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Financial Accounting Standards Board
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Also submitted to director@fasb.org

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

Dear Mr. Golden:

Thank you for allowing us to comment on the Proposed Accounting Standards Update *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities.* Washington Federal is a $13 billion publicly traded thrift institution headquartered in Seattle Washington. The company is a portfolio lender, meaning all loans originated are kept on the books until maturity or prepayment by the borrower. These proposals will significantly affect the accounting for loans, debt and equity securities, and many other types of financial instruments and will likely have a materially adverse impact on our employees, clients and shareholders.

Bank Stock Investors Don't Appear to Be in Favor

One reason the FASB is apparently considering this fair value proposal is perceived demand from investors. From our experience and direct communication with investors this is simply untrue. Investors want financial statements that reflect the results of operations of the Company in accordance with its business model. We are unaware of any investor who believes that it would be prudent to write up the value of a loan, simply because interest rates have temporarily decreased when the bank has no intention of selling the loan. The mark-to-market proposals will create unnecessary volatility in the company's reported financial results, benefitting only short-term speculators in the company's stock, while damaging traditional long-term value investors. We believe that our company's core investors, many of whom are individuals, invest in our securities primarily for the predictable consistency of results produced by the current accounting framework.

Inconsistent with Bank's Business Model

While mark-to-market accounting for trading assets seems appropriate, the banking business model is predicated on making loans for their contractual cash flows. Almost two thirds of the banking industry's $12 trillion of earning assets are loans. The majority of banks originate these loans with the intent of holding the asset to maturity. What matters then, is not how the loan is valued in the market place, but whether or not the bank will recapture its principal contractual interest earned over the full life of the loan. The market value of the loan is only relevant if the bank wishes to sell the loan, which is typically not the case. Also, unlike securities, which in most cases are readily tradable, most loans are not. Each loan has unique collateral, repayment terms and guarantees. As such, we question the reliability of using fair value as the basis for financial statements.

Difficulties in Marking Loans to Market

We are concerned that this proposal would reduce the reliability and comparability of financial statements. Many loans have no readily discernable market in which to determine fair value, thus banks could see a significant increase in "Level 3" assets, a designation that investors appear to view with a fair degree of skepticism. While one of the FASB's objectives is to reduce inconsistencies in the reporting of financial instruments, we believe this proposal would create even more inconsistency. We believe it's highly likely that, given the heterogeneous nature of loans and lack of ready market, many loan types will not be valued consistently across organizations.

Our main focus is on how the loan will perform over the life of the credit, but we do believe the market's view is of interest. However, footnote disclosures—and not on the face of the financial statement—seem to be more appropriate, in our view. Currently banks disclose the Fair Value of financial instruments, thus providing this important but imprecise information to investors.

Transparency Reduced

As detailed in the preceding section, with no liquid market for loans existing, requiring these assets to be marked-to-market as opposed to held at amortized cost could result in less transparency and comparability, not more. Furthermore, the proposed requirement that FASB would have banks subtract "unrealized losses on loans/securities" from "net income" to come up with "total comprehensive income", seems to imply that mark to market is the most important measurement. Placing the fair value on the face of the balance sheet amplifies the significance of it. This inherent volatility that would be unduly placed into these numbers has the potential to reduce the comparability between companies.

Capital and Liquidity Concerns

We believe this proposal has the potential to create undue volatility in bank earnings and capital. Subjecting a bank's equity to volatility to degrees that may not ultimately be realized and subjecting long-duration assets to short-term volatility could put into question a bank's capital level, which, in our view, has serious micro and macro ramifications. In addition, it would make it more difficult for banks that truly need to raise fresh capital as investor confidence would be diminished. Furthermore, an increase in volatility, as well as Level 3 valuation techniques for loans with no readily available market, could also increase the cost of capital for all banks. While it is possible that regulators disregard fair value accounting when assessing capital, we still have reservations. For example, many investors lost confidence in Tier 1 capital ratios during the recent crisis, despite the historic emphasis on this metric by regulators. The market focused primarily on tangible common equity to tangible assets, based on GAAP financial statements. Furthermore, we would be concerned as to what impact such disclosures could have on depositors and ultimately on the liquidity of institutions.

Could Increase Pro-cyclicality

We also believe these rules could intensify downturns as well as asset bubbles. Capital rules, liquidity rules, FDIC insurance premiums and mark-to-market accounting all subject banks to increased pro-cyclicality. After closely watching bank financial statements over the past several years, we would have thought FASB—along with other bodies—would have wanted to take steps to reduce pro-cyclicality, not increase it. Of note, in addition to loan loss reserves being at their lowest level when things are best (i.e. the day before they start to get worse), the proposal now does the same thing with capital. It could also inhibit the banking system's ability to lend when lending is most needed to revive the economy.

Divergence with the IASB

While FASB proposes that all financial instruments are reported at fair value, the International Accounting Standards Board (IASB) seeks to retain some of the existing financial instruments accounting model that used a combination of fair value and amortized cost, depending on the nature of the financial instrument. The recent IASB proposal also seems to recognize the importance of a company's business model when prescribing accounting rules. As such, FASB's approach seems to counter that of the IASB, a result that is not in keeping with the goal expressed by both organizations, as well as the G-20 and the Basel Committee on Banking Supervision. We generally support the convergence efforts of the FASB and IASB, which can be seen in other areas of financial reporting (this month's leasing guidance, for example). We are surprised that the two agencies appear to be taking very different routes here (though we have concerns about their proposal as well). Furthermore, it could put U.S. companies at a competitive disadvantage with international competitors.

Costs Could Outweigh Expected Benefits

Existing accounting, credit, deposit, security and risk management systems cannot handle the proposal, which would result in increased costs. Audit costs and credit rating fees would increase as a result of the difficulty in determining the estimated fair value of these largely heterogeneous assets and liabilities. FASB seems to acknowledge this in the proposal, as it defers implementation for smaller banks by four years. With larger balance sheets, it could be more difficult for bigger banks to meet the proposed timeline , despite increased resources and possible economies of scale.

Conclusion

In conclusion, we do not believe the proposal—and marking loans to market in particular—improves financial reporting. We believe this proposal lacks relevancy to the banks' business model and we worry about its reliability. Furthermore, we believe a credit impairment model that allows for earlier recognition of expected losses would be beneficial. Still, changes here appear to be needed, as we believe banks should be able to use future expectations as opposed to being limited to past events and existing conditions. It is not helpful when loan loss reserves lag losses inherent in the portfolio. We would also find it useful if originated and purchased financial assets are accounted for in the same manner, to simplify or eliminate the purchased credit impaired loans and accretable yield concepts. Also, we are generally supportive of the proposal's simplified approach to accounting for derivatives and hedging.

Thank you again for the opportunity to comment on these issues. If you have any questions, please contact us at (206) 777-8331 or brent.beardall@washingtonfederal.com.

Sincerely,

Brent J. Beardall
Executive Vice President & Chief Financial Officer
Washington Federal, Inc.