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To the Technical Director, FASB:

This comment letter is intended to address the marking of specific financial instruments to market.

As the CFO of a community bank, a primary objective is always that the readers of our financial statements have an accurate picture of Tioga State Bank's financial position. Requiring a bank like TSB to place a "market value" on the loans and deposits that we have no intention of selling will, in my opinion, be extremely misleading to the users of our financial statements. Rather than improving relevance it will seriously distort the actual financial position of the bank. I understand the need to provide market values when there is an expectation that the financial instrument will be traded. As is the case with most community banks, TSB holds its loans and deposits; we do not go out into the market to sell.

This new proposal could have a devastating effect on even the strongest community banks, thus further upsetting the industry. I understand the FASB intent to create consistent accounting treatment of balance sheet items, but this seems to be a case where forcing consistent treatment will create very misleading financials. Although the instruments may be similar, the business model which directs how those instruments are treated are very dissimilar. By requiring all companies, regardless of their business model, to treat loans and deposits the same will certainly create confusion and reduce transparency.

**More specifically, regarding marking loans and deposits to market:**

Loans that are expected to be held through term should not be reported at fair value. Most loans on the books of community banks are to local individuals and businesses and are held on the books for the life of the loan. Determining "fair value" on these instruments would be extremely difficult and, therefore, would default to some national factors that would distort the true picture at the local level. Below are some concerns with determining and applying fair value accounting to loans held to maturity:

A market determined fair value will not include the value of the relationships. For example, a deposit account might pay higher interest or a loan might charge a lower rate because, by doing so, the bank retains an extremely important relationship...overall a very profitable one. By simply overlaying a "market value" based on some nation-wide constant, such as interest rate or term, is very misleading to investors.

Community bank personnel are keenly aware of the unique situations and interconnected economics that often present themselves when dealing with a loan customer. A lower yielding loan that helps to keep 200 people employed in the community is far more valuable to investors in that community bank than a higher yielding loan whose funds are utilized elsewhere. Using only the interest rate to "value" these 2 loans would provide investors with incorrect information.

Think of how many different rate scenarios you could pass through during the life of a 20

year mortgage. Fluctuations in rates will present wildly differing asset values, resulting in disparate capital balances year after year, even though the loan will simply pay down as originally anticipated. When you extrapolate this one loan to hundreds and thousands, financial statements become extremely volatile and unpredictable. These statements do not present an accurate picture of your institution and you are doing a gross injustice to investors.

If loans are intended to be sold, they should be reflected at fair value on the balance sheet. Normally these loans must conform to strict nationally-used standards and, therefore, would be easier to mark-to-market.

The current process for recording and reporting securities makes sense and should not be altered. By requiring fair value changes in traded securities to be reflected in the income statement and changes to securities not intended for sale (but available) to be reflected in the OCI makes sense. This reflects an accurate picture based on the business model of the company. Perhaps this should also be your model for loans and deposits.

Again, as described above, fair value reporting for liabilities that are intended to be held until maturity would end up distorting the financial picture of a company, rather than provide additional clarity.

The process for determining and fairly assessing “intangible” components can turn into a never ending spiral of “what-ifs”. It should, once again, be stressed that the business model for most community banks does not call for a trading portfolio of deposits. Requiring banks to mark all deposits to some industry-wide default value would create confusion for readers, not to mention the amount of work that would be involved in preparing these new financials.

How do you value the “intangible” benefit of providing a slightly higher interest rate to municipal deposits so the school tax dollars get recycled within the community?

How do you value the “intangible” benefit of offering sweep accounts to local businesses which provide employment and economic stimulus to the community? Those same dollars could go anywhere in the world and the resulting loss to our community would go beyond the cost to the bank.

FAS107 already requires fair values be presented in footnotes.

### **Regarding the recognition of Credit Impairment**

As part of the calculation of an allowance for loan and lease losses, FAS 114 already does a good job of identifying credit impairments for all classified loans and banks go through rigorous audits to ensure all loans are categorized correctly.

If we read the proposed regs correctly, we would need to get new credit ratings on individual loans to assess any potential credit impairments. This is not feasible for most banks without adding staff. Even pooling like-kind loans would result in an enormous amount of work for little benefit over what we do today.

### **Summary of areas of concerns:**

Capital ratios will be effected unrealistically by requiring that financial statements reflect

financial numbers that are not reflective of the company's business model. This puts strong community banks at a FASB-imposed disadvantage.

This change could exacerbate boom/bust cycles by reflecting values at the extremes and have investors putting money in or pulling money out at exactly the wrong time. In the past 2 years, we have witnessed how fair value accounting can cause a problem situation to become a crisis situation.

If there is an insistence on including some form of marking loans and deposits to market, they should at least use the current system used for investments, which considers the business model of the company, i.e. do they trade these financial instruments or do they hold till maturity.

These changes would require a good bit of additional work for companies and could seriously drive up the cost of writing a loan or taking a deposit. Please give additional consideration to the cost/benefit ratio of some of these changes on smaller community banks (many of which are private financial institutions).

Finally, if this ruling becomes law, community banks which have no intention to sell loans or deposits will have to reconsider making long term loans (even mortgages) or taking long term deposits because of the impact future rates could have on their financials and, in turn, their capital. This will hamstring many banks who have been doing a wonderful job of providing strong, steady financial services to their communities.

Thank you for requesting this feedback. Please contact me if I can be of any service.

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