



VIA Electronic Mail (director@fasb.org)

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Technical Director
Financial Accounting Standards Board
401 Merritt 7, P. O. Box 5116
Norwalk, CT 06856-5116

File Reference: No. 1810-100

Dear Board Members and FASB Staff:

The National Multi Housing Council (NMHC) and the National Apartment Association (NAA)¹ appreciate the opportunity to comment on the Proposed Accounting Standards Update, *Accounting for Financial Instruments and Revisions to the Accounting for Derivatives Instruments and Hedging Activities* (Proposed Update). The stated objective of the Proposed Update is to provide financial statement users with a more timely and representative depiction of an entity's involvement in financial instruments, while reducing the complexity in accounting for those instruments.

Comments

International Accounting Standards Convergence

NMHC/NAA support the FASB and IASB working to consolidate and establish a common standard for classification of credit instruments to bring more consistent and transparent reporting for hedging activities. Significant differences exist between the proposed FASB and IASB models. Unless there is a common rule there would be an adverse impact to both preparers and users of financial statements if they have to go through back-to-back conversions.

¹ The National Multi Housing Council and the National Apartment Association represent the nation's leading firms participating in the multifamily rental housing industry. Our combined memberships are engaged in all aspects of the apartment industry, including ownership, development, management, and finance. The National Multi Housing Council represents the principal officers of the apartment industry's largest and most prominent firms. The National Apartment Association is a federation of 170 state and local affiliates comprised of more than 50,000 multifamily housing companies representing more than 5.9 million apartment homes¹. NMHC and NAA jointly operate a federal legislative program and provide a unified voice for the private apartment industry.

FASB's Proposed Fair Value for All Financial Instruments

NMHC/NAA Observations on Classification and Measurement: We support a continued measurement model that allows assessing some assets on amortized cost and some on fair value as assets are different and investors maintain a variety of asset investments for different purposes. Therefore, we must disagree with FASB's proposal for entities to present all financial instruments (as Defined by FAS157) at fair value in the balance sheet.

Fair value is not the appropriate approach for all activities contained on the balance sheet when the business strategy is to collect or pay the contractual cash flows from those assets over an extended period of time. While, fair value is appropriate for financial instruments that are held for trading or for short-term changes in market value. If the intent is to hold an asset for long-term cash flows or to hold a liability for contractual cash payment, amortized cost, i.e., discounted cash-flow, should be the primary means of measurement.

The Proposed Update would highlight a measurement attribute that is contrary to the way we understand that most banks manage their business. The accounting principles should closely follow the business model. Financial institutions hold assets for typically three purposes: (1) short term profit taking or trading, (2) long-term cash flows and (3) for liquidity or other asset/liability management purposes.

Therefore we are concerned that the Proposed Update would require that a significant portion of securities that are presently accounted for as Available-for-Sale (AFS) would instead be accounted for at fair value on a net income basis. This is contrary to what we perceive to be prudent asset/liability management practices. We feel such practice calls for a portion of liquid long-term investments be held for long-term cash flows. It is also prudent that such assets be available for short-term liquidity purpose or asset/liability duration rebalancing. These should be carried at fair value with changes in fair value going to other comprehensive income (OCI) in the Proposed Update. However, we are concerned that they would not meet the proposed criteria in the Proposed Update for measurement at fair value.

Finally, the proposal would result in more assets measured based primarily on Level 3 inputs (significant unobservable inputs to fair market value as specified in FAS 157) in the balance sheet which are less reliable and more subjective.

NMHC/NAA Recommends: We believe that the current rules providing for three classifications of financial instruments appear to be working and need no major overhaul. However, if FASB insists on moving to a two classification model, it needs to 1) broaden the definition of the held for cash flow category to accommodate AFS assets and 2) allow the cash flow assets and liabilities to be measured at amortized cost in the balance sheet.

Majority of Users Do Not Want All Financial Instruments to be Carried at Fair Value

NMHC/NAA is very concerned with the impact on financial institutions ability and desire to issue credit. We feel that the proposed rule on impairment will further debilitate institutions ability to make loans. FASB cites the main objective of the Proposed Update is to provide users with a more timely and representative depiction of an entity's involvement in financial instruments. FASB consistently points to users as the main reason for proposing fair value accounting in the balance sheet for all financial instruments. A study earlier this year by PriceWaterHouseCoopers (PWC) concluded that a majority of respondents favored a mixed measurement model, with fair value reporting for short-term instruments and amortized cost reporting for instruments that the reporting entity intends to hold for long-term cash flows.² An analysis by Barclays Capital produced similar results.³ The overwhelming percentage of respondents (90%) disagreed with FASB's financial instruments exposure draft on fair value accounting and credit loss recognition.

Impairment Recognition

NMHC/NAA Observations on Impairment Recognition: NMHC/NAA has a number of concerns and recommendations with respect to the Proposed Update on impairment of financial assets:

- The FASB model would require a reporting entity to put up an allowance for loan losses at origination of a loan if there is adequate history for that class of loans to estimate life of loan losses. NMHC/NAA points out that such accounting is contrary to the matching principle that underlies much of Generally Accepted Accounting Principles (GAAP). The interest rate includes a premium related to credit. Accordingly, proper matching would require the provision for loan losses to be spread out over the life of the loan. From a practical standpoint, providing for loan losses at origination creates capitalization of future losses on longer-term loans that is unrealistic and will cause banks to favor only short-term credit instruments and reduce incentives to provide credit.
- It is our understanding that banks and other financial institutions will incur added cost that is unnecessary and that the proposed accounting will be cumbersome, requiring significant changes in loan accounting systems and processes and will also distort net interest margin, a key measurement used by analysts.
- Present accounting principles require recognition of impairment for principal losses. Loss of future interest income is taken into account in the non-accrual practice and ultimate charge-off of principal. The Proposed Update would require the provision and allowance for loan losses to include both principal and interest cash flows. NMHC/NAA believes that this is not a reasonable position and that the focus should be dedicated to principal reserves, not profits, especially since future interest income is not booked until it is reserved.

² PriceWaterhouseCoopers, *What Investment Professionals Say About Financial Instrument Reporting*, June 2010.

³ ABA, *Daily Newsbites: Investors Say 'No' on Mark-to-Market Proposal*, June 25, 2010.

NMHC/NAA Recommends:

It is our recommendation that FASB use the following principles in finalizing the impairment portion of the Proposed Update:

- Impairment should be recognized on an expected loss basis when feasible.
- Impairment charges should be recognized over the life of the financial assets, not at origination. This will provide for appropriate matching of an expense with the appropriate period the entity benefits from the asset.
- Only principal cash flows should be included in the impairment estimate. Lost interest should be addressed at default and as part of the ultimate charge-off.
- Since there is a potential that default could occur early in the life of a loan, it is reasonable to establish a minimum floor of one year of estimated charge-offs for the allowance for credit losses.

The NMHC/NAA appreciates the opportunity to share these comments with the Board. Any questions about our comments should be directed to David Cardwell, NMHC Vice President of Capital Markets and Technology at (202) 974-2336 or dcardwell@nmhc.org.

Sincerely,



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