1810-100 Comment Letter No. 1404



Don Abernathy, Jr., President & CEO Email: DAbernathy@TheBankersBank.com

September 30, 2010

Mr. Russell Golden Technical Director Financial Accounting Standards Board 401 Merritt 7 P.O. Box 5116 Norwalk, CT 06856-5116 VIA ELECTRONIC MAIL

File Reference: No. 1810-100 [Accounting for Financial Instruments and Revisions to the

Accounting for Derivative Instruments and Hedging Activities]

Dear Mr. Golden:

The Bankers Bank provides a wide range of operational products and services to nearly 300 community banks located in Oklahoma, Texas and elsewhere. Our holding company, Bankers Bancorp of Oklahoma, Inc., has ninety-seven shareholders, all of which are community banks or their respective holding companies.

As President of both organizations and on behalf of their shareholders, this is to register our profound misgivings over the "Fair Value" and "Loan Impairment" provisions in the subject Exposure Draft. Both sets of provisions are detrimental to the objectives they are ostensibly designed to serve, for the reasons discussed below.

A. The "Fair Value" and "Loan Impairment" Reporting Standards of the Exposure Draft Inherently Posit the Commoditization of Loans.

Like the vast majority of financial institutions commenting on the Exposure Draft, The Bankers Bank and its respondents are not in the business of buying and selling loans¹ for indeterminate profit.

Some of our respondents participate as originators in certain highly-structured affordable mortgage programs sponsored by federal instrumentalities and, to that limited extent, can be said to "sell" loans. We exclude these securities transactions from our discussion.

September 30, 2010 Mr. Russell Golden, FASB – Comment re: File Reference No. 1810-100

Page 2 of 4

Rather, community banks extend credit for the purpose of holding the loans until maturity to realize pre-agreed returns.

A bank makes each lending decision on an individual basis. To be sure, current market conditions are initially considered and periodically re-evaluated throughout the credit term. However, it is a general background metric, nothing more. Numerous borrower-specific factors - - such as confirmable repayment sources, collateral, asset and income configuration, credit history, stated loan purpose, the borrower's demonstrated character, review of regularly updated financial disclosures, public data banks, information learned through a bank's participation in the relevant community, and periodic visits with the borrower to name a few - - combine to better inform a bank's decision regarding (i) whether or not to establish credit relationship that is likely to span a number of years, and (ii) how best to steer that relationship around or through a storm.

There is no dispute that the value of a bank's loan case should be reported as realistically as possible, to better manage their businesses, and to promote meaningful oversight by regulators and shareholders. We wish there were a formula that consistently predicted which loans would perform in the ordinary course, which would require special handling to eke out the agreed return, and which would result in what degree of loss. Such a tool could project a loan's value with perfect accuracy, and every bank in the world would gladly use it. But nothing of the kind exists. Until it does, bankers must present their best estimates of loan value, developed by applying their educations, talents, experiences and hard work to all relevant metrics, including those listed above. The current reporting methodology, amortized balance less loss reserve, is a fully transparent expression of the bank's evolving loan valuation judgment.

Perhaps the most troubling aspect of the Exposure Draft is the suggestion that banks value their loans by reference to the market price for similar loans. We recognize, of course, that there is a well-established market for some kinds of loans (though not all types customarily made by banks) which sorts and prices them in bulk according to various criteria. However, the grading criteria are closely-guarded trade secrets not subject to a bank's examination or validation. Furthermore, borrower-specific factors are unavailable for effective pre-purchase review, the absence of which adds uncertainty and is reflected in a discounted price. The value attributable to a continuing business relationship with the borrower is also stripped out for a discount, as is the anticipated servicing expense. Finally, secondary market buyers are looking for higher returns than are available to original lenders, especially in the current interest environment, hence their demand for still further discount.

Essentially, the bulk loan market disregards the very characteristics that distinguish retail loans from fungible commodities. And, except as to collateralized debt obligations, which are accounted for

September 30, 2010 Mr. Russell Golden, FASB – Comment re: File Reference No. 1810-100

Page 3 of 4

differently, the buyers and sellers populating this market are NOT banks. Nearly all regular players in the bulk loan market are formally referred to as "liquidation companies," but "vultures" and "bottom-feeders" are probably the more common tags. All things considered, we are puzzled by your Board's recommendation that bankers should conform their loan value judgments to the price verdict of a commodity market which necessarily ignores certain value elements, serves a different industry, and operates on secret algorithms. How this could make for more accurate and transparent financial reporting remains a mystery to us.

B. The "Fair Value" and "Loan Impairment" Reporting Standards of the Exposure Draft Are Disproportionately Burdensome to Community Banks.

<u>Perhaps</u> very large banks have the capacity to comply with the Exposure Draft's reporting standards, misguided and unnecessarily complicated though they are. However, unlike their bailed-out brethren, community banks are fully engaged in lending, not stockpiling reserves, nor do they have a cadre of investment bank underwriters and analysts with time on their hands. Given the proliferation of present and anticipated regulation, community banks are less likely to find economic justification for the additional person-hours required to repeatedly survey the market for loan values, especially in light of this metric's doubtful utility.

C. The "Fair Value" and "Loan Impairment" Reporting Standards of the Exposure Draft Are Detrimental to Public Confidence in the Banking System.

As stated above, <u>nearly</u> all regular players in the bulk loan sale market are vultures. We exclude from such characterization the most significant supplier of feedstock to this market, Federal Deposit Insurance Corporation. Through assisted transactions or bank failures, FDIC winds up owning rafts of loans (most of them defaulted or otherwise rejected by assuming banks), many of which it sells in bulk to replenish the deposit insurance fund and pay the failed banks' creditors. None would deny that FDIC's responsibilities are massive, particularly today. If the Exposure Draft presented new reporting standards that would assist FDIC's open bank oversight by reasonably approximate the value of an operating bank's loan case, even if those new standards were somewhat more onerous, The Bankers Bank suspects they would meet with little resistance.

However, as FDIC well knows, the business model of an operating bank is wholly different from that of a bulk loan trader. Thus, if open banks were required to value their loans as if they were in FDIC's business as a liquidator, open banks' carrying value for their loan assets would be drastically reduced by volatility and downward pressures that do not exist in the relevant open bank market. As banks are regularly reminded, "Federal Deposit Insurance Corporation (FDIC) is an independent agency

1810-100 Comment Letter No. 1404

September 30, 2010 Mr. Russell Golden, FASB – Comment re: File Reference No. 1810-100

Page 4 of 4

created by the Congress to maintain stability and public confidence in the nation's financial system." The inappropriate valuation method pressed in the Exposure Draft is at cross-purposes with FDIC's mission, as it would inevitably distort the financial reporting of open banks, creating the false appearances of instability, haphazard management, capital erosion, and overall weakness. Bank shareholders and customers would hardly benefit from miscast information, to say nothing of the pointless havoc it would wreak in the general public.

Traditional bank lending has always been bottomed on the prudent exercise of informed judgment in light of relevant individual circumstances and the relevant economic environment. Since loans are not fungible, no formulaic approach or bulk market average can replace that judgment in projecting the value of loan assets held by an operating bank. Respectfully, we observe that the Exposure Draft fails to recognize this practical reality at the heart of the banking business; and it is our customers, shareholders and regulators that will suffer from adoption those reporting standards, not yours. Therefore, we vehemently request that the Exposure Draft be withdrawn.

Sincerely,

Don Abernathy, Jr.

Don Abernathy, Jr.