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September 1, 2010

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

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

Dear Mr. Golden:

Thank you for the opportunity to comment on the exposure draft Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities (the "proposal").

I urge the Board to drop its proposal to report financial instruments at fair value, with specific concern over reporting on the basis of its estimated fair value, the financial position of a loan portfolio held for investment.

There is no doubt that previous changes to long-standing accounting rules mandating mark to market accounting on an expanding population of financial instruments exacerbated the financial crisis that began in 2008 and contributed greatly to the financial panic and deep recession that followed. The Financial Accounting Standards Board now wants to extend mark-to-market accounting to virtually the entire balance sheet of banks, importantly including loans held as investments. The impact on bank lending and the economy will be profound. From an investor's perspective, this will cloud transparency rather than improve it, and put into question the most critical element of a bank's financial position and the perception of the bank's stability: bank capital. From a debtor's perspective, this will likely reduce the product offerings available to finance their operations.

## **Banking Business Model**

For most banks, carrying a loan at fair value is fundamentally inconsistent with its basic business model, which is to originate and hold loans until maturity (i.e. hold for investment). Since bank's normally don't manage these long-term loan portfolios on a fair value basis, the proposal will result in less relevant information than the traditional amortized cost approach. The intrinsic value of a loan may change because of a shift in interest rates or credit issues – both perceived and real. If there is a problem with repayment, a banks' typical process is to work the problem out with the borrower rather than sell the loan. So, even if it were easy to find a market value, that value is irrelevant to the ultimate resolution of that asset, as in almost all circumstances, the bank would not sell the loan for the amount a potential investor would offer; rather than immediately liquidate its portfolio, a bank is more likely to realize higher cash flows from the resolution of credit issues on portfolio loans directly with the borrower.

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## **Impact on Borrowers**

Banks will become more restrictive in their lending (i.e. reduce longer-term lending) and offer fewer options to their customers, in order to minimize the fair value volatility of their loan portfolios. That volatility would directly impact net income or comprehensive net income under these new requirements. Hence, fair value accounting will reduce dollars, options and eligible borrowers, thereby impeding economic recovery and not better representing the business.

## Valuation Uncertainty

The expanded use of fair value for financial reporting introduces greater complexity and volatility that most investors do not need or understand. For most loans, there is not a viable marketplace from which to derive benchmark prices for generic categories of loans. Additionally, with individualized payment terms, collateralization, and guarantee structures, the vast majority of commercial loans have no reliable market in which they could be sold, further calling into question the reliability of using fair value as the basis for financial reporting. The presentation of the subjective modeling assumptions necessary in order to determine "market" credit and liquidity spreads on commercial loans (which often have both non-standard underwriting criteria and terms) will likely confuse investors and make difficult any attempt at comparing financial results of different banks. Loans will likely be classified as Level 3 in the fair value hierarchy; therefore, causing more misrepresentation and unnecessary efforts to comply with disclosure requirements relating to level-3 assets.

Even if there were active markets, fair value is not the appropriate measurement for these loans since it does not represent the cash the bank will receive. Loans cannot be priced as quickly, efficiently or as reliably as corporate bonds. Consequently, loan fair value amounts will lack certitude and will likely be viewed by readers of the financial statements as ambiguous and potentially misleading. Additionally, integrating valuation issues on non-publicly traded portfolio loans into the reporting of earnings will substantially increase the costs of producing financial reports and the time needed to report financial results to the marketplace.

As a result of the proposal, bank capital will be affected by market swings that cannot reasonably be expected to ever be realized by the bank. The reliability and comparability of bank capital, since it will largely be dependent on the fair values of assets with no active markets, will drastically diminish. The unnecessary volatility of, and the decline in confidence in, bank equity will cause an increase in the cost of capital, due to perceived increased risk. This will invite more short-selling and other short-term trading activities (which will feed volatility). In addition, the increase in the cost of capital and in higher operational costs may eventually drive out product offerings that may be subject to greater fair value volatility (loans with long-term, fixed interest rates, or to those with lower credit scores) or drive up the rates offered. Hence, the constituency advocating for instability, uncertainty and devaluation is the short trader, not the investor in corporate America or the borrower.

In addition, the FASB proposal on impairment will have a significant impact on bank capital levels, through the requirement to recognize the expected losses on an asset over the life of that asset at the time the asset is acquired/originated. This front-loading of charges will significantly reduce bank earnings and capital and going forward will also distort the economics related to the financial statements by fostering more volatility in earnings irrespective of how the underlying business performs. Separately the requirement to recognize such losses based on the expectation of current loss factors continuing into the future (i.e. the inability to look forward to forecast the impact of changes in such factors over the life of a particular asset will dramatically increase pro-cyclicality).

I am concerned that the finalization of this proposal as exposed will induce banks to change their business model. An investor's desire to hold equity securities generally declines as volatility increases. Some investors will likely put pressure on banks to reduce the volatility, and, in many cases, this may result in shifting toward an investment

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banking model rather than a traditional banking model, or result in limiting our loan products to those that are sheltered from market volatility. This, to me, seems to be an illogical and unintended result.

Additionally, I am very concerned about the costs and resources that will need to be dedicated to produce and audit such data. We have learned from the recent financial crisis that markets are sometimes illiquid and sometimes irrational. Because banks do not use fair values in managing their cash flows, I anticipate that this could require banks to hire more staff and/or consultants to assist with estimating fair values and to pay significantly higher audit fees. In the end, investors will be paying consultants and auditors significant sums to make estimates that shareholders will put aside. In this vulnerable economy, "fortunetelling accounting" will destroy fortunes.

In closing, I recommend that you drop the proposal to report loans and other financial instruments at fair value. From my perspective as an investor and a financial executive it does not improve financial reporting. The reality is mark-to-market accounting obscures, rather than clarifies, economic reality and financial performance.

Thank you for considering my views. Please feel free to contact me if you would like to discuss my concerns.

Sincerely,

Joseph R. Ficalora Chairman, President and Chief Executive Officer