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FIAC

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Financial Institutions Accounting Committee

Ms. Suzanne Q. Bielstein
Director of Major Projects and Technical Activities
Financial Accounting Standards Board
401 Merritt 7
Post Office Box 5116
Norwalk, Connecticut 06856-5116

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Oakland, CA

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RE: Fair Value Measurements

Dear Ms. Bielstein:

The Financial Institutions Accounting Committee (FIAC) looks forward to the opportunity to meet with the FASB members and staff on Friday, August 27, 2004. To facilitate our discussion, we would like to express our views regarding the Board's proposal on Fair Value Measurements.

FIAC is a group of 11 financial professionals working in executive level positions in the banking and thrift industries 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 comments within this letter are representative of FIAC as a whole and do not necessarily reflect views of the individual institutions represented on the Committee.

Before discussing the specifics of this proposal, I would like to make it perfectly clear that we do not like fair value accounting. For the business model of our industry, fair value accounting can be a horrible mismatch.

The current delineations for loans (held for sale vs. held in portfolio) and securities (trading, available for sale and held to maturity) presently provide for appropriate and adequate disclosure or earnings statement recognition of changes in market values in those circumstances in which those values are relevant to the intended or actual economic reality of what will occur with respect to that asset. Extending the market value model to a purely theoretical scenario is of little to no relevance and could very well present a misleading picture of what has been and in the future will be the economics of the business being measured. Prudent investors and readers of financial statements do not value companies based on the impact of changes in the value of long-term assets and liabilities arising from transitory swings in interest rates. Rather, business valuations and investments decisions are based on the consistency, sustainability and predictability of recurring net revenues and expenses derived from contractual (i.e. cost based) cash flows. Mixing unrealized market valuations with realized contractual cash flows is an unnecessary distortion of the reality of the business model.

While holding a loan portfolio to maturity, interim, mark-to-market changes in fair, or liquidation value, are a false promise of profits that were not actually realized. Or, conversely, they can be hits to income that never happened. Furthermore, any measure on the hierarchy of fair values beyond "Level 1 estimates for Same Items" begins to get scary. The farther one gets away from Level 1, the more sketchy the fair value becomes. The opportunity for playing games gets very wide by the time you get to the level 3 estimates involving cash flow present-valued projections or cost-approach/replacement cost analyses. These can be poor substitutes for transaction-validated results.

We have made these points to you before (see July 8, 2002 comment letter) and we don't want to be repetitive, but, if you feel the need to push everyone down the "Fair Value Path," we offer two important, big-picture suggestions:

1) The application of full fair value to GAAP cannot ignore the liability side of side of the balance sheet. Our industry has significant value that is locked up on the liability side that can be sold in the marketplace. In our industry, changes in fair value in assets are often offset, in whole or in part, on the liability side and vice versa.

Some critics hold that it's not possible to establish a fair value for a liability (e.g. a deposit account) that can be settled at par at the option of the depositor. This has no basis in reality. There is a very large, well established and widely accepted body of empirical data that supports the assertion that a determinable number of depositors will not exercise the imbedded option to reprice their account even though it may be advantageous for them to do so. From this data, it's possible to establish a value (intangible asset or contra liability) applicable to deposit liabilities. This depositor behavior is both sufficiently predictable and of such critical importance to the sound execution of a depository institutions' business model that failing to take it into account in establishing a market-based valuation would render the valuation not only worthless, but actually misleading.

2) Confusion is created in the minds of the readers of financials if real, transaction-proven profit and cash flows are mixed in with unrealized, theoretical flows derived from fair value measurements. We would encourage you to consider an income statement that has a) a section for cost-driven results that leads to a sub-total for "net income," b) a section for fair value adjustments and c) a final total at the bottom for "Comprehensive Net Income."

Now, with that said, let's discuss the specifics of the exposure draft on fair value measurements.

If the concept of fair value accounting is going to be in effect at all, we need clear, consistent guidance on its use. The FASB's decision to provide that quality guidance with this proposal is timely and welcome. The decision on the usage of block discounts makes sense to us as does the unit-of-account concept, (particularly as it would be applied to the sale of deposits in our industry.) The transition approach and effective date are well-thought out and are such that we can easily accommodate them.

One concern we have is that for items traded in an established broker/dealer market, the draft requires the use of the bid price for an asset and the asked price for a liability. For certain traded items (such as interest rate swaps) the item can swing from one period to the next between being an asset and a liability. From an operational view, that could prove to be a bit sticky as we would be using a bid price one day and possibly the asked price the very next day, thus, adding a level of volatility that is without meaning.

We appreciate the opportunity to share our views on this project with the Board and look forward to discussing them further at our liaison meeting on August 27th.

Sincerely,

Bill Nunan
Chairman
Financial Institutions Accounting Committee