

May 15, 2013

Technical Director  
Financial Accounting Standards Board  
401 Merritt 7  
Norwalk, CT 06856-5116

Re: Proposed Accounting Standards Update: Financial Instruments—Overall  
(Subtopic 825-10), Recognition and Measurement of Financial Assets and  
Financial Liabilities; File Reference No. 2013-220

Dear Ladies and Gentlemen:

The Independent Community Bankers of America (ICBA)<sup>1</sup> appreciates the opportunity to comment on the proposed accounting standards update *Financial Instruments—Overall (Subtopic 825-10), Recognition and Measurement of Financial Assets and Financial Liabilities (ASU)*. The objective of the proposed ASU is to improve financial reporting for financial instruments by enhancing the transparency and relevance of the recognition and measurement model so that financial statement users will have access to more useful information about an entity's involvement with financial instruments reported in the financial statements.

The proposed ASU largely fails to meet its intended objective for many users of financial statements through the expanded use of fair value for financial instruments. The introduction of the fair value measurement for loans adds no transparency to understanding the historical financial performance of an organization that can demonstrate its ability to continue as a going concern. The largely adverse impact of the proposal would be most painstakingly felt by nonpublic entities including nonpublic community banks, whose stakeholders have little or no desire or need to comprehend fair value measurements. The end result of adopting the proposed ASU will move FASB further from its goal of promoting quality financial information that can meaningfully serve the needs of stakeholders.

---

<sup>1</sup> The Independent Community Bankers of America®, the nation's voice for more than 7,000 community banks of all sizes and charter types, is dedicated exclusively to representing the interests of the community banking industry and its membership through effective advocacy, best-in-class education and high-quality products and services.

With nearly 5,000 members, representing more than 24,000 locations nationwide and employing more than 300,000 Americans, ICBA members hold more than \$1.2 trillion in assets, \$1 trillion in deposits, and \$750 billion in loans to consumers, small businesses and the agricultural community. For more information, visit ICBA's website at [www.icba.org](http://www.icba.org).

## **Background**

The proposed framework for classifying and measuring financial instruments involves a two-step process. First, the entity would determine whether a financial asset's contractual terms involve the receipt of cash flows that are solely payments of principal and interest on the principal amount outstanding. If this contractual cash flow test is not met, the financial asset would be measured at fair value with all changes in fair value reported in net income. If the contractual cash flow test is met, the entity would classify the financial asset based on management's objective for that asset. If the objective is to hold the asset for the collection of contractual cash flows, the resulting measurement would be amortized cost. If the objective is to hold the asset for the collection of contractual cash flows or to sell the asset, the resulting measurement would be fair value with changes in fair value recognized in other comprehensive income. If the entity's objective for the financial asset is not consistent with any of these two objectives, the financial asset is measured at fair value with changes in fair value recognized in net income.

Entities would be permitted the ability to reclassify a financial asset only when the business model for that asset changes. However, reclassifications would be expected to be isolated and unusual and occur very infrequently. Sales of certain financial assets measured at amortized cost could occur while retaining consistency with the hold-to-collect objective. Those events would include sales based on a significant deterioration in the issuer's creditworthiness, certain changes in tax laws, changes in statutory or regulatory requirements, changes in risk weights or capital requirements for financial institutions, and major dispositions of financial assets due to a business combination. Sales due to changes in interest rates and prepayment speeds would not be consistent with the amortized cost classification.

Financial liabilities would continue to be carried at amortized cost unless the entity's business strategy for the liability at incurrence is to transact at fair value in the future or the liability results from a short sale. Equity investments would be measured at fair value with all changes in fair value reported in net income. A practicability exception would be permitted for equity investments without readily determinable fair values that do not qualify for the practical expedients under current fair value guidance. Those equity investments would be carried at cost.

The requirement to bifurcate an embedded derivative in a hybrid financial asset would be eliminated. Hybrid financial assets would be measured at fair value with changes in fair value recognized in net income consistent with the requirements above. Bifurcation of embedded derivatives for financial liabilities would be retained. The current unconditional fair value option as it exists today would no longer be permitted. The fair value option would be permitted for groups of financial assets and financial liabilities where the entity manages the net exposure on a fair value basis. The fair value option would also be permitted for hybrid financial liabilities under certain conditions.

Public entities would be required to report the fair value of all financial assets and most financial liabilities parenthetically on the face of the balance sheet when those financial instruments are recognized at amortized cost. Nonpublic entities would not face such fair value disclosure requirements.

### **Impact on Community Banks**

ICBA believes that the proposed ASU has not met its intended objective and serves to further complicate the presentation of the financial statements for all financial enterprises including the nation's more than 7,000 community banks. Community banks' traditional, relationship-based lending practices result in earning asset portfolios that do not change over time. Community banks maintain simplified business models that assist in efficiently managing credit and interest rate risk while generating a healthy return for shareholders. These shareholders, along with depositors and other stakeholders, care very little for the fair values of a community bank's financial assets regardless of the bank's intent for those assets over the next two years. This lack of interest lies primarily in the fact that community banks maintain an originate-and-hold business model with asset sales being very uncommon and, in some cases, entirely nonexistent. Additionally, stakeholders have little desire to review asset fair values since they often times do not properly reflect the earning power of the asset or its ability to generate healthy cash flows for the institution.

The proposed ASU pushes more loan accounting towards fair value even for community banks that do not sell loans. Currently banks of all sizes are dealing with an unprecedented interest rate environment, where the need to maintain thorough contingent liquidity plans is required by prudential regulators. In some cases those contingency plans may call for the selling of some loans if certain duration mismatch criteria are met. Additionally, changing interest rate environments would impact prepayment speeds on mortgage assets and deposit balances. This phenomenon would seriously discourage community banks from placing certain financial assets in the amortized cost category even if historical asset sales have been rare. Prudential regulators would be unwilling to allow community banks to continue amortized cost classification based on the proposal's guidance stating that a pattern of sales stemming from changing market risks like interest rate risk or prepayment risk would not be consistent with the amortized cost business model<sup>2</sup>.

Entities such as community banks that designate themselves as "buy and hold" or hold-to-collect investors should be allowed the ability to classify financial instruments at amortized cost to appropriately match their intended objective for holding the financial instrument without having the same concerns that current holders of investment securities have when they consider designating securities as being held to maturity. ICBA requests that the purpose for holding a financial instrument at amortized cost and the decisions around when an entity decides to sell or reclassify that financial instrument should

---

<sup>2</sup> ASC 825-10-55-33 as proposed

become a matter to be decided solely by management, subject to that entity's own accounting policy governance. **Therefore, ICBA requests that any final ASU on the classification and measurement of financial instruments clarify that decisions concerning how assets are classified and whether they are being held to maturity or for sale be up to management, with appropriate disclosure in the financial statements when those matters are significant.**

The applicability of the proposed recognition and measurement model should not be expanded to small entities, including nonpublic community banks of all sizes, without changes that better reflect the business model of the nation's small and nonpublic community banks. With the exception of financial instruments that meet the definition of a derivative or contain an embedded derivative that requires bifurcation, the FASB should resort to a truly simplified model that creates a default amortized cost category for these financial instruments. Financial instruments should only be considered for recognition at fair value with gains and losses recognized in comprehensive income when it becomes more likely than not that the entity will sell a specifically identified asset or a pool of financial assets. Financial instruments should only be considered for recognition at fair value with gains and losses recognized in earnings when they are specifically identified for sale. **This proposed alternative accounting treatment properly matches the need for transparent financial reporting with the underlying business model for small and nonpublic community banks.**

ICBA supports FASB's decision to consider the troublesome accounting burden on nonpublic community banks by allowing those institutions to avoid parenthetical fair value disclosures of financial instruments on the face of the balance sheet. ICBA believes that these disclosures should also not be required for small public community banks that generally maintain the same business model as nonpublic community banks. Stakeholders of small public community banking institutions gain little or no useful insight into the profitability of the organization or its ability to continue as a going concern. **Therefore, ICBA requests that the FASB exempt from the fair value disclosures of amortized cost financial instruments all nonpublic and public financial institutions with consolidated assets of \$10 billion or less.**

ICBA appreciates the opportunity to comment on this proposal. If you have any questions or would like additional information, please do not hesitate to contact me at (202) 659-8111 or [james.kendrick@icba.org](mailto:james.kendrick@icba.org).

Sincerely,

/s/

James Kendrick  
Vice President, Accounting & Capital Policy