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Via electronic mail (director@fasb.org)

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Mr. Russell G. Golden, Technical Director File Reference No. 1810-100 Financial Accounting Standards Board 40.1 Merritt 7 PO Box 5116 Norwalk, Connecticut 06856-5116

I respectfully request that I be considered a participant for your roundtable on October 11, 2010 concerning the exposure draft on the Proposed Accounting Standards Update "Accounting for Financial Instruments and Revision to the Accounting for Derivative Instruments and Hedging Activities",. I believe that I can add value to your roundtable based upon my experience, expertise and interest in fair value as described below.

Background Concerning Fair Value of Financial Instruments

I was in public accounting for 33 years and had many commercial banks, brokers and dealers, mutual funds, trust companies and insurance companies as clients. As well, I had a convertible security mutual fund client which fair valued its convertible securities every business day. Most of these convertible securities were thinly traded or not traded at all. In the early 1970's, banks were able to begin fair value of their mortgage portfolio available for sale for the first time, which I advised my clients on the implementation of this first application of fair value.

After retiring from public accounting, I became the Superintendent of Banks, State of California. I then organized a new Department of Financial Institution (DFI), State of California and became the first Commissioner of DFI as a regulator of many different types of financial institutions (commercial banks, savings and loan associations, money transmitters, credit unions, and industrial loan companies). I experienced another dimension of the financial institution industry.

After serving my term as the Commissioner, Department of Financial Institutions, State of California, I served on 10 for profit boards of directors, and was Chairman of the Audit Committee for each board. Five of the boards were public and five were private. One of the boards was a commercial bank and an insurance company. Currently, I am on the board for Bank of the West and serve on the Audit Committee. Again, this experience gave me an expanded knowledge of the commercial banking industry and the many

applications of accounting standards. During this period, fair value applications were numerous and difficult to apply.

Most recently, I was the Chief Accountant of the Securities and Exchange Commission for the period 2006 – 2009. During this time, the financial panic of 2008 occurred, and I was involved in every aspect of this unusual economic event. I spent most of my time and effort on problems and issues related to the implementation and use of fair value accounting standards. I had many meetings with investment bankers, commercial banks, insurance companies, regulators, lobbyists, trade associations, congress, investors and preparers concerning the role of fair value in our financial crisis. Furthermore, I issued the following guidance and information concerning fair value:

- Report and Recommendation Pursuant to Section 133 of the Emergency Economic Stabilization Act of 2008:
 Study on Mark to Market Accounting to Congress – December 2008
- January 8, 2008, public Letter to A. Harnish and S. Ranzilla (Financial Executives International and Center for Audit Quality) concerning evidence of losses and other matters
- August 2008, SEC's Advisory Committee on Improvements to Financial Reporting (CIFIR) recommended as "judicious approach" in expanding the use of fair value in financial reporting until a number of practice issues are understood and resolved.
- September 2008, SEC staff and FASB joint press release clarifying the application of SFAS No.157 to clarify the measurement of fair value when an active market for a security does not exist.
- October 2008, public letter to R.H. Herz, chairman for FASB, concerning additional guidance regarding OTTI in the context of perpetual preferred securities.
- Various public roundtables on mark-to-market accounting

Thus, I view this Exposure Draft from a unique perspective. I have seen fair value applied from the preparer's side, user's side, regulator's side and investor's side. Personally, I consider myself an intelligent investor, and use financial statements as one of many factors in which to base my investment decisions.

Framework

I am disappointed that FASB and IASB did not issue identical Exposure Drafts. The two approaches by FASB and IASB are quite divergent and do nothing to encourage the convergence to a high-quality global standard. The spirit and intent of the latest Memorandum of Understanding concerning convergence are not present in the two exposure drafts.

This exposure draft is not in the best interest of promulgating a high- quality, global standard. The framework for the banking industry should focus on the nature of the industry. Mortgages and loans generally are held for the long term investment purposes. Core deposits are the main sources of funds to fund mortgages and loans. Asset and Liability Management is a key management process, and therefore important to a bank's long term financial growth and profitability. Thus, entities have different missions and business strategies. An all-inclusive model is not the best approach.

There is no organized, daily transparent, liquid market for core deposits and loans and mortgages. Observable market prices (Level 1 Category) are seldom available for these financial instruments. Why impose fair value on these financial assets and liabilities of a bank?

Loans are very complex and individualized financial instruments. There are many variables in each loan originated. Each loan is different because of the 3 C's of credit – Character, Capacity and Capital. When necessary, another variable called Collateral is added. Some of the larger banks will securitize financial assets and debt instruments. Again, there is no orderly market generally for loans.

During the financial crisis, all financial institutions had difficulty in valuing securitized portfolios. All loans are subject to credit impairment risk. Loans are properly reviewed for this impairment and the new guidance emphasizes the need for review. I believe that the credit impairment factor is the largest factor in the valuation of a loan. Thus, the allowance for losses on loans and leases provide enough fair value attention and application of fair value. I believe the guidance improves the accounting for ALLL.

The Report and Recommendations pursuant to Section 133 of the Emerging Economic Stabilization Act of 2008: Mark to Market Accounting issued by the US Securities and Exchange Commission, Office of the Chief Accountant and Division of Corporate Finance to Congress in December 2008 explored the effects of fair value accounting standards on financial institutions' balance sheets. The report stated this:

"This section explores the effects of fair value accounting standards on financial institutions' balance sheets. In the debate concerning fair value accounting, some assert that accounting standards that require fair value accounting may

inappropriately affect the balance sheets of financial institutions. This section studies those concerns by analyzing a sample of fifty financial institutions that were selected from a broad-based population of financial institutions in our markets."

"The effects of fair value accounting standards on each financial institution was studied to gauge the prevalence of assets measured as fair value on the balance sheet and the subset of those assets that are also marked to market through the income statement. This study also evaluated, among other items, the level within SFAS #157's fair value hierarchy in which assets fell. Information was analyzed by type of financial institution to draw out common characteristics and dissimilarities that may exist within each industry type."

"From the sample of financial institutions studied in this section of the study, the Staff observed that fair value measurements were used to measure a minority of the assets (45%) and liabilities (15%) included in financial institutions balance sheets. The percentage of assets for which changes in fair value affected income was significantly less (25%), reflecting the mark-to-market requirements for trading and derivative investments. However, for those same financial institutions, the Staff observed that fair value measurements did significantly affect financial institutions' reported income."

As noted in the study, fair value measurements did signicantly affect financial instutions reported income. I am concerned that the all-inclusive fair value approach will cause banks to focus only on the short term management of assets and liabilities. This approach could change hedging positions strategy to manage earnings on a quarterly basis and result in more volatility of banks financial statements.

Page 3 of the ED asks the question "What are the Main Aspects of the Proposed Guidance"? The answer is to provide the most useful, transparent and relevant information to investors about the financial assets and financial liabilities of an entity. This is a good goal, except there are many classes of investors. There is a small minority of sophisticated investors who might use this "all inclusive fair value" information. Some sophisticated users, such as credit rating agencies, might find fair value information relevant. However, this information would be just one of many factors used by any investor making an investment decision. Furthermore, investors have fair value information available in the footnotes.

This ED does not consider the business strategy of banking institutions. Banks generally use a strategic plan to manage financial assets and liabilities and this business strategy should be considered in the ED. Fair value changes the perception and concept concerning the management of financial assets and liabilities. Each financial institution business strategy revolves around net interest margin, credit quality, cost of funds and management of risks. The use of an all-inclusive fair value method does not fit into this business strategy.

The ED seems overly complex, and in my mind, is more of an academic textbook and rule based approach. I believe that the all-inclusive ED approach needs to be simplified, and

changed to reflect the short and long term business strategies of the banking industry. The complexity in the ED needs to be eliminated. The numerous examples and cases illustrate the complexity of this ED. The ED focuses only on a short term fair value to be changed every quarter. The banks' business strategy is to make long-term investments, either in terms of securities or loans.

Options or elections should not be allowed. A choice of an accounting standard distorts comparability of financial statements, and confuses the users of the statements.

My hope is that FASB and IASB will develop a high-quality, global accounting standard that will provide quality guidance for financial instruments. This guidance should be principle-based, simple to apply, easy to understand, and practical to implement. Financial reporting should be improved. The guidance should be indicative of the banking industry and useful to users and investors. As a result, the guidance should increase the worldwide capital for financial institutions.

Specific Comments

Page 23 of the ED, the "objective" states that recognizing and measuring many financial instruments at fair value, without eliminating amortized cost information in the entity's financial statements, increases the usefulness of the information. I disagree, since the ED is an all-inclusive model and does not allow for selectivity as indicated by the word "many" in the objective.

I believe that the objective should be reversed and that amortized cost be used in the financial statements. The accounting for financial instruments should be a mixed measurement business model:

- Trading securities at fair value
- Securities available for sale at fair value
- Securities held to maturity at amortized cost
- Core deposits at amortized cost
- Loans held for collection or payment of contractual cash flows at amortized cost
- Loans held for sale at fair value
- Own debt at amortized cost

Page 24 of the ED – 4.C.4 – Topic 718 – on stock compensation is exempt from the ED. This is wrong. The current standard on stock compensation is ignored by financial analysts. The standard records a fictitious expense which cannot be reversed and is based on a dubious foundation concerning a model. What should be done is that stock options should be valued at fair value each quarter as the option is vested. If the option is above the grant price, then an expense is recorded. If the vested option is below the grant price, then no expense is recorded. If the option is terminated, or not exercised, any expense remaining with the option would be reversed. I am surprised that the ED does not include stock compensation in the all-inclusive fair value approach.

Page 26 of the ED, Glossary – All-In-Cost-To-Service-Rate

Core deposit liabilities should be measured at amortized cost – not a re-measurement of current value which is not a fair value method.

7. b – The expense of maintaining a branch network is not a valid factor in the equation. Retail branches serve many purposes – selling investment products, insurance, originating loans, wealth management and trust services. Thus, a branch has many functions for which a cost allocation is not available. Normally, during an acquisition of a bank, the buyer will have a deposit study conducted to determine the fair value of deposits. The study is expensive to conduct and contains many variables and assumptions, such as customer's length of service, other products sold to the customer, average balances in the customer's account, volatility of balances, etc. The expense of maintaining a branch is not a factor in the deposit study.

Also, core deposits are subject to redemption by the customer on demand at face value (cost) of the deposit – not fair value.

Page 40 of ED – 38, etc - Credit Impairment of Financial Instruments

More flexibility is needed to implement the concept of expected credit losses. Reliance only on the use of expected cash flow estimates is too narrow and not a principle based standard. The use of statistical data, historical trends, economic conditions and affordable credit information are important factors to determine if a credit is impaired. Credit risk is managed using many factors – not just cash flow estimates.

As to portfolios, impairment should be applicable to portfolios just as they are for regulatory, capital purposes. This approach is in line with how banks manage their assets and utilize internal risk management.

One other comment - immediate recognition of credit impairment does not seem appropriate. I believe that amortization over the life of the portfolio is more relevant and meaningful.

Page 52 – 53 of ED – Statement of Comprehensive Income

Other comprehensive income (OCI) needs to be discussed further as to its usefulness and relevancy. If a table illustrating all of the classifications of OCI in the ED was presented, I feel that most readers would agree in the ASU complexity of OCI. The use of fair value in OCI could cause volatility in net income. Also, most investors are not educated about the purpose, meaning and use of OCI. Banking regulators would have to consider the impact on the capital requirements of a bank.

Pages 54 and 138 of ED – Changes in an Entity's Own Credit Standing - #94, 98, BC, 109 The current standard (former SFAS159) on an entity's own debt does not reflect fair value correctly. Lehman had over \$650 million in profits on its own debt before it went bankrupt three weeks later. Analysts predict that Morgan Stanley and Bank of America will have over a \$1 billion profit on its own debt because the credit worthiness of the bank is less than the face amount owed and sells at a discount.

The theory behind this standard is not valid on the assumption that companies can buy back their debt at a discount. This is not the case. Lehman had no ability to buy back its

heavily discounted debt because it had no cash or sources of cash. The assumption is faulty. Lehman could never have realized this paper gain.

I believe that a company's own debt should be recorded at amortized cost. This is the face amount which has to be paid and the company owes this amount – not some discounted amount.

Page 57 of ED – 107 Disclose 10% Increase and Decrease in the Discount Rate The extreme variance of a 10% swing does not seem meaningful and relevant even over a very long period of time.

Page 58 of ED – 109. Level 3 Fair Value Measurement Uncertainty Analysis There is adequate disclosure now concerning Level 3 fair value measurement and classification. However, care should be exercised on large mark to market adjustments as to substantial support for such adjustments.

Page 58-62 of ED – Derivative Instruments and Hedging Activities

The ED does simplify and propose qualitative measurement for hedge effectiveness using a guideline of "reasonably effective". The old standard for derivatives and hedging was over 800 pages of detailed rules.

Because banks and companies add new hedging relationships, or remove current hedge relationships when the risks associated with the hedge changes, the banks and companies should be allowed to terminate upon a change in business strategy or risk profiles. Macro hedging should be allowed because this again is the normal practice and business strategy in the banking industry, especially as to internal rate risk.

Page 71 of ED – IG22 a.b.c. Inputs and Assumptions to Core Deposit Liabilities Remeasurement Approach

Reviewing surge balances, temporary accounts and transient accounts is not practical and is costly to perform every quarter. This is over-defining core deposits.

Page 93 of ED – IG111.b Regulatory Reports of Examinations

These examination reports are confidential and should not be made available for the purpose of these normal credit review procedures.

Page 176 of ED - BC240 Benefits and Costs

I believe that the costs associated with the ED are greatly underestimated and do not justify the benefits of the ED.

The external auditing costs will be greatly increased because of the many specialized experts needed in the fair value applications. Banking regulators will need to train their examiners and hire experts on fair value. Preparers will have to train and hire fair value experts, and change their information technology systems to accommodate another set of accounting records. Field testing should be required before the adoption of any standard changes with the financial institutions and banking regulators.

Furthermore, banking regulators will have to redefine the capital accounts which will need to reflect the volatility created by this ED.

Summary

The ED should be completely revised to reflect the banking industry's current accounting practices, which were tested during the past two years. An all-inclusive, one size fits all ED approach, of applying fair value does not provide users and investors with any benefit to offset the excessive, additional costs to obtain this information. A simplified, principle-based, practical and easy to understand implement approach is needed. The framework I have provided would make the accounting for financial instruments relevant, transparent, reliable and useful for all parties. The ED calls for disclosure which is important for transparency, and relevant information to users and investors. However, proprietary information should not be disclosed, and considerable judgment should be allowed by the preparer. Too much detailed disclosure results in meaningless boiler-plate disclosure.

FASB should work with IASB to ensure that this convergence project on financial instruments, as well as the other convergence projects, are truly convergence and not a compromise on divergence. The convergence efforts should yield high quality, global accounting standards that will be useful to everyone.

Please feel free to contact me to discuss any of my comments. Prior to the September 30th deadline, I may submit further information.

Sincerely, Con

Conrad W. Hewitt
Past Chief Accountant
US Securities and Exchange Commission

- c.c. M. Schapiro, Chairman, SEC
 - J. Kroeker, SEC
 - D. Tweedie, IASB
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