

# Massachusetts Bankers Association

September 30, 2010

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

File Reference Number 1810-100

Dear Mr. Golden:

I am writing on behalf of the Massachusetts Bankers Association (MBA), which represents approximately 190 commercial, savings and co-operative banks, federal savings banks, and savings and loan associations throughout the Commonwealth and New England. MBA appreciates the opportunity to comment on the Exposure Draft entitled, “*Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities*”.

The Exposure Draft (ED) proposes significant changes to bank financial reporting, particularly issues related to the classification and measurement of financial assets and liabilities by expanding “fair value” accounting. MBA is extremely concerned with the impact these changes will have on our member institutions, the nation’s banking industry and the overall economy. We urge FASB to withdraw the proposal, which we believe will result in a misrepresentation and misinterpretation of banks’ financial statements among investors, customers and other users. Our comments will focus primarily on the “fair value” portion of the ED.

## **Background**

The proposal requires the presentation of both amortized cost and fair value on an entity’s statement of financial position for most financial instruments held for collection or payment of contractual cash flows. It also requires the inclusion of both amortized cost and fair value information for these instruments in determining net income and comprehensive income. Financial instruments held for sale or settlement would be recognized and measured at fair value with all changes in fair value recognized in net income.

According to the ED, by presenting both amortized cost and fair value information on the financial statements, the amortized cost would provide information about management’s expectations about the instrument’s contractual cash flows; the fair value would provide the best available information about the market’s assessment that the cash flows will occur. Financial instruments required to be classified using fair value with changes reflected in net income include trading instruments, derivatives, equity securities and hybrid instruments containing embedded derivatives that would otherwise require bifurcation and separate accounting.

## **Fair Value Accounting in Relation to Bank Business Models**

MBA supports transparency and accuracy in financial reporting and we believe that some revisions to the current accounting and reporting standards may be warranted; particularly given the role accounting

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rules may have played in the recent financial crisis. However, the Association supports accounting principles that are based on an institution's business model: not those that create unnecessary volatility in the marketplace.

The vast majority of our member banks fund their operations by taking deposits and holding loans on their balance sheets on a long-term basis. These financial instruments are not readily marketable and banks are not in the business to create or purchase assets or liabilities for resale. Financial instruments managed for fair value and trading purposes should be accounted for at fair value, while those held as long-term investments should be accounted for at amortized cost. This more accurately reflects how the institution generates its future cash flows.

### **Impact on Financial Statements and Bank Investors/Stakeholders**

While the intent of the proposal is to provide better transparency and comparability of financial statements, the fair value measurements will depend on many subjective assumptions. Reporting the fair values of loans distracts from other key metrics on an institution's balance sheet, namely managing the credit risk of the bank's borrowers, and focuses investor attention on unrelated market reactions to interest rate, credit spread, and liquidity movements. In addition, since there is no active market for the majority of loans held by depository institutions, banks will be required to use various models to determine fair values as opposed to using quoted prices.

Financial statements will become more complex and opaque, as this will force investors and other users to analyze these values based on modeling that could vary from institution to institution. It will also make it far more difficult for investors to evaluate and compare financial statements throughout the industry. Investors and analysts will be required to understand how banking models operate across wide ranges of products and geographic areas.

MBA strongly believes that accounting standards should not be pro-cyclical and recent market conditions have demonstrated the pro-cyclical nature of mark-to-market accounting as declining values of financial instruments necessitated write-downs and sales, causing further write-downs and sales. We believe that the proposed accounting changes will exacerbate cyclicity in financial results due to the greater reliance on fair value measurements, valuations that will be less accurate than current accounting requirements.

Based on our conversations with our member institutions, bank investors do not support the ED, as they do not see it as an improvement in transparency. Additionally, more than 70 percent of the banks in Massachusetts are mutual institutions, with no shareholders or investors. The primary stakeholders and users of these institutions' financial reports are banking regulators, carriers insuring the institution, and the Federal Home Loan Bank of Boston. It is important for FASB to recognize that "investors" are not the only users of these financial reports and that accounting principles should not be skewed so heavily towards them as to lessen the financial statement's value for these other, equally important stakeholders.

It is important to note that possibly the most important stakeholders and users of financial reports, the banking regulatory agencies, have publicly stated their concern with FASB's ED. Since the regulators are charged with ensuring the safety and soundness of the more than 8,000 banks throughout the nation, they should have access to the most accurate and transparent information on these institutions. If the changes proposed in the ED were implemented, the reliability of bank capital levels could be compromised and comparability between banks in particular peer groups greatly lessened. These changes would affect the

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ability of the regulators to perform their examination and oversight function of the industry in an efficient manner. Their serious concerns with the ED alone should give FASB pause before implementing this proposal.

### **Impact on the Banking Industry**

If FASB adopts the changes proposed in the ED, banks will need to expend significant resources to comply with these new standards as current accounting and reporting systems were not designed to implement fair value principles. Compliance will require adding additional staff, making significant system changes and in many cases hiring outside consultants to provide valuation assistance. Banks will also expend significant amounts of funds to implement and comply with the accounting treatment, funds that would be better used to provide needed credit to their communities. For public institutions, we believe that investors would not view these costs, which must come out of bank earnings, as being either reasonable or worthwhile.

Implementation of the rules as proposed will be extremely complicated and take a minimum of four years after the final standard is released with nonpublic entities with less than \$1 billion in total assets having an additional four years to implement the new requirements. The fact that FASB has proposed this extended implementation timeline, which could apply to more than 90 percent of the nation's banks and credit unions, underscores the complexity and magnitude of the changes. We question whether the proposal meets any cost-benefit test.

Compounding this complexity, requiring fair value accounting on loans necessitates a fair value measurement of deposits, including core deposits. The ED, however, does not use a fair value measurement; instead, it proposes a present value method that excludes certain factors, such as customer relationships, normally used in estimating the fair value of the deposits. Except in instances of business combinations, investors almost never ask about the inherent value of deposits. Bank customers however will be concerned to learn that their accounts will be recorded on a bank's books and records for amounts less than the deposit's principal balance. Banks may be forced to explain these subtleties to depositors, potentially eroding confidence in the institution and the banking system.

Most importantly, if the proposed accounting treatment goes forward, community banks will have to reconsider making longer-term loans and deposits because of the impact of the changes in fair values they will need to record. For example, institutions would no longer be able to hold long-term fixed-rate loans in their portfolio due to changing valuations: thus shifting interest rate risk to consumers, who are untrained to manage this risk – unlike banks. In addition, long-term deposits could also cause substantial fluctuations on an institution's balance sheet, impacting earnings and making these products unsustainable in the future.

### **Conclusion**

MBA strongly opposes the accounting changes contained in the Exposure Draft and urges FASB to withdraw the proposal. The will mislead investors and financial statement users and place a substantial compliance burden on the banking industry with questionable value. The entire business model of banking will be altered and products such as the fixed rate mortgage may no longer be available offerings if the ED is approved.

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Thank you again for the opportunity to comment on the Exposure Draft. If you have any questions or need additional information, please contact me at (617) 523-7595 or via email at [jskar@massbankers.org](mailto:jskar@massbankers.org).

Sincerely,

A handwritten signature in black ink, appearing to read "Jon K. Skarin". The signature is fluid and cursive, with a long horizontal stroke at the end.

Jon K. Skarin  
Director, Federal Regulatory & Legislative Policy