

From: [Gayle Furness](#)
To: [Director - FASB](#)
Subject: FASB's Proposed Accounting Standards Update on Disclosures about Liquidity Risk and Interest Rate Risk, specifically for credit unions
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Technical Director
Financial Accounting Standards Board
401 Merritt 7
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Subject: FASB's Proposed Accounting Standards Update on *Disclosures about Liquidity Risk and Interest Rate Risk*, specifically for credit unions.

The proposed interest rate risk disclosures, if passed, would provide dangerous and misleading information about the safety and soundness of a financial institution, and therefore, the financial services industry.

Our primary concerns are:

1. The inclusion of credit unions
2. FASB taking a one-size-fits-all approach
3. The requirement to use antiquated and inadequate methodologies

There are many reasons that support our statements. We have outlined just a few.

The Exposure Document states, "The objective of financial reporting is to provide information that is useful to present and potential investors, creditors, donors, and other capital market participants in making rational investment, credit, and similar resource allocation decisions."

In response to Question 20, we believe credit unions should be exempt from this Proposed Update since they do not seek capital market participation, donors or potential investors. They also do not issue bonds to creditors. As a result of the credit union structure, the Benefits versus Cost is not appropriate for credit unions. FASB should understand that the list of who would benefit does not apply to credit unions.

Additionally, a credit union survey was conducted. Participants were asked how many times potential investors, creditors, donors, and other capital market participants or members have asked for information from the credit union regarding its interest rate risk profile. Of the 126 credit unions that responded, only one said they had been asked for this type of information. The 126 credit unions represented over 7 million member-owners. Even though FASB "staff interacted with more than 40 users of financial statements, including sell-side analysts, equity investors, and credit analysts," to develop its Proposed Update, we do not believe it was the right audience to represent credit unions.

While there are many aspects of accounting and financials where the one-size-fits-all approach may make sense, interest rate risk is not one of them. FASB is attempting to take the very complex

issue of quantifying interest rate risk and forcing all financial institutions to quantify risk in the same fashion, or squeeze them into a one-size-fits-all approach.

Conversely, NCUA recently released the Interest Rate Risk Policy and Program Final Rule that goes into effect September 30, 2012. In the rule, NCUA clearly states that a one-size-fits-all approach to interest rate risk quantification is not appropriate. It doesn't make sense for FASB to establish a one-size-fits-all approach that is contradictory to the NCUA's new IRR rule.

NCUA, not FASB, is the insurer of the credit union industry. It is likely that FASB's proposed standard does not intend to supplant the regulators' responsibility or authority to ensure safety and soundness. However, it would not be unreasonable for a decision-maker to argue with a regulator that, if FASB disclosures are adequate for investors and capital markets, they should be adequate for regulators.

Once the quantification of risk is incorporated into audited financial statements, the users of the audited financial statements should have reason to believe the information provides a realistic depiction of the exposure to interest rate risk. Otherwise, why add the additional burden of reporting and the additional cost of auditors to audit?

The proposed reporting would not provide reliable information regarding a financial institution's exposure to fluctuations in market interest rates. In fact, if used as a basis for determining and managing risk, FASB would invite a material increase in exposure to risk taking in the financial services industry.

Present and potential investors, creditors, donors and other capital market participants should understand that each organization is unique and therefore requires unique due diligence. To have any governing body impose a requirement that would delude the end user of the financial statements regarding the exposure to interest rate risk is imprudent.

What gets measured gets focus. The required methodologies of GAP Analysis and one-year income simulation are inadequate for disclosing interest rate risk. These methodologies were relied on back in the 1970s and 80s prior to the Savings and Loan crisis. **They were not effective then and they will not be effective now.**

GAP Analysis

The following quotes sum up GAP analysis quite well.

GAP analysis is a simple IRR measurement method that reports the mismatch between rate sensitive assets and rate sensitive liabilities over a given time period. GAP can only suffice for simple balance sheets that primarily consist of short-term bullet type investments and non mortgage-related assets.

—Interest Rate Risk Policy and Program, 12 CFR Part 741, NCUA, February 2, 2012
(<http://www.ncua.gov/Legal/Documents/Regulations/FIR20120126InterestRateRiskProg.pdf>)

Although simple maturity gap analysis for assessing the impact of changes in market rates on earnings may continue to be a viable analytical tool for small institutions with less complex IRR profiles, many institutions now use some form of simulation modeling to measure IRR exposure.

—Advisory on Interest Rate Risk Management, FFIEC, January 6, 2010
(<http://www.ffiec.gov/pdf/pr010710.pdf>)

The FASB Exposure Document does not focus only on financial institutions with simple balance sheets.

One-year income simulation

In the Exposure Document, FASB goes on to say, “A financial institution shall provide an interest rate sensitivity analysis that presents the effects of specified hypothetical, instantaneous interest rate changes as of the measurement date on after-tax net income for the 12-month period immediately after the reporting date and on shareholders’ equity.”

We agree with the focus on income simulation and shareholder equity versus economic value. However, one-year simulations are inadequate. Keep in mind that market interest rates are at historical lows and many financial institutions have heavy reliance on mortgage-related loans and investments; this is also during a period of a sustained flight to safety. Looking out one year is not an adequate disclosure of risks to earnings and shareholder equity. It would be imprudent for any governing body to enforce such an antiquated methodology.

*Institutions gain a better understanding of when rate and cash flow options may be exercised by using **longer simulation time horizons**. For example, significant levels of options risk embedded in assets and liabilities can cause large shifts in repricing cash flows over time. Depending on the type of scenario, and the nature of the options, these shifts may **not become apparent until a simulation is projected beyond***

***one year**. This volatility in cash flows likely causes an institution’s earnings-at-risk profile to change significantly as the simulation progresses. To capture this potential “cliff effect,” **exposures should be projected over at least a two-year period**. To understand how risk evolves, management is encouraged to measure earnings-at-risk for each 12-month period over the simulation horizon. Although not expected for community institutions with less-complex balance sheets, longer-term simulations (five to seven years) are a useful tool to highlight option risk positions and better evaluate risk. Long-term simulations can provide a complementary metric to “risk-to-capital” measurements, allowing institutions to understand how interest rate shifts could affect future earnings over longer time horizons. [Emphasis Added]*

—Interagency Advisory on Interest Rate Risk Management, Frequently Asked Questions, FFIEC, January 12, 2012, (http://www.ffiec.gov/PDF/01-12RR_FAQs.pdf)

No change in asset mix

In the Exposure Document, FASB states, “The interest rate sensitivity analysis shall disclose the effects of hypothetical interest rate changes on financial assets and financial liabilities included in the statement of financial position as of the reporting date. That is, the financial institution should not incorporate any forward-looking expectations regarding non-interest revenues, non-interest expenses, tax rates, projections about growth rates, asset mix changes, or other internal business strategies in preparing the interest rate sensitivity analysis.”

While FASB does not use the terms constant balance sheet or static balance sheet, based on the description above, it appears that is the objective.

History shows that when rates change, the mix of assets changes. To assume the asset mix or liability mix does not change is a simplifying and unrealistic assumption. One of the reasons static simulation modeling can be misleading is that it ignores the likelihood that the mix of deposits will change. This can be especially dangerous because the distribution of deposits and deposit trends in the financial services industry has changed significantly with the flight to safety and the prolonged economic downturn.

This simplifying assumption can actually hide risk, especially in a rising rate environment, producing more optimistic results. This, in turn, could lead to the unintended consequence of more risk taking and providing misleading information to the end users.

The simplifying assumption of holding loans constant as a percent of assets also needs to be evaluated.

Is it prudent to assume in a risk simulation that, if mortgage rates go up, demand for mortgage loans will be sufficient to keep balances constant?

It may not be prudent, as the reasons for rates increasing can have a dramatic impact on loan volumes:

- If rates are going up because the economy is good, then assuming loan volumes remain constant could be a good starting point. However, it may be optimistic considering the impact of rates rising from historically low levels.
- Conversely, if rates are going up for reasons that are not driven by economic growth, then the simplifying assumption of holding loans constant can mislead investors and creditors.

If there is a sustained increase in interest rates and either of these methodologies have been incorporated into financial statements and, therefore, into decision-making, the threat of assessments to cover losses in the financial services industry will be high. As noted above, financial institutions currently have heavy reliance on mortgage-related loans and investments, combined with extremely low funding costs as a result of the flight to safety. This combination typically results in higher levels of interest rate risk.

Financial institutions are still paying for the losses incurred from the recent banking crisis. Why would any governing body intentionally set the financial services industry up for another crisis? This potential cost is not worth achieving FASB's objective of comparability across financial institutions. Additionally, this will not add value for consumers or shareholders.

FASB states throughout the document the comparability across institutions is a key objective in order for the report to be useful. **Placing a higher priority on the objective of achieving comparability across institutions versus good decision information is not a prudent decision driver in running a business.** Further, FASB's methodology does not achieve an apples-to-apples comparison. At the risk of FASB adding more requirements, we believe it is important to point out that, while FASB is promoting no change in asset mix, they are not standardizing new volume repricing of assets and liabilities to keep the balance sheet a constant size. An institution may assume that loans can be made at much higher yields when others may assume lower yields.

Higher yield assumptions would create better results. Additionally, they may assume that they would not have to increase rates on deposits as rates increase. Therefore, it will not provide the simple comparability that FASB is seeking.

Auditor expertise

As noted earlier, quantifying interest rate risk is very complex. If the Proposal is accepted and goes into effect, how long will FASB allow for auditors to get specialized training that will result in appropriate expertise for auditors to effectively audit the interest rate risk reporting?

Conclusion

For many reasons, just a few stated above, the Proposal does not provide useful decision information to present and potential investors, creditors, donors and other capital market participants and, contrary to its stated objectives, will likely create an unrealistic measure of safety and soundness.

Regards,

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