

Letter of Comment No: 105
File Reference: EITF03-1A

October 28, 2004

Mr. Lawrence Smith
Director & Chairman of the Emerging Issues Task Force
Financial Accounting Standards Board
401 Merritt 7
Norwalk, CT 06856

Comment Letter Re: EITC 03-1

Dear Mr. Smith:

I am writing in opposition to the proposal that might require us to mark our hold to maturity investment portfolio to market.

Banks must currently divide their investment portfolio into three categories: Trading, Available for Sale, and Hold to Maturity. For community banks, the trading account would generally not apply.

For a number of years now, banks have had to mark their available for sale investments to market value on their periodic financial statements through balance sheet adjustments to the asset account and an adjustment in their capital accounts. Hold to maturity investments are carried at amortized cost.

I have been in banking for over 43 years, with the last 28 being in a senior management position responsible for handling the bank's investments.

The business of banking at the community bank level involves taking deposits from the local community and investing those funds into loans to businesses and individuals in their market to the maximum extent possible. If deposits exceed loan demand, excess funds are placed into interest bearing short-term investments such as fed funds or into other liquid investments such as government or agency securities. Also, a small portion of the investment portfolio is generally invested in municipal bonds, partly for the tax benefit. Municipal bonds are generally less marketable than the government or agency securities and are generally purchased with longer maturities. Municipals are commonly held to maturity.

Over the course of a number of years, interest rates rise and fall as economic activity and actions of the Fed interact with the markets. When economic activity is strong, interest rates generally rise and demand for loans is strong. During this part of the rate, or economic, cycle, banks generally use available funds to meet loan demand and may draw down their investments. Conversely, when economic activity slows down and interest rates fall, loan demand is slack and banks perform add to their investment portfolio.

This supply/demand situation produces a situation where investments are made while rates are low, and little or no excess funds are available to invest when rates are high.

As the economy moves out of a recession and the Fed begins to raise rates, fixed rate investments tend to lose value, as purchasers in the market require low yielding assets be discounted to offset their low interest rate. Conversely, when the economy becomes slack and the Fed lowers rates, existing investments tend to gain in market value. Just because an investment has a current market value that is higher or lower than amortized cost has little to do with the decision to buy or sell. Temporary market value fluctuations are not the driving force as to whether an investment will be purchased or sold at either a gain or loss.

Without trying to cloud the issue at hand, it is my observation and belief that the management of a bank should have wide latitude as to when or if an investment should be sold before maturity. While we are currently required at the time of purchase of a security to designate it as available for sale or hold to maturity, based on our ability and intent to hold the instrument, future events should be allowed to change that decision without triggering a negative accounting consideration.

By way of example, if a bank were to invest \$15 million with one million maturing each year over the next 15 years, it would likely look at those investments maturing within the first 10 years as available for sale, and the remaining \$5 million as hold to maturity. In this example, the available for sale investments would likely be in government and agency securities, while the hold to maturity would be in municipals. The available for sale securities would have a 5-year average life, while the hold to maturity securities would have a 12.5-year average life.

Assuming no new investments or redemptions, after one year, \$1 million of governments would mature. The average maturity of the available for sale securities would be reduced to 4.5 years. The hold to maturity securities would now have a 11.5-year average life. To restore the old balance in the maturity range, the \$1 million now available for reinvestment would have to go into municipals which are in the hold to maturity portion of the portfolio. This would reduce the available for sale portfolio from \$10 million to \$9 million and reduce the average life to 4.5 years. The hold to maturity portfolio would have a new average life of 12 years and would have increased from \$5 million to \$6 million. A repeat of this pattern over five years would result in \$10 million now in hold to maturity with an average life of 10 years. The available for sale portion would have been reduced from \$10 million to \$5 million and the average life would have been reduced to 2.5 years.

Repeating this pattern for 15 years would result in the entire portfolio being classified as hold to maturity and the average life would be 7.5 years with everything in municipals. This is simply a bad result.

We should have the flexibility to take some of the securities in the hold to maturity category and sell and replace to reestablish our desired maturity ranges or for other purposes without exposing that portion of our investments to the mark-to-market rules.

The following tables show the amount of investments our bank had at the end of the prior four quarter ends in available for sale and hold to maturity. Our bank has about \$58 million in assets. The investment portfolio represents less than 20% of our assets. As you can see, market values can change quite drastically from quarter to quarter. Surprisingly, we experienced significant market depreciation during the second quarter. After the Fed began raising rates in June 2004, we expected to see further erosion in our market value, but instead, we recovered a large portion of the loss recorded in the second quarter.

The idea of recording temporary variations in market value of assets that are purchased with the intent to hold for a number of years does not make sense to me and would lend less useful financial reporting.

	Dec 31, 2003	Mar 31, 2004	June 30, 2004	Sept 30, 2004
Avail for Sale				
Book Value	\$5,740,782	\$8,337,305	\$6,779,570	\$6,764,189
Market Value	\$5,710,977	\$8,454,063	\$6,647,344	\$6,753,204
Gain or (Loss)	(\$29,805.00)	\$116,758.00	(\$132,226.00)	(\$10,985.00)

	Dec 31, 2003	Mar 31, 2004	June 30, 2004	Sept 30, 2004
Hold to Maturity				
Book Value	\$3,953,271	\$2,002,899	\$3,651,355	\$3,649,796
Market Value	\$4,020,984	\$2,107,148	\$3,561,708	\$3,687,158
Gain or (Loss)	\$67,713.00	\$104,249.00	(\$89,647.00)	\$37,362.00

Thank you for your consideration.

Sincerely,
 First National Bank of Niagara
 Niagara, Wisconsin 54151

Jack M. Weinert
 President