American Bankers Association
Building Success. Together.

Donna J. Fisher
Senior Vice President
Tax, Accounting & Financial Management
(202) 663-5318
DFisher@aba.com

June 20, 2016

Robert Storch
Chief Accountant
Federal Deposit Insurance Corporation
550 17th St, NW
Washington, DC 20429

Dear Bob,

Thank you for meeting with ABA member banks and staff in March regarding concerns about the new accounting for equity investments, which is triggered by Accounting Standards Update 2016-01 (Recognition and Measurement of Financial Assets and Financial Liabilities). During our meeting, you suggested that we follow up with you to further describe how we would resolve our concerns, and that is the purpose of this letter.

As we discussed during the meeting, recording changes in unrealized gains and losses in income poses significant concerns for banks that were grandfathered (under FDICIA and several state banking laws) and allowed to invest in equity securities. Banks that have equity security portfolios manage them in a similar manner as banks whose portfolios consist primarily of debt securities, in that these equity portfolios are managed to achieve a balance of current income (dividends) and long-term appreciation. However, the new accounting for equities will mean that unrealized gains and losses are reported in income while unrealized losses on debt securities will remain in accumulated other comprehensive income (AOCI). This reporting difference can be very misleading.[1] (See Attachment 1.)

Many users of bank financial information that is obtained from Call Reports assess the safety and soundness of institutions based on metrics that include return on assets (ROA) and return on equity (ROE). Application of the new accounting standard could result in significant period to period swings in ROA and ROE, which will not accurately reflect the performance or safety and soundness of the institution. Therefore, it is extremely important for banks to be able to clearly show the users of their Call Reports the impact of the changes in unrealized gains and losses on

[1] We acknowledge that debt securities and equity securities are different and understand why FASB chose to mark equity securities to market, as equity securities do not have a maturity date. Absent credit risk, debt securities will be repaid at maturity; whereas, for equity securities, there is no face amount required to be paid. However, the FASB has also acknowledged that there is a difference between debt securities held to maturity, debt securities available for sale, and debt securities held for trading, and the accounting differs depending on the intent. Part of the reason for this is that recording gains and losses on debt securities that are held to maturity would be misleading and could result in irrelevant volatility in earnings. Our point is that the same is true for equity securities, and regulatory reporting should recognize this.

net income in a location that is near the final net income number in Schedule RI. The most straight-forward solution would be to report "net income before unrealized gains and losses on equity investments," followed by a separate line item that would isolate the unrealized gains and losses. Attached is a marked version of Schedule RI to help visualize our recommendation. (See Attachment 2).

For many customers, regulators and investors in smaller banking institutions, their primary source of financial information is generally the Call Report and the Uniform Bank Performance Report (UBPR) data. Additional detail provided in the Call Report can help supplement and clarify the GAAP financial statements.

The practices and strategies of banks that are permitted to invest in equities have been deemed consistent with the safe and sound operation of these banks during decades of supervision. Changes in accounting rules that encourage termination of these strategies, and the concomitant divesture of successful portfolios as a result of adverse financial metrics and CAMELS ratings, would likely damage the affected institutions. Although the accounting standard is not effective until 2018 for public business entities and 2019 for non-public business entities, there is an urgent need to resolve these concerns in a timely manner before these banks abandon successful strategies and decide to liquidate their equity investment portfolios.

We respectfully request that the agencies make the Call Report changes recommended above as soon as possible and announce their intent to do so as soon as the decision is known. This will help relieve pressure to re-cast investment portfolios and will assist bank customers, investors, and other users of Call Reports and Call Report data in better understanding these banks' financial positions.

Thank you again for taking the time to meet with us and for giving serious consideration to this proposal. Please do not hesitate to contact me if I can be of assistance or provide further information.

Sincerely,

Donna J. Fisher

Donna Fisher

Attachments

cc: Rusty Thompson, Chief Accountant, OCC
Joanne Wakim, Chief Accountant, Federal Reserve Board

Attachment 1

Equity Investment Accounting Changes

Background on the accounting for equities

Banks that carry equity investments normally have equity securities that have readily attainable fair values. Currently, the vast majority of these investments are classified as "available for sale" and the changes in the fair value of the instruments (if not considered "other than temporary impairment") are recorded in accumulated other comprehensive income (AOCI), rather than in net income.

Current regulatory treatment allows banks under $250 billion in assets to exclude the effect of all changes in fair values of equity securities (if those fair values remain above their cost basis in an unrealized gain position) from regulatory net income and CET1 capital. When there is an unrealized loss below the cost basis, the loss is excluded from net income but included in CET1 capital.

In January 2016, FASB issued an accounting standard (ASU 2016-01, Subtopic 825-10, Financial Instruments—Overall: Recognition and Measurement of Financial Assets and Financial Liabilities), which will eliminate the different classifications of equity investments, and changes in the fair value of most equity investments will be recorded in net income rather than through OCI. At the effective date (2018 for public business entities and 2019 for all other companies), companies will record a one-time cumulative effect adjustment as of the beginning of the year.

Grandfathered banks

Recording changes in fair values of equity investments in net income poses significant concerns for a number of banks, especially those that were grandfathered and have been investing in equities for decades. They were allowed to continue to hold equities under the Federal Deposit Insurance Corporation Improvement Act (FDICIA) and several state banking statutes. As a result of merger activities over the past 25 years, banks of all charter types currently are among those with grandfathered status.

Grandfathered portfolios

Many of these banks continue to manage low-risk, low-beta stock portfolios under buy and hold strategies that enhance financial stability and support community services. Because these banks hold and manage their equity investments with long-term strategy goals that are similarly used by other banks in managing the long-term portion of their debt securities, the new difference in the accounting rules between the two (unrealized gains and losses in income for equities and in AOCI for debt) can be very misleading. Recording temporary unrealized gains and losses in net income can lead investors, examiners, and others who use information from Call Reports, Uniform Bank Performance Reports, and income-related metrics to inappropriate conclusions relating to performance. Market swings could also have a negative impact on banks' CAMELS ratings, which would be misleading. Currently, these banks generally have unrealized gains in their portfolios and do not manage their bank capital based on such gains.

Absent regulatory action, in order to accurately evaluate safety and soundness, the various parties (customers, management, bank examiners, and investors and other third-party organizations) that are either concerned about the health of their bank as customers or analyze current results and capital metrics based on Call Report data will need to make adjustments for this in order to understand these banks' results.

Recommendation

As soon as possible, banking regulators should modify the Call Report Schedule RI so that users of banks' financial statements can better understand the impact of reporting unrealized gains and losses in income. Our recommendation is to identify unrealized gains and losses as being included in the line 10 subtotal: "Income before extraordinary items, unrealized gains and losses recorded in income on equity investments, and other adjustments", with an additional line to report unrealized equity investment gains and losses net of income taxes inserted between existing lines 11 and 12. This information will improve the information provided to users of banks' financial information and assist examiners and other users of financial statements better understand the true ROA, ROE, and other metrics.

Attachment 2

Schedule RI-Continued

Dollar Amounts in Thousands	Year-to-date RIAD	Bil	Mil	Thou	
2. Interest expense (continued):					
d. Interest on subordinated notes and debentures	4200				2.d.
e. Total interest expense (sum of items 2.a through 2.d)	4073				2.e.
3. Net interest income (item 1.h minus 2.e)	4074				3.
4. Provision for loan and lease losses	4230				4.
5. Noninterest income:					
a. Income from fiduciary activities[1]	4070				5.a.
b. Service charges on deposit accounts	4080				5.b.
c. Trading revenue[2]	A220				S.c.
d. (1) Fees and commissions from securities brokerage	C886				5.d.(1)
(2) Investment banking, advisory, and underwriting fees and commissions	C888				5.d.(2)
(3) Fees and commissions from annuity sales	C887				5.d.(3)
(4) Underwriting income from insurance and reinsurance activities	C386				5.d.(4)
(5) Income from other insurance activities	C387				5.d.(5)
e. Venture capital revenue	8491				5.e.
f. Net servicing fees	8492				5.f.
g. Net securitization income	8493				5.g.
h. Not applicable					
i. Net gains (losses) on sales of loans and leases	5416				5.i.
j. Net gains (losses) on sales of other real estate owned	5415				5.j.
k. Net gains (losses) on sales of other assets (excluding securities)	8496				5.k.
l. Other noninterest income*	8497				5. l.
m. Total noninterest income (sum of items 5.a through 5.l)	4079				5.m.
6. a. Realized gains (losses) on held-to-maturity securities	3521				6.a.
b. Realized gains (losses) on available-for-sale securities	3196				6.b.
7. Noninterest expense:					
a. Salaries and employee benefits	4135				7.a.
b. Expenses of premises and fixed assets (net of rental income) (excluding salaries and employee benefits and mortgage interest)	4217				7.b.
c. (1) Goodwill impairment losses	C216				7.c.(1)
(2) Amortization expense and impairment losses for other intangible assets	C232				7.c.(2)
d. Other noninterest expense*	4092				7.d.
e. Total noninterest expense (sum of items 7.a through 7.d)	4093				7.e.
8. Income (loss) before income taxes and extraordinary items and other adjustments (item 3 plus or minus items 4, 5.m, 6.a, 6.b, and 7.e)	4301				8.
9. Applicable income taxes (on item 8)	4302				9.
10. Income (loss) before extraordinary items, unrealized gains and losses recorded in Income on equity investments and other adjustments (item 8 minus item 9)	4300				10.
11. Extraordinary items and other adjustments, net of income taxes*	4320				11.
12. Net unrealized gains (losses) recorded in income for equity investments, net of income taxes					12.
13. Net income (loss) attributable to bank and noncontrolling (minority) interests (sum of items 10, 11 and 12)	G104				13.
14. LESS: Net income (loss) attributable to noncontrolling (minority) interests (if net income, report as a positive value; if net loss, report as a negative value)	G103				14.
15. Net income (loss) attributable to bank (item 13 minus item 14)	4340				15.

*Describe on Schedule RI-E-Explanations.

1. For banks required to complete Schedule RC-T, items 14 through 22, income from fiduciary activities reported in Schedule RI, item 5.a, must equal the amount reported in Schedule RC-T, item 22.
2. For banks required to complete Schedule RI, Memorandum item 8, trading revenue reported in Schedule RI, item 5.c, must equal the sum of Memorandum items 8.a through 8.e.

NOTE: The concept of extraordinary items has been eliminated from U.S. generally accepted accounting principles for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. References to extraordinary items in the captions for Schedule RI, items 8, 10, and 11, will be removed at a later date.