial liabilities at any given point in time at a value different than the contractual amount due (amortized cost) as PenFed pays its liabilities at the amounts due within the contractual terms of said liabilities and, thus, amortized cost is the most relevant measurement.

Conclusion

PenFed appreciates the opportunity to share its view with the Board, and supports the goal of clear and sound disclosure of financial instruments through improved timing, clarity and usefulness of financial statements disclosures. PenFed finds, in general terms, that accounting for long-term assets and long-term liabilities is best valued and measured within its contractual terms as part of an amortized cost framework. With that said, improved and enhanced disclosure of fair value could be achieved through balance sheet parenthetical disclosure for long-term assets and liabilities and expansion of the footnotes integral to those statements. More expansive and standardized fair value measurements and disclosures should be part of the notes to financial statements for reference and analysis within a meaningful fair value measurement and disclosure methodology.

If you have any questions in regard's to the comments above, please contact me at 703-838-1073.

James Duke
VP- Finance