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cuna.org

September 30, 2010

Technical Director
File Reference No. 1810-100
Financial Accounting Standards Board
401 Merritt 7
Norwalk, CT 06856

Re: Proposed Accounting Standards Update – Accounting for Financial

Instruments

To Whom It May Concern:

The Credit Union National Association (CUNA) appreciates the opportunity to comment on the Financial Accounting Standards Board's (Board's) proposed accounting standards update on Accounting for Financial Instruments and Revision to the Accounting for Derivative Instruments and Hedging Activities. By way of background, CUNA is the largest credit union trade organization in the country, representing approximately 90 percent of our nation's nearly 7,700 state and federally chartered natural person credit unions, which serve approximately 93 million members. The comments provided in this letter were developed under the auspices of CUNA's Accounting Subcommittee, chaired by Scott Waite, CFO of Patelco Credit Union, located in San Francisco, CA.

#### **Discussion of CUNA's Views**

#### **General Comments**

The Board's proposal is intended to provide financial statement users with a more timely and representative depiction of a reporting entity's involvement in financial instruments, while reducing the complexity in accounting for those instruments.

In the strongest terms possible, CUNA opposes the aspects of the proposal that would direct entities to report most financial assets and liabilities at fair value on the balance sheet and apply an expected loss method of loan loss provisioning. If the proposal is adopted, credit unions will be forced to incur



substantial direct and indirect costs to come into compliance, with little or no benefit to credit unions, or their members or other stakeholders.

# Application of Fair Value Measurement to Credit Unions

Credit unions operate under a unique structure as member-owned cooperative financial institutions and, for the most part, are in the business of holding financial instruments to maturity. This practice is much different from that of many larger financial institutions that are very active in constantly buying and selling portions of their balance sheet, including whole loans, participation loans, and other financial instruments. Credit unions generally fund their operations by taking deposits and holding loans for the long term. Most financial instruments that credit unions hold are not readily marketable.

Unlike users of other types of financial institutions, users of a credit union's financial statements are not typical investors, such as stockholders. Credit union stakeholders are: (1) their members; (2) their creditors, such as corporate credit unions and Government Sponsored Enterprises; (3) their board members and management; and (4) their regulators. Regulators have already indicated they see no reason to force these changes on financial institutions. Also, the information required of a reporting entity by this proposal is of questionable value to investors of publicly traded companies and the investor community has been quite outspoken about this. The relevance and value of such information to a credit union's "investors" is even less apparent.

#### Concerns with Fair Value as a Measurement Tool

In addition to our concerns that fair value is not appropriate for credit unions, we believe there are inherent shortcomings within fair value as a measurement tool that further decrease any benefit that might result from using it. As has been highlighted by the recent economic challenges surrounding investment in mortgage-backed securities, it is quite difficult to accurately determine the market value of an instrument for which there is no active market. In such situations, models are used to approximate the market value of the instrument as if there were an active market. These models rely heavily on underlying assumptions, such as on future interest rates, borrower prepayment, and future discount rates.

Fair value models can be useful tools for determining market value in an inactive market. However, reliance on underlying assumptions is such that even minor adjustments to an assumption can result in drastic changes in valuation, which can lead to potentially inaccurate measurement of the instrument's value.

In order to comply with the requirements set forth in the proposal, most credit unions will need to hire outside valuation firms to measure the fair value of their financial assets and liabilities. Even with the assistance of outside expertise, fair value measurement still relies on assumptions and inputs, which, based on what we know today, may not necessarily be accurate for the future. In addition, since entities will likely use different assumptions, there will be limited consistency between entities and comparability will be diminished.

## Financial Asset and Liability Measurement

The proposal generally requires that an entity measure its financial assets and financial liabilities at fair value on each reporting date with all changes in net income, with the exception of certain debt instruments. For credit unions, it is unclear how frequently this will be required. As noted above, credit unions will incur great expense every time they fair value their financial instruments, whether done in-house or by a third party. Even if such valuation is limited to annually, the costs will be substantial. It would also seem that the percentage of any change in an instrument's fair value due to credit loss would need to be considered to accurately determine the frequency of valuation.

The proposal would require an entity to measure its core deposit liabilities each reporting period using the "core deposit liabilities remeasurement approach." Under this approach, such deposit liabilities would be measured at the present value of the average core deposit discounted at the difference between the alternative funds rate and the all-in-cost-to-service rate over the implied maturity of the deposits. CUNA opposes this proposed requirement for measuring core demand deposits. We believe this approach would provide inaccurate information and the calculations would be expensive and time-consuming for many, if not most, credit unions. In addition, this measurement approach would result in a value different from book value.

## Credit Impairment and Loan Loss Provisioning

The proposal establishes a credit impairment model that would be based on all available information relating to past events and existing conditions but potential future events could not be considered. In addition, the proposal removes the "probable" threshold for recognizing credit impairment. If the entity expects a favorable change in cash flows as compared with its previous expectations, it would reverse the previously recognized impairment expense and decrease the allowance for credit losses.

We do not support the Board's proposed removal of the "probable" threshold, as we believe doing so will increase required loan loss reserves unnecessarily.

Furthermore, the shift from the incurred loss model to the expected loss model will accelerate credit losses and likely require loss reserve estimates to be increased without producing any benefit to stakeholders. We do not support this proposed approach and have serious concerns regarding the impact it would have on credit unions. In addition, the proposal may encourage many credit unions that currently consider reasonableness based on 12 months of historical charges to increase this to 30 months, which would likely reduce their net worth without justification. Although the incurred loss model did not forecast the financial crisis, we believe it is a more reasonable approach, especially since it has the ability to keep earnings less volatile.

We support the concept of a proposed single impairment model for all financial instruments. However, we do not support the proposed model because operationally, it would be quite challenging to implement. We believe most credit unions currently lack the systems necessary to support such modeling; and they would need to acquire much more robust systems capable of accepting input on credit loss estimates before being able to comply.

## Presentation in Financial Statements

Under the proposal, the balance sheet would need to include financial assets and financial liabilities separately depending on whether all changes in their fair value are recognized in net income or whether qualifying changes in fair value are recognized in OCI.

For fair value-OCI financial instruments, we believe that such a presentation model would not be feasible for credit unions, especially smaller ones that have more limited resources. Since not all credit unions are required to have audited financial statements, much of the data would likely be inaccurate, resulting in comparability issues.

Additionally, for fair value-OCI financial instruments, we do not believe that the presentation of amortized cost, the allowance for credit losses, the amount needed to reconcile amortized cost less the allowance for credit losses to fair value, and fair value on the face of the balance sheet would provide decision-useful information. We generally believe that such information should more appropriately be included in the footnotes, allowing additional accompanying information.

As you are aware, while credit unions did not contribute to the financial crisis facing our nation, we have not been immune to the unprecedented

difficulties the recession and its aftermath have created. While credit unions are generally well-capitalized and in better shape than others in the financial marketplace, credit unions are not in a position to incur additional unnecessary costs which divert resources from their ability to serve their members. While we support accounting standards and practices to protect credit unions and their 93 million members, we do not see any evidence that this proposal will achieve these goals but will nonetheless inflict enormous costs on the credit union system.

In sum, CUNA strongly opposes the requirements in this proposal. CUNA staff and a credit union representative will be participating in one of the Board's upcoming roundtables and we look forward to discussing this proposal. Meanwhile, if you have any question about our views, please do not hesitate to give Senior Vice President and Deputy General Counsel Mary Dunn or me a call at (202) 508-6743.

Sincerely,

Luke Martone

Regulatory Counsel

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