Letter of Comment No: 1250-001
April 10, 2006

Dear Director,

The Financial Institutions Accounting Committee (FIAC) is pleased to comment on the exposure draft ("ED") issued by the FASB titled The Fair Value Option for Financial Assets and Financial Liabilities.

FIAC is a group of 12 financial professionals working in executive level positions in the banking industry and is a standing committee of the Financial Managers Society. FIAC's primary responsibility is to evaluate those accounting and regulatory matters that affect financial institutions. The Financial Managers Society is a professional association of approximately 1,600 CFO's, controllers, CEO's and auditors. Although its mission is primarily educational, through FIAC, the Society monitors and responds to significant regulatory or accounting changes that will impact its membership.

FIAC's Position

FIAC recognizes the potential promise that comprehensive fair value accounting may hold for users of the financial statements of companies in certain industries. We also appreciate the tremendous opportunity for a reduction in complexity that this proposal offers.

However, FIAC would like to reiterate our position (FIAC Comment letters of 7/8/02; 8/14/04; and 7/22/05) on the potential intellectual and conceptual problems associated with fair value measurements for financial institutions with loans and deposits. We remain concerned that fair value measurements would not properly reflect the full value that would be realized when liquidating a deposit portfolio. We are also concerned that applying fair value to a deposit portfolio that will never be sold will create the appearance of current profits even though those profits will be realized only indirectly over time through the ability of the institution to retain cost-effective funding. We also remain concerned that fair value accounting is less relevant for assets that are held to maturity and/or where no active market for the financial instruments exists.

Without proper consideration of these concerns, a standard allowing fair value reporting in the primary financial statements could result, for our industry, in less useful information in financial statements than what is provided under the current, mixed-attribute standards.
April 10, 2006
Page Two

It is important to note that the amounts of deposits and loans carried by financial institutions can get very large and are usually a huge percentage of the balance sheet. Small changes in the fair value of these items can cause massive, even laughable, changes in reported profitability under a fair value model.

Notwithstanding the above, we want to acknowledge that we understand that the FASB is boldly taking the initiative, with this proposal, to alleviate much of the confusion and reduce the frequency of restatements that we have seen in American business in this decade arising from the application of principles that were designed to bridge the gap between historical cost and fair value accounting (i.e. FAS 133). We are excited by the possibility of having all financial assets and obligations (other than loans and deposits) recorded at fair value and we would fully appreciate the simplicity that this proposal would bring to the accounting world. However, it is crucial that FASB appreciate that, in certain industry segments, fair value accounting will result in phantom gains that will never be realized. In our business, the recording of unrealized gains and/or losses on a loan during the period between origination and payoff is not meaningful.

Specific Issues in the Proposal

Presentation

The presentation of the effect of the fair value measurements on the income statement is a very important aspect of this proposal. One of the casualties left by fair value accounting will be comparability among companies, especially when the fair value decision remains optional. We encourage the Board to isolate the effect of the fair value measurement on the income statement in such a way that the reader can easily see the full effect of the fair value adjustments. For meaningfulness and comparability, the reader must be able to easily adjust the income statement and compare financial results on both a fair value basis and on a cost-method basis. We would encourage the Board to not overlook the “scorekeeping” aspect of accounting. It is a competitive world out there. And there is a strong need for everyone to know how their company is doing versus the competition.

We would like to see the fair value impact reported as one line item on the income statement with a footnote to include the breakdown of each significant component.

Issue 3 - Demand Deposit Exclusion

We find it interesting (and encouraging) that FASB felt the need to exclude certain line items, particularly deposits, in Phase 1. When a financial institution liquidates deposits via the sale of selected branches, a common occurrence in our industry, a significant premium (sometimes as high as 15%) can be expected on the sale. However, if the deposits are not sold (as is the case the vast majority of the time) no premium would be realized. Thus, a struggling financial institution, given the option of applying fair value to selected financial instruments, would be tempted to take the gain and the resulting capital boost by recording its deposits at fair value even though it has no intention of ever selling these deposits. Fair value accounting is a bad fit for industries who settle their assets and liabilities at face value.

FIAC agrees with the Phase 1 exclusions, but more importantly, we believe that the exclusions substantiate, for our industry, the conceptual flaws of a fair value model for all financial assets and liabilities. As we have raised with the FASB in the past, a fair value measurement that does not properly reflect the full value of customer relationships, or one that is selectively applied, will only result in misleading information in our industry. For these reasons, we strongly urge FASB to carefully consider the difficulties in measuring the fair value for demand deposits and seek further input from financial institutions when deliberations begin in Phase II of the FVO project.
April 10, 2006
Page Three

Issue 6 - Changes in Credit Worthiness

The FIAC does not agree with entities reporting changes in fair value for their own debt liabilities, including fluctuations caused by changes in that issuer’s creditworthiness, as gains or losses in earnings. We believe that reflecting a gain in earnings caused by deterioration of the entity’s own debt distorts the true profitability of the entity and weakens the transparency of financial reporting. The fluctuations in earnings could be substantial, and would require comprehensive disclosures in order to prevent the financial statement users from misinterpreting the “artificial” gains associated with deterioration of the entities’ debt.

Conclusion

The FIAC recognizes that there are both strong advocates for, and adversaries against, the notion of fair-value reporting, with both parties bringing compelling arguments to the table. However, the nature of the operations and balance sheets of financial institutions present additional complexities when trying to achieve a reliable fair-value measurement. We shudder to think of fair-value accounting being applied to held-to-maturity loan portfolios, deposits, or one’s own debt. These three, along with pension and lease accounting, should receive special consideration in phase two. Hopefully, the fair-value option, ultimately, will not apply to them.

We understand that this proposal is part of FASB’s effort to reduce complexity in the accounting literature. We applaud FASB for having that goal and for being bold enough to offer this proposal because we feel that the proposal, with a few minor tweaks, will be successful. As CPAs who have chosen accounting as our life’s work, we are very encouraged and impressed by FASB’s leadership, vision and willingness to listen.

We appreciate the opportunity to comment on this proposed guidance.

Sincerely,

William C. Nunan, Chairman
Financial Institutions Accounting Committee