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**To:** [Director - FASB](#)  
**Subject:** Comment Letter: File Reference: No. 1810-100 Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities  
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September 29, 2010

Mr. Russell Golden  
Technical Director  
Financial Accounting Standards Board  
401 Merritt 7  
P.O. Box 5116  
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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 Board's Exposure Draft regarding "Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities." I write as a user of financial statements in my position as an equity research analyst of financial institutions, most notably of traditional commercial banking companies. I do not purport to have the background to comment on the minute, technical details of the ED in the context of existing accounting guidelines. My comments are my own and should not be construed as reflecting the views of Columbia Management or its parent company, Ameriprise Financial.

I am decidedly not supportive of the proposed adoption of fair value accounting for loans held for investment or for deposits and have reservations about the proposed approach regarding the recognition of interest income on financial assets.

Critical to the determination of the investment attractiveness of a bank equity security is a view of the relative earnings potential of a company given its operational effectiveness and strategic positioning. As well, a multi-faceted assessment of the financial strength of these companies, given the inherent leverage employed in the business model, is of paramount concern. Unfortunately, elements of the ED would, in my view, create a framework that would diminish our ability to more accurately assess the economic profitability of these enterprises. Like some other accounting guidelines adopted in the past ("gain on sale accounting" for securitizers, hedge accounting, QSPEs/VIEs, etc.), a well-intentioned though "academic" accounting proposal is likely, in the end, to become value destructive when unanticipated circumstances evolve.

My major concerns revolve around the issues of business model, "pricing" availability, liquidity/volatility issues, and pro-cyclicality.

Traditional banking institutions are levered institutions. Their business model is largely based on holding the predominant portion of their assets to maturity to collect cash flows. The customer bases of many of these companies often reflect long-term relationships, which may be of increased focus in the prospective banking environment. The resolution of credit issues at clients is decidedly different as compared to a purely transactional/trading relationship. The importance of the banking function often evidences itself during periods of capital markets stress. Adoption of the ED would likely negatively affect the industry in periods where financing is most in need given the accounting-based reduction in asset values and equity likely to

result as a consequence of the ED. A going concern framework versus effectively a liquidation value framework seems much more appropriate for these types of companies.

The composition of loan portfolios within the industry suggests that fair value calculations would ultimately be divorced from underlying economic reality. No daily, external, and observable “price” exists to accurately value many of the loans in the book. Other asset classes that possess substantially greater liquidity than small- or middle-market bank loans can exhibit significant price volatility in the short term when excess demand or supply hits the market for a transitory period. The likely, practical (and likely negative) impact on fair value for assets that are substantially more illiquid, i.e. many bank loans, is likely to be magnified.

Given that fair value estimates are likely to show greater volatility around extremes in the economic environment, the implementation of the ED would inject an even greater pro-cyclical element into the financial statements of banking companies. The fair value measurement of liabilities (deposits in this case) would invariably be an insufficient offset to the fair value changes in assets. The market also has a tendency to ignore increased “value” created from market value adjustments to liabilities. Given the impact this all has on bank capital, particularly in the context of the forthcoming Basel III capital regime, I believe the ED would inject much greater volatility into the financial statements, effectively in pursuit of a highly theoretical quest for a single point of the fair value of equity. The economy and the business of banking make it too complicated to achieve that through the adoption of a complex set of accounting guidelines.

Since I don’t view the ED as ultimately providing greater transparency toward determining true “value,” I’d argue for enhanced disclosure in the footnotes in regard to managements’ assumptions in providing current fair value disclosures rather than adoption of the proposals.

As for the proposal on the recognition of interest income to effectively reflect a greater credit-related component, my reservations as a financial statement user revolve around the diminished information content entailed in interspersing revenue/margin and credit data. Net interest income reflects the contractual inflows and outflows related to assets held and the liabilities supporting them. While reflecting some credit-related component (e.g., nonaccrual loan impact), current financial statement presentation allows for better assessing an institution’s financial performance via a separation of margin/interest sensitivity metrics versus credit risk metrics. I would encourage the Board to continue its other efforts to enhance the accounting presentation around loan loss reserving but don’t believe the elements related to it in this ED effectively improve information for financial statement users.

Sincerely,  
Ted Paluszek

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