

From: jmarina@totalbank.com
To: [Director - FASB](#)
Subject: File Reference: No. 1810-100, "Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities"
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September 27, 2010

Russell Golden
Technical Director
Financial Accounting Standards Board
401 Merritt 7, PO Box 5116
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Dear Mr. Golden:

TotalBank appreciates the opportunity to comment on the Exposure Draft: Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities. TotalBank is a community bank with \$2 billion in assets operating in Miami, FL. Like most community banks, we are focused upon serving the financial needs of small businesses and consumers in our community. As the Chief Financial Officer at TotalBank, I would like to share some of my observations on the Exposure Draft with you.

After reviewing the Exposure Draft, TotalBank urges the Board to withdraw its proposal to expand fair value accounting for financial instruments for the following reasons:

- The proposed accounting standard is not consistent with the business model of most banks, regardless of size
- The proposed accounting treatment of financial instruments will inevitably impact the product offerings of banks and the access consumers and small businesses have to the financial products they require
- The inconsistency between the business model and the accounting treatment would diminish rather than improve the relevance and utility of financial reporting
- The proposed accounting model will result in banks being valued at a liquidation value that is not reflective of the Bank's true market value in most cases
- The inevitable substantial cost of implementing the guidance would not outweigh any perceived benefits

The proposed accounting standard is not consistent with the business model of most banks in the United States. Like most banks, TotalBank generates loans in its community with the intention of holding the loan to its maturity and collecting the contractual cash flows. These loans are funded through deposits obtained in the community and supplemented with wholesale funding sources, as necessary.

The earnings process at TotalBank and most other banks is derived by managing the spread relationship between earnings assets and funding liabilities. Fluctuations in market prices of these loans and funding liabilities due to market conditions are generally irrelevant to the

Bank's ability to generate core earnings on an ongoing basis.

Managing this spread relationship between earning assets and funding liabilities is a function of interest rate risk management, which is designed to ensure that the Bank's ongoing net interest margin will not be severely impacted by upward or downward movements in interest rates. Perhaps additional disclosures surrounding a Bank's interest rate risk management processes and projections in upward and downward rate scenarios would provide investors with more useful financial information. Fair value accounting will not provide an investor with an accurate picture of the Bank's interest rate risk position or if the Bank has taken excessive interest rate risk.

As a result of this inconsistency between the proposed accounting treatment for financial instruments and the current bank business model, bank product offerings will inevitably be impacted. Under the proposed standard, banks would favor shorter term loans with adjustable rates since these instruments are less volatile to changes in market rates. As a result, traditional banking instruments like the 30-year fixed rate mortgage may no longer be the foundation of a community bank's (or any bank's) loan portfolio.

While a bank could theoretically fund these 30-year mortgages with long term liabilities in order to effectively off-set the inevitable sharp fluctuations in market values inherent in these instruments, such longer term funding sources are only typically available in the wholesale market since retail deposit customers have a general aversion to any deposits with maturities beyond one year. Concurrently, banks of all sizes are under pressure from regulatory agencies to limit their utilization of wholesale funding sources. Therefore, there are no long term funding sources currently available of any substance that could be utilized to off-set the volatility of longer term loans, such as 30-year fixed rate mortgages, without incurring regulatory criticism.

Product offerings of both national and community banks will be affected by the punitive effect the proposed standard will have on relationship pricing. It is common practice in the banking industry for banks to offer their best customers that maintain several products with the bank more advantageous loan and deposit pricing. For example, TotalBank offers its small business and residential lending customers more attractive pricing on loans if they maintain certain other products with the Bank.

Another unintended consequence of the proposal could be increased credit risk at financial institutions that avoid fixed rate loans in favor of floating rate loans. Many small businesses and consumers prefer fixed rate loans since their required cash outflows to pay the loan are known. A focus on floating rate loans will increase credit risk since debt service coverage ratios will decrease as market rates increase, causing an increased number of borrowers to default.

Unfortunately, the proposed standard does not recognize the value of customer relationships and a Bank's proven ability to cross-sell customers when valuing loans and deposits. Instead, the proposed standard dismembers the Bank piece-by-piece in order to arrive at "fair value" or, more appropriately, liquidation value. Consequently, loans or deposits priced on a relationship basis would effectively result in the Bank recognizing a loss upon booking the financial instrument. Such treatment does not recognize the customer's true value to the banking franchise. Therefore, fair value accounting will have an adverse effect on consumers, small businesses, and banks alike.

As a result of the Bank being valued at a liquidation value, investors would be provided with financial information that is not relevant. Assessing the value of other products and services provided to that customer and a bank's proven ability cross-sell products to customers is a critical component of valuing customer relationships. The fact is that the loans that would be valued on a disaggregated basis under the proposal are more valuable to the bank that originated the loan and owns the customer relationship than to a 3rd party investor that would have limited ability to extract additional value from the customer relationship.

The proposed valuation approach for core deposits is also fatally flawed. The proposal measures core deposits based on the present value of the average deposit balance over its implied maturity, discounted at a rate equal to the difference between the alternative funds rate and the all-in-cost-to-service rate over that maturity.

Besides the same relationship value flaw detailed above, the calculation inherently assumes that a bank can rid itself of core deposits and fund itself entirely with alternative funding sources. As previously mentioned, regulators have been and will continue to apply pressure on banks to reduce alternative or wholesale funding levels. While the core deposit valuation approach may make theoretical sense, it fails to capture the true value of core deposits in the real world in which all banks operate.

In order to implement this proposed standard that attempts to value financial assets and liabilities at fair value and comply with its requirements, banks will incur substantial costs to revamp core systems and loan accounting modules. The cost for a community bank such as TotalBank can easily reach the high six figure range and enter the 7 figure range to overhaul its systems. Such expenses would be incurred at a time that many banks can least afford them.

In conclusion, TotalBank urges the Financial Accounting Standards Board to reconsider its Exposure Draft on Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities. TotalBank believes that the proposal will adversely affect the quality of financial reporting instead of improving it.

Sincerely,

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Executive Vice President & Chief Financial Officer
TotalBank