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To:	Director - FASB
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Technical Director
File Reference No. 1810-100
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To the Director:

In response to the release of the Exposure Draft of a proposed Accounting Standards Update of Topic 825 (Financial Instruments) and Topic 815 (Derivatives and Hedging), the New York Bankers Association (NYBA) is submitting these comments. Our Association urges that the Financial Accounting Standards Board (FASB) table this Exposure Draft and redirect its energies to updating Topics 825 and 815 in a fashion that appropriately reflects the lessons learned over the past two years. NYBA believes that current accounting for financial instruments contributed to and exacerbated the effects of the recent recession on the financial services industry and fails to provide investors with useful guidance in addition to what could be learned if it were included in footnotes to financial statements. The New York Bankers Association is comprised of the community, regional and money center commercial banks and thrift institutions doing business in New York State. Our members in aggregate hold more than $11 trillion in assets and employ well over a million bankers throughout the world.

This Exposure Draft is intended to improve accounting for financial instruments by supplying investors with both amortized cost and mark-to-market data for both assets and liabilities held by financial institutions. The proposal would expand the applicability of so-called “fair value” measurements beyond assets held either in a trading account or for sale, to assets held for collection or payment of cash flows. In addition, the proposal would expand the category of anticipated credit losses by

removing the “probable” threshold for recognizing credit losses. The proposal would also create a single credit impairment model for both loans and debt securities and is designed to simplify the criteria for hedge accounting.

In its Exposure Draft, FASB states as among the goals of the proposal “reducing the complexity in accounting for [financial instruments],” and yet this proposal would substantially increase the complexity of financial reporting by requiring that all financial instruments, including those held for investment, held to maturity, held for sale and trading securities, be presented as measured by both amortized cost and mark-to-market measurements and that the results of both measurements be run through a reporting entity’s balance sheet and income statement. Investors will be seriously confused by these often conflicting presentations as financial statement users will be invited, in effect, to “flip a coin” in determining the true value of financial instruments.

The crux of the problem with this approach is FASB’s continuing commitment, in the face of overwhelming evidence to the contrary, to the proposition that so-called “fair value” or mark-to-market accounting is an appropriate and accurate representation of the value of financial instruments.

For more than twenty years, FASB has pursued mark-to-market accounting as the appropriate standard for accounting for more and more financial instruments. In general, mark-to-market accounting requires that certain financial instruments be adjusted in value to the most recent purchase or sale transactions in the marketplace. However, this requirement currently applies only in regard to those financial instruments that are either held for sale or held in certain types of trading accounts. The requirement does not typically apply to assets held for investment or held-to-maturity debt securities. In addition, it applies only to certain classes of financial instruments – typically, publicly traded debt or equity instruments – and not to liabilities, such as deposit accounts or assets that are typically kept on an institution’s books, such as loans.

FASB’s original mark-to-market mandate required only footnote disclosure of the marked values of covered assets. However, over many strenuous objections from the financial services industry and many investors, FASB changed its requirements to mandate that the value changes in instruments subject to mark-to-market accounting be run through an institution’s profit-and-loss statement, creating an immediate impact on earnings from changes in accounting values, and ultimately affecting capital. The purpose of accounting statements is to reflect an accurate presentation of a company’s finances, but the result of this amendment was not to reflect but to reinforce changes in the market. During boom times, accounting values were inflated by the application of the value of the last trade to the entire balance sheet. During bad times, accounting values deflated even more quickly, spiraling downward until finally no trades at any price could be effected. The result is an expansion of available credit when the market is in little need of additional credit and the contraction of available credit at the worst possible time – when the market is already feeling pinched for lendable funds.

Even FASB recognized the procyclical effect of its mark-to-market accounting requirements during the recent recession. Administration officials, regulators, Congressional committees, and industry and investor groups all called out for relief from a system that was depressing balance sheet statements far beyond what any realistic analysis could justify. See, for example, the speech by Federal Reserve Board Chairman Ben Bernanke on March 10, 2009 before the Council on Foreign Relations or the testimony of FRB Governor Dan Tarullo before the Senate Banking Committee on August 4, 2009. Recognizing the inadequacy of mark-to-market accounting when the market was distorted or there was no effective market, FASB in April 2009 adopted two significant changes. FSP FAS 157-e, *Determining Whether a Market Is Not Active and a Transaction Is Not Distressed* and FSP FAS 115-a, FAS 124-a, and EITF 99-20-b, *Recognition and Presentation of Other-Than-Temporary Impairments* were intended to assist banks in more appropriately reporting their financial statements. However, they were limited steps, holding out the prospect that the next financial meltdown will be significantly deepened by FASB rules, unless they are changed. Unfortunately, the likelihood of another financial bubble is also increased by the procyclical effect of FASB's mark-to-market accounting, making the possibility of the bursting of that bubble in another recession that much more likely.

This proposal would expand the mark-to-market accounting regime in two directions. First, by subjecting liabilities for the first time to mark-to-market, it will cause bank deposit products – checking accounts and savings, CDs and other time deposits – to have their market value adjusted on bank balance sheets and have income statements reflect income that never existed. Second, by subjecting assets always intended to be held to maturity, such as loans, to market adjustments, they will greatly distort earnings and encourage greater use of the secondary market to increase liquidity. After all, if a loan's value is going to be adjusted as if it were being sold, and the balance sheet is going to reflect the adjustment, why not simply sell the asset and enhance liquidity? Study after study (See, for example, Did the CRA cause the mortgage market meltdown? by Neil Bhutta and Glenn B. Canner, Federal Reserve Bank of Minneapolis, March 2009; and The Community Reinvestment Act: A Welcome Anamoly in the Foreclosure Crisis by Warren Traiger, 2008) have shown that loans held in portfolio perform better than those sold in the secondary market, so that the effect of encouraging increased sales into the secondary market may actually decrease the value of the very assets being sold.

FASB has also stated on several occasions its intention that Generally Accepted Accounting Principles (GAAP) converge with internationally accepted accounting standards adopted by the International Accounting Standards Board (IASB). IASB has already announced its intention to develop accounting standards that move away from mark-to-market accounting. This proposal encourages further divergence from IASB standards, and is inconsistent with principles adopted by the leadership of the Group of 20 industrial nations, and by other national leaders and accounting industry experts. Federal bank regulatory agencies which have commented have unanimously opposed the expansion of mark-to-market accounting and the Chief Accountant of the Securities and Exchange Commission has testified to the Commission's opposition.

The accounting model used by a financial services business should follow the business model of that firm. A securities firm or investment bank, trading into and out of financial markets on a daily basis, should appropriately mark its trading account to market. A commercial bank or thrift institution accepting its customers' deposits subject to the customers' needs or making loans that it intends to hold to maturity, should be able to carry these liabilities and assets at amortized cost. Shoehorning both accounting models into the business profile of all types of financial institutions will simply cause needless additional expense and add no value to investors. An investor who is handed a balance sheet showing both values is likely to have little factual basis on which to distinguish which most accurately represents the true financial worth of the institution being analyzed. An increasing number of studies show that most investors are more concerned with losing money than they are enthralled by the prospects of taking increased risk. As Benjamin Graham put it in The Intelligent Investor, "First, don't lose." It is, therefore, likely that investors will pay more attention to whichever model produces the lower value. Such a result would seriously damage the competitiveness of America's banks and thrifts, reduce capital and the availability of loans it brings and distort incentives for business actions.

For these reasons, we urge that FASB table the expansion of mark-to-market accounting being proposed and review the extent to which it can narrow such accounting to those business models that would be accurately reflected by it. We appreciate the opportunity FASB has provided to comment on this proposal.

Sincerely,

Michael P. Smith

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