

September 27, 2010

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

Dear Mr. Golden:

Re: Accounting for Financial Instruments (File Reference No. 1810-100)

On behalf of Spectrum Federal Credit Union, I appreciate the opportunity to comment on the above-referenced proposal, which would modify GAAP to require most financial instruments to be marked to market (“fair value”) on the balance sheet—including loans. In addition, the changes would require loan loss reserves to be measured on a forward-looking “expected loss” basis instead of the historical “incurred loss” method currently used.

Currently, Spectrum Federal Credit Union is on a voluntary Net Worth Restoration Plan as recommended by NCUA because our Net Worth is below 7.0% but this not because we have made bad investments or bad loans. We are very conservative in granting loans to our members but because of the condition that is happening to our economy we are now greatly affected by the continued decline in value of the mortgage collateral and continued increase in unemployment. If this proposal will take effect, I don’t think that we are going to recover and we will just be forced to merge with another credit union.

Credit unions are subject to a lot of restrictions which banks and other financial services providers are not. We are restricted by statute to a limited field of membership composed of specific groups or those in a geographical area. In addition, credit unions are the most heavily regulated of all financial institutions, operating within limitations on business lending, loan interest rates, loan maturities, investments, and a host of other restrictions that don’t apply to banks. Further, credit unions are limited to accumulating capital through earnings only (they are not allowed access to capital markets) and are restricted on secondary capital alternatives. Finally, due to their structure, limitations, historically conservative business practices, and long-term focus on their members, a majority of credit unions are portfolio lenders, even on real estate loans.

Because of the credit union business framework we think that the proposal to mark loans to market is 1) unrealistic in practice; 2) significantly and unnecessarily burdensome on credit union resources and balance sheets; and 3) ultimately harmful to credit union members—and U.S. consumers—who have come to depend on the lower loan rates and fees that credit unions provide. Our concerns and opposition to the proposal are such that we must urge the FASB to withdraw the exposure draft as proposed. In our view, it appears to be at odds with the Board’s stated intent that the proposal “provide financial statement users a more timely and representative depiction of an entity’s involvement in

financial instruments, while reducing the complexity in accounting for these instruments.” We at Spectrum FCU have never sold any loan and we have modified at least 20% of our loan portfolio.

Requiring fair value measurement of loans does not realistically reflect credit unions’ (and likely many banks’) business model. For portfolio lenders like credit unions, loans are not made with the expectation that they will be sold. Rather, they are made with the intent to hold them for the purpose of collecting the contractual, amortized cash flows until maturity. The amortized cost—which generally represents the amount owed by the borrower, adjusted for net fees with premiums and discounts—is most reflective of the cash that will be received (supplemented, of course, by a robust loan loss reserve process). Even when a member/borrower experiences financial problems, the first response of a credit union lender is not to contemplate liquidating the loan, but to attempt to work out the loan terms to the member’s—and credit union’s—best interests. So, in most cases, market value is irrelevant to credit union management (and to credit union members).

In addition, measuring fair value in an inactive market continues to be an extremely difficult and highly subjective endeavor. Valuing financial liabilities is not the equivalent of a transfer of an asset from a willing buyer to a willing seller. Many financial liabilities are not transferable, making fair valuation very challenging, if not impossible. As an example, loans made to small and mid-sized businesses currently have no liquid/active market. How, for instance, would a credit union located in a small town in central California value a loan made to a local drug store? Determining a fair value for these loans would have to take into consideration the illiquidity for them, thus creating an artificially low market value.

Spectrum Federal Credit Union believes that a realistic measurement basis for financial instruments should be determined by the business model and strategy of the entity. For loans made by most credit unions—and many banks—that model and strategy is based on the amortized cost of a loan, which provides an objectively verifiable and understandable accounting basis. Implementing fair value for loans would serve to flip this fundamentally sound model on its ear, making the *accounting* the driver of the business model, instead of the other way around. We strongly believe that this is ill-advised and detrimental to prudent management and sound financial reporting.

Marking loans to market would add significant and unnecessary costs to credit unions’ operations, without any additional benefit to credit unions or their members. Much of the increased costs would be related to use of outside firms to value financial instruments, and increased costs for the resources necessary to gather and analyze needed information. For many credit unions, this additional expense would represent a significant portion of their overall expenses. In addition, the proposed requirements for the Allowance for Credit Losses (accounting by class and by pool versus individually assessed loans) represent an immense increase in complexity—and additional resources—with little or no discernible benefit.

Credit union balance sheets would also be adversely affected, as their net worth (i.e., capital) would largely be dependent on the fair value of assets with no active markets. In addition, moving from a historical basis to future expected losses to include fair value will significantly impact impairment funding, ultimately effecting net worth. (In fact, in many instances the proposal would require credit unions to record life of loan credit losses through net income at the time of loan origination.) This will have a drastic effect on the stability and reliability of credit union capital levels. Such an effect cannot be readily rectified, as credit unions are limited to accumulating capital through earnings only, and are restricted from secondary capital alternatives. Given the current precarious state of the economic recovery, this would only serve to undermine the vitality of U.S. credit unions.

The bottom line is that the requirements in the proposal, if implemented, will serve to harm credit union members—as well as all U.S. consumers—in a number of ways. First, the higher operational costs and adverse effects on capital levels associated with the fair value model may eventually drive out product offerings that are subject to greater fair value volatility. This would include, for example, loans with long-term fixed interest rates, or loans to those with lower credit scores. Second, these same factors could serve to drive up loan rates and/or fees. This is especially important for U.S. consumers as a whole, as the lower rates and fees offered by credit unions have long served as a competitive determinant of bank rates and fees in local consumer lending markets. Third, lending to small businesses could be significantly curtailed. As we mentioned earlier, loans made to small and mid-sized businesses currently have no liquid/active market. This could force credit unions and other business lenders to limit lending to very short-term loans to only the highest quality borrowers, as longer term loans would carry the fear of possible write-downs, even for loans that are being paid as agreed. As a result, a five-year loan to a farmer, local restaurant, drug store, towing company, or clothing store would be a thing of the past. Such a loss could prove to be devastating to small business owners, and crippling to a still-fragile and recovering economy. Fourth, the FASB's exposure draft states: "The proposed guidance focuses on providing the most useful, transparent, and relevant information to investors about the financial assets and financial liabilities of an entity." Spectrum FCU believes that, for credit unions, the opposite of this intent will be the result. The proposed requirements introduce complexity that most credit union members do not need or want. Since the accounting under mark-to-market will not reflect how a credit union is managed, the result will be more complex—and confusing—financial statements. This is likely to result in members misunderstanding a credit union's financial performance. This, in turn, could result in unwarranted public relations challenges, as financial statements subject to mark-to-market valuations will not reflect a credit union's true strategy, management, or operations regarding financial instruments. This type of scenario is likely to play out across industries other than the credit union industry, and we find it deeply troubling that the FASB does not appear to have placed much weight on the comprehensive effects that this aspect of the proposal is likely to have on the market.

Finally, we are perplexed and disturbed as to why the FASB has chosen to present an exposure draft that deviates so significantly from the basic principles for financial

reporting that were previously discussed—and jointly affirmed—with the IASB. The FASB exposure draft has taken a very different approach to financial instruments reporting than that taken by the IASB. While the FASB’s approach proposes that all financial instruments are reported at fair value, the IASB seeks to retain some of the existing financial instruments accounting model that used a combination of fair value and amortized cost, depending on the nature of the financial instrument.

Also, as the FASB no doubt realizes, disagreement about the FASB exposure draft is global, going beyond the IASB to include the Basel Committee, the G-20 nations, other nations’ financial accounting reporting boards, and many regulators.

There are a significant number of credit unions already that are suffering from the current economy which were either liquidated by the NCUA or merged with another credit union or currently surviving but currently on NCUA’s watch list and implementing this new regulation would drive the credit union out of existence.

We appreciate your consideration of our comments, and urge the FASB to recognize that a more reasonable and viable framework for financial instruments reporting is needed than what has been proposed. Thank you for giving us the opportunity to provide feedback prior to the implementation.

Sincerely,

Alfred Gelasio  
Spectrum Federal Credit Union  
Vice President Finance and Technology