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November 12, 2008

Mr. Robert H. Herz
Chairman
Financial Accounting Standards Board
401 Merritt 7
P. O. Box 5116
Norwalk, CT 06856-5116

Re: Deferral of Fair Value Not Yet Implemented: SFAS 141(R); SFAS 157 for Non-Financial Assets and Liabilities

Dear Chairman Herz:

The purpose of this letter is for the American Bankers Association (ABA) to express its continued concern about the application of fair value and the current and potential impact of fair value on the markets. ABA brings together banks of all sizes and charters into one association. ABA works to enhance the competitiveness of the nation's banking industry and strengthen America's economy and communities. Its members – the majority of which are banks with less than $125 million in assets – represent over 95 percent of the industry's $12.7 trillion in assets and employ over 2 million men and women.

We are concerned about accounting projects in the pipeline that, if finalized, could ignite new disruptions in the market place. Not only are some of these projects highly controversial with respect to whether or not they improve the accounting literature, but they could hardly come at a worse time, becoming new sources of insecurity and instability in financial markets that are in more need of calm. ABA has expressed significant concerns about fair value, and in our October 13, 2008, letter to the Securities and Exchange Commission (SEC), we recommended that any new fair value standards be suspended pending Congressional review of the fair value study[1] mandated by the Emergency Economic

[1] The study is being performed by the SEC in consultation with the Secretary of the Treasury and the Board of Governors of the Federal Reserve System. Under the terms of the EESA, the study will focus on: (1) the effects of such accounting standards on a financial institution's balance sheet; (2) the impacts of such accounting on bank failures in 2008; (3) the impact of such standards on the quality of financial information available to investors; (4) the process used by the Financial Accounting Standards Board in developing accounting standards; (5) the advisability and feasibility of modifications to such standards; (6) alternative accounting standards to those provided in SFAS 157.

Stabilization Act of 2008 (EESA).[2] We recommend that the FASB take into consideration the importance of the study by suspending any fair value guidance that has not has not yet been implemented. This would include:

- Fair value for business combinations – Deferral of the effective date of SFAS 141(R) (Statement of Financial Accounting Standards No. 141(R), *Business Combinations*).[3] The current effective date is for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008.
- Fair value for non-financial assets and non-financial liabilities – Deferral of the effective date (delayed application) of SFAS 157 (Statement of Financial Accounting Standards No. 115, *Fair Value Measurements)* for non-financial assets and non-financial liabilities. The current effective date (delayed application) is fiscal years beginning after November 15, 2008, and interim periods within those fiscal years.

The new effective dates should be delayed indefinitely and should be re-established only after a thorough analysis of the significant issues involving fair value accounting, including such questions as to whether the proposed standards are clearly to the benefit of users of financial statements, whether fair value is pro-cyclical, whether the impact of the proposals on the marketplace has been adequately taken into account and provided for, and whether entities of all sizes have the ability to prepare their own financial statements without undue cost burdens.

During the SEC Roundtable on fair value on October 29, 2008, Mr. Aubrey Patterson, CEO of BancorpSouth, Tupelo, MS, and Mr. Chuck Maimbourg, Director of Accounting Policy, Key Bank, Cleveland, OH, both noted that the combination of SFAS 157 and SFAS 141(R) have prevented acquisitions of financial institutions from occurring during 2008. Other ABA members have had this same experience. Prior to SFAS 141(R) and SFAS 157, assets and liabilities were required to be marked to market under the purchase accounting rules. However, SFAS 141(R) requires new fair value for loans, and SFAS 157 defines fair value in such a way that it tends to result in lower fair values.

The current approach in accounting for business combinations (purchase accounting) has assumed that when a company is acquired, the acquisition is based

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[2] According to the SEC's website, the study is to be completed by January 2, 2009.

[3] According to the summary on the FASB's website, SFAS 141(R) "…requires an acquirer to recognize the assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree at the acquisition date, measured at their fair values as of that date, with limited exceptions specified in the Statement. That replaces Statement 141's cost-allocation process, which required the cost of an acquisition to be allocated to the individual assets acquired and liabilities assumed based on their estimated fair values."

on the fair values of individual assets and liabilities.[4] This fair value primarily included fair value adjustments for interest rate effects and minor credit adjustments. Under the new standards (SFAS 141(R) and SFAS 157), acquired loans must be recorded at a different fair value. That fair value is defined under the new definition in SFAS 157, *which is based on exit price*, and includes discounts for liquidity and credit risk that exceed the previous definition of fair value and the accrued losses currently recognized under GAAP for loans. Although the acquirer may not expect to realize these estimates of market losses on the loans, it must write the loans down, which reduces capital at acquisition. Over time, that loss will be accreted back into income. However, the liquidity and credit spread discount on the fair value of the loans can be so severe that such effects as higher goodwill levels, potentially higher capital needs, etc., make acquisitions undesirable. The result in 2008 has been the nearly total disappearance of mergers as a means of resolving troubled financial institutions at the very time when this important tool would be of significant value to regulators and to the financial system as a whole. That is to say, that a crucial tool in reducing systemic risk has been taken off the table by the effect of these fair value rules.

An additional complication with the use of fair value in SFAS 141(R) is the increased complexity in accounting for loans. Loans typically represent a significant portion of the assets of financial institutions. Historically, the allowance for loan and lease losses (ALLL) related to the acquired entity's loans and leases has been carried over from the acquired institution's books to the acquirer's books. Thus, the loans are displayed on the balance sheet at the loan balance along with the corresponding ALLL contra-account. This makes it clear to readers of financial statements the amount of credit losses accrued against the loans. However, under 141(R) the acquired loans are required to be recorded at fair value at acquisition, and the ALLL is only recorded if losses are incurred subsequent to acquisition. This results in a mixture for the newly combined entity of some loans being reported at the fair value as of the acquisition date with no ALLL, some reported at the fair value as of the acquisition date with ALLL, and other loans being reported at current balances with ALLL. The use of fair value in SFAS 141(R) also results in inconsistency in the treatment of loans on an institution's books, systems problems for tracking the various accounting methods for loans, and difficulty in measuring or understanding credit risk both for regulators and management. Understanding credit risk is paramount, especially in the current environment. This accounting will make financial institutions' financial statements more difficult to understand for investors and other users of financial statements.

In summary, the problems that exist in today's financial markets can be traced to many different factors. One key factor that is recognized as having exacerbated these problems is fair value accounting. The use of fair value has been controversial for many years, with heightened controversy during the financial crisis,

[4] Some bankers have expressed concern that this approach, which is based on fair values of individual assets and liabilities, does not reflect the economic value of a business or even a segment of a business. When a business is acquired, it is acquired as a going concern – not as discrete assets and liabilities about to be liquidated – and the true value of the acquisition consequently differs from narrowly defined fair values.

as is evidenced by the level of interest in the issue by all forms of media, Congress,[5] participants in the SEC Roundtable on fair value on October 29, 2008, and others.[6] These problems are ongoing, and it is important that the FASB, as a key participant in the process of the study required by Congress, take steps to ensure that its standards do no further harm by requiring further fair value during this period. To continue to require these effective dates for SFAS 141(R) and the remaining scope items in SFAS 157 would, at a minimum, further stir up financial markets that are in need of composure, and would moreover presume an outcome from the congressionally mandated study that has not yet been determined. Further study is needed before requiring that these standards be implemented in order to ensure that users of financial statements have relevant, reliable, and useful information at a reasonable cost.

Sincerely,

Donna J. Fisher

Donna Fisher

cc: Jim Kroeker, Securities and Exchange Commission
Charles Holm, Federal Reserve Board
Arthur Lindo, Federal Reserve Board
Jeffrey Geer, Office of Thrift Supervision
Zane Blackburn, Office of the Comptroller of the Currency
Robert Storch, Federal Deposit Insurance Corporation

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[5] See Sections 132 and 133 of EESA.

[6] See comments received by the SEC at http://www.sec.gov/comments/4-573/4-573.shtml.