1810-100
Comment Letter No. 2241

PREFERRED
BANK

September 20, 2010

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

Mr. Golden,

Thank you for the opportunity to comment on some very pressing matter currently before the Board, specifically mark-to-market accounting and the proposed revisions to accounting for derivatives and hedging activities.

As the Chief Financial Officer of Preferred Bank, a banking institution in Los Angeles, California with $1.4 billion in total assets, I am writing to express my opinions on the proposed mark-to-market accounting and the proposed revisions to accounting for derivatives and hedging activities.

I am strongly opposed to the portion of the proposal that requires all financial instruments – including loans – to be reported at fair value (market value) on the balance sheet. The first reason that I object is that the fair value information is already contained in the footnotes to the financial statements under the FAS 107 disclosures. In addition, FAS 157 created further disclosure requirements regarding the calculation of the fair market value of certain financial assets. I submit to you that this disclosure is quite substantial and is sufficient for readers of the financial statements to understand the difference between the FMV and the carrying costs of these assets.

Our bank does not sell our commercial loans nor our commercial real estate loans nor our construction loans. Basing our balance sheet on fair value carries the potential to lead readers of our financial statements to believe that we will at some point, liquidate these loans, which is not the case. In addition, once we have identified a loan as impaired, we are required to determine what the value of that asset is and provide an allowance for any shortfall that is identified, essentially marking that loan to market from a credit impairment standpoint.

If there are issues with a borrower's ability to repay a loan, we typically work through the collection process with the borrower rather than sell the loan. This has always been the strategy which is most economically viable and leads to the best outcome for the bank.

Since there is no active market for most of our loans, estimating a market value of these loans makes no real sense and carries with it a high propensity to manipulate assumptions used in a cash flow analysis which one bank may do very differently from another bank, resulting in wide variances for similar types of loans at different banks.

Even if we could easily obtain a market price, since the loan is just one part of the financial relationship that we have with the customer (multiple loans, deposits, etc.), there is no financial incentive to sell.

Marking all loans to market would cause our bank's tangible capital to sway with fluctuations in the markets – even if the entire loan portfolio is performing. Instead of providing better information about our bank's health or its ability to pay dividends, the proposal would mask it.

Even if the banking regulators' Tier 1 capital excludes fair value fluctuations, we still will have to explain the fluctuations to our tangible common equity to our investors, customers and depositors.

The costs and resources that we will need to comply with this new requirement would be significant. This will require us to pay consultants and auditors to estimate market value further eroding our earnings capabilities.

I regularly speak with our institutional and retail investors and they have expressed no interest in receiving this information. We believe our investors would not view these costs, which must come out of bank earnings, as being either reasonable or worthwhile.

For the reasons stated above, our bank respectfully requests that the fair value section of the exposure draft be dropped.

On the subject of derivatives and hedging, I support the change of the requirement that a hedge is "reasonably effective" (as opposed to being "highly effective"). This should make it easier for banks like mine to implement hedge accounting. In 2006 and 2007, we specifically did ***not*** implement a hedging strategy which would have been beneficial to us simply because of the accounting implications. The change in language to "reasonably effective" would have been a benefit to us and perhaps we would have implemented that strategy had the accounting requirements been different. With that being said, I believe that it is very important that the term "reasonably effective" be better defined.

The "shortcut" and the "critical terms match" methods should be maintained. This greatly helps medium and smaller banks like mine to reduce the cost of compliance with the hedge accounting rules.

Thank you for your consideration.

Best regards,

Edward J. Czajka
Executive Vice President
Chief Financial Officer

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