

Financial Accounting Standards Board September 30, 2010

Director@FASB.org

Via email

Re: File Reference no. 1810-100: Proposed Accounting Standards Update—Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities

Dear FASB,

Performance Trust Capital Partners, LLC focuses on advising community financial Institutions through strategic financial advisory services. Much of our focus is on teaching analytics and strategy for disciplined, responsible portfolio management in the fixed-income marketplace. We work with over 500 community financial institutions nationwide and have approximately 120 fulltime employees. Our principal offices are in Chicago, Illinois.

We appreciate the opportunity to comment on File Reference no. 1810-100: Proposed Accounting Standards Update—Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities ("Exposure Draft"). Many financial statement users, preparers, auditors, and other interested parties have written comments to date and covered the issues extensively and effectively. Our focus will be on the two primary objectives of the proposed standard as stated in the June 30, 2010 Overview of the Project and Exposure Draft which are:

- 1. To provide information about how an entity operates its business (business model) and the associated risks the financial instruments the entity uses and
- 2. A more timely depiction of an entity's investments in financial instruments while reducing the complexity in the accounting.

The Exposure Draft's primary proposal is to require fair value accounting for virtually all financial instruments on the balance sheet with changes in fair value recorded in the income statement. Exceptions are made for certain financial instruments that have certain characteristics. These instruments are still recorded at fair value on the balance sheet but the changes in fair value are recorded in other comprehensive income. Additionally, the Exposure Draft requires that accrued interest income is calculated net of the allowance for credit impairments for financial instruments with excess interest received increasing the allowance balance.

We do not think this proposal helps achieve either objective. The Exposure Draft runs counter to a financial institution's primary business model. Whereas, the primary business model for most lending institutions (i.e., providing credit to their communities and across the nation) takes a long-term outlook; while fair value forces a bank to manage for the short-term. In the normal business

course for the financial institution, value is derived from the receipt of principal and interest over the life of the financial instrument. The institution's risk management consists of managing its credit quality and funding costs of their financial instruments until their maturity so that a positive spread is earned and recorded. It would be consistent with this purpose if the accounting model reflected this business model by recording earnings throughout the life of the financial instruments. However, fair value accounting effectively treats all financial instruments as sold each reporting period. This creates a tension between the banks overall business model and the proposal in the Exposure Draft. It seems inconsistent that in an environment where new accounting standards are issued (Accounting for Transfers of Financial Assets) and proposed (Revenue Recognition) that are tightening the guidance on when a sale has occurred or when revenue is recorded, this Exposure Draft goes the opposite direction and proposes recognizing revenue when a sale has not even been contemplated.

The second objective is to provide more timely and relevant information regarding the financial instruments while reducing the complexity. Many of the financial instruments held by institutions are non-liquid instruments requiring significant assumptions to determine a fair value. The amount of subjectivity involved in determining the appropriate credit and liquidity spreads in addition to modeling cash flows, call into question both the usefulness of a fair value estimate and the complexity involved in determining the fair value. Further, loans are often priced based on an overall customer relationship which includes deposit balances, fee income and other services. The fair value of the customer relationship would not be captured in the loan terms and consequently left out of the financial statements.

It is clear from reading the many comment letters submitted to date along with other commentary from industry participants that the majority of the preparers, regulators and auditors have significant issues with the Exposure Draft. There does appear to be a debate as to the degree of which investors' desire fair value information in the financial statements. The FASB believes the investors want this as it would provide the most effective single snapshot of the financial condition of an institution eliminating the need for investors to make their own adjustments to the reported financial statements in order to assess its value. Our response is to be careful about the unintended consequences. Under the current exposure draft, investors now will need to investigate the financial statements to understand and assess:

- 1. What financial instruments are recognized in net income and what are through other comprehensive income?
- 2. What are the significant assumptions and methodologies used to determine fair value and are they reasonable?
- 3. What part of the net interest margin relates to credit impairments?
- 4. What part of the earnings to date relate to net cash flow versus unrealized gains and losses and how those unrealized gains and losses will reverse over time?

These answers will need to be compared to other financial institutions and their own methodologies and assumptions to understand the relative value of the institution.

The alternative solution would be to continue to use the amortized cost model as the default method for financial instruments held for investments and to provide significant disclosures in the footnotes including fair value estimates. The trading assets or assets held for sale should continue to be held at fair value with changes in fair value recorded in the income statement. This puts all financial statements on a level playing field at recorded amounts that users understand and balances that are verifiable. The disclosures in the footnotes would supplement the financial statements to help understand the credit and interest rate risk of the institution. This is a cost effective solution consistent with existing accounting standards that provides the necessary information for all financial statement users.

James V. Lorentsen, CPA Senior Vice-President

Vice President and Chief Financial Officer

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