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

Re: File Reference No. 1250—001, Proposed Statement of Financial Accounting Standards, *The Fair Value Option for Financial Assets and Financial Liabilities – Including an amendment of FASB No. 115*

Dear Director:

The American Bankers Association (ABA) appreciates the opportunity to submit comments on the Financial Accounting Standards Board's (FASB) Proposed Statement of Financial Accounting Standards, *The Fair Value Option for Financial Assets and Financial Liabilities – Including an amendment of FASB No. 115* (proposal). The ABA brings together all categories of banking institutions to best represent the interests of the rapidly changing industry. Its membership – which includes community, regional, and money center banks and holding companies, as well as savings associations, trust companies and savings banks – makes the ABA the largest banking trade organization in the country.

Summary of ABA Position

We oppose fair value accounting for financial instruments¹, unless such accounting reflects the business model used by the reporting entity. We also believe that a piecemeal move to fair value accounting is inappropriate. The ABA's constituency varies considerably, from small community banks to large bank holding companies. Some of our members strongly support the fair value option, but this support is motivated by a desire to repair some of the current problems with Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities* (SFAS 133). On the other hand, those members and other ABA members are concerned with the FASB's move toward fair value accounting. Nearly all members strongly oppose a full fair value accounting model because of the lack of its relevance given our relationship-based business model, the unreliability of the mark-to-model approach that will be necessary for nearly all loan and deposit products, the potential for accounting abuses, and the significant cost and complexity of implementation and application without a corresponding benefit.

¹ For the most comprehensive summary of ABA's position, see letter from the Joint Working Group of Banking Associations to the Joint Working Group of Standard Setters. October 1999.

Many in our industry and in other industries believe that the intent of this proposal is and should be simply to improve SFAS 133. They have not focused on the fact that it is a major step toward full fair value accounting. Any major step such as this should not be done with such a short comment period and so little time for discussion.

Fair value accounting as a test, which is what the proposal appears to represent, is inappropriate. Additionally, the proposal would not represent a comprehensive test, because: (1) presumably, only those whose business models are based on fair value will elect fair value (and the FASB's intent is to use fair value whether or not the business model is based on fair value), and (2) the proposal does not represent a true fair value model for financial institutions (because demand deposits cannot be marked to market under the proposal).

We would like to recommend an alternative solution, which we hope the FASB will consider. In lieu of the proposal, we recommend that the FASB identify the major shortcomings of SFAS 133 and issue solutions that could be issued and adopted very quickly. We are not suggesting an overhaul of SFAS 133; instead, we hope that the FASB will target the limited number of major problems that can be expeditiously addressed, and we would like to work with the FASB on such effort.

SFAS 133 Shortcomings

SFAS 133 is an extremely complex standard, as is evidenced by the 180 Derivatives Implementation Group (DIG) issues with over 800 pages of reading material. We understand that some FASB Board members share the same concerns that have been expressed by industry and others with respect to SFAS 133.

Part of our original objection to SFAS 133 is its one-sided nature. Prior to the issuance of SFAS 133, the ABA recommended to the FASB that if it pursued a fair value model for derivatives and hedging, it should also match (at fair value) the derivative with the hedged item, preferably through a basis adjustment.² Unfortunately, the requirements to match the derivative with the hedged item at fair value added considerably to the standard's complexity. Additionally, we note that many of the entities that have recently restated earnings as a result of problems with SFAS 133 also objected to the issuance of the standard, citing complexity and difficulty in application as their biggest concerns.

Again, we emphasize that we do not request that SFAS 133 be re-written. As a matter of fact, some ABA members have emphatically stated that they do not want substantial revisions to SFAS 133, simply because they have spent so much time and money to understand and implement the standard. Instead, they have suggested that we attempt to repair the most problematic areas of SFAS 133, which could be done within a short turnaround time. Our hope is that by repairing the problematic areas, the complexity and the detailed processes required by SFAS 133 will be reduced. We

² See letter from ABA to FASB, October 11, 1996: "If the FASB decides to pursue a fair value model for derivatives and hedging, it will be critically important that there be a 'matching' of the derivative with the hedged item, preferably through the basis adjustment."

are currently identifying issues and developing solution proposals to assist in this endeavor.

We recognize that one of the FASB's goals with the proposal is the convergence between U.S. standards and those issued by the International Accounting Standards Board (IASB). Although we believe convergence is important, we also believe this convergence is not compelling enough to move away from meaningful and useful accounting guidance. There are many similarities between the FASB proposal and the IASB final standard relating to its fair value option; however, we believe that the FASB's proposal is unnecessarily broader than the IASB standard. Further, the IASB and FASB worked closely together to ensure that the IASB's accounting for derivatives was similar to SFAS 133. Thus, the IASB inherited SFAS 133's problems, and the IASB's constituents searched for solutions to make it more meaningful. One such solution was the IASB's fair value option. Although their fair value option helped achieve some of the necessary relief, this loop should not be repeated solely for the sake of convergence. We prefer to repair the problem rather than simply add hurriedly conceived accounting.

Specific Comments on the Proposal

The proposal represents a profound change to generally accepted accounting principles (GAAP). The proposal states that the FASB intends to move toward a fair value accounting model for financial instruments. We do not support the FASB's move toward fair value accounting. This will have a significant impact on all industries and will significantly impair the comparability of financial statements. The indication on the FASB's website that the IASB "believes that the fair value option will enable constituents to become more familiar with using fair value as a measurement attribute for financial instruments" is frightening. Experimental accounting, without sufficient study, should not be used for financial reporting measurement purposes, particularly because it can have such a significant impact on an entire industry. If this is the goal, then the FASB and IASB should provide a discussion document for comment on fair value. This document would need sufficient study and consultation with industry and users *prior* to issuing a standard. Without sufficient study, this experiment could fail.

It is difficult to believe that such a major step to fair value would be provided in a document many thought was originally intended to repair SFAS 133 and that such a short comment period is provided. Many questions remain unanswered by the FASB, such as: What is the logic in requiring fair value only for financial instruments, especially if an entity's business model is not fair value? If the logic is that it is a practical cut, then what will the impact be on the cost of capital for those that make the cut versus those that do not make the cut? What is the impact of fair value on community banks? These and other questions are critical issues that must be addressed before moving to fair value – even if it is elective.

The ABA has written numerous letters over the last two decades in response to the FASB's move toward fair value accounting in various standards. In these instances and in meetings, we have requested that the FASB conduct a comprehensive study of the impact of the use of fair value in measuring financial instruments prior to additional fair value requirements. In 1998, the FASB published a focus group

research study that examined the relevance of fair value. To perform the research project, the FASB's hired consultants requested input from a group of users (primarily analysts and portfolio managers). Interestingly, the user group generally did not favor fair value. However, the views of the user group were dissected by slicing the focus group into a small "knowledgeable" group of users and a larger "less informed" group of users. Based upon this slicing, the report stated that even the knowledgeable group of users was evenly split between those that favored a fair value model for financial instruments and those that did not. We would question the basis for the distinction between knowledgeable and less informed users, the need for such differentiation, and who was responsible for making the determination.

To this end, the ABA recently conducted its own interviews with ten bank financial statement user groups (among the analyst community) to determine whether they want fair value. We would argue that knowledgeable users of bank financial statements (among the analyst community) are those that are practicing analysts directly responsible for analyzing banking institutions. They are familiar with bank operations, the banking business model, the financial statements of banks, interpreting the results, and their own processes for analyzing and interpreting those financials.

Generally, these users have modeled the existing mixed-attribute financials and find the mixed-attribute model reliable, useful for their predictive value, useful as a measure of management's performance, and reflective of the business model of the banks they follow. Not surprisingly to us, these user groups were generally strongly in favor of mixed-attribute presentation on the face of the financials when reflective of the business model and in favor of additional fair value disclosure where appropriate. There was even some expressed desire for a return to a fully historical presentation. We strongly suggest that the FASB conduct similar interviews before moving to a practice round of fair value, especially because these represent many of the users of financial statements that the FASB is attempting to please.

The Fair Value Option as a Solution

SFAS 133 is so narrowly defined that it prohibits many hedging activities from qualifying for hedge accounting. There is no denying that the proposal offers an attractive solution to the problems of SFAS 133 concerning documentation and restrictions on use, it offers what appears to be a simple application, and it helps resolve the restriction of allowing hedge accounting for only a narrow subset of hedging activities.

Demand Deposit Accounts in a Fair Value Model

The proposal currently excludes demand deposit accounts from the list of balance sheet accounts for which fair value can be elected. The ABA has conferred with banks nationwide and has come to the conclusion that demand deposit accounts, arguably the most valuable asset of a bank, should not be excluded from a fair value model in Phase I. Although the issue of valuing demand deposit accounts will not be an easy process, these deposits fund the assets that will be carried at fair value. Without the option to report both sides at fair value, the result is to require a one-sided mark, which is one of the problems that the proposal is attempting to resolve for derivatives.

Changes in Creditworthiness

Theoretically, in a fair value world, changes in a preparer's own credit may be appropriate; however, we believe that the affect of changes in a preparer's own credit should not be reflected in valuations of their debt on their own financial statements. The adjustments to the financial statements that would result are illogical and not reflective of the economic health of the company. A company with an improving debt rating would appear to reduce solvency as the rating increased and the reverse would be true of a downgrading preparer. Reflecting the change in income is also not indicative of the underlying economics.

Comparability/Consistency Issues with the Fair Value Option

The issue of comparability among entities in the proposal has been discussed and discounted by the FASB as matter of preference for the use of fair value. We believe this lack of comparability will be a significant concern for the users of financial statements. Additionally, we are concerned about inconsistency within an entity in an elective fair value model, because new fair value elections can be made from period to period. While the option of choosing or not choosing fair value may be useful to certain preparers, it is not necessarily in the best interests of users in the absence of a business model correlation or a hedging relationship. If an entity chooses fair value without some sort of rationale, how will the users of financial statements have a better understanding of the financial statements? Similarly, how will the users be able to compare entities? This is also in contradiction to the desire the FASB has expressed in the past to have two similar financial instruments accounted for using similar methodology.

Timing/Convergence of the Fair Value Option

We believe the best solution is to target the problem areas of SFAS 133 with an eye on applicability, ease of use, and orientation to business model economics. If the FASB chooses not to take this recommendation, we suggest that the final standard include a delayed effective date with early adoption permitted (not early adoption recommended). This would provide some of the much needed relief from SFAS 133 this year, and would also provide more time for those who are not ready to make these major decisions.

We have considered the idea of including application guidance similar to that provided in International Accounting Standard No. 39, *Financial Instruments: Recognition and Measurement*, with regard to business model alignment and alleviating mismatched accounting. Although the ABA staff views these as limitations that could make the election of fair value more logical, we are learning that some view these limitations as fairly broad. If the FASB were to include such language, it could unnecessarily increase the level of documentation that would be required for audit purposes without changing the outcome. Thus, some of our members have recommended that the FASB not include those limitations. Again, these are the types of decisions that need to be better understood and discussed with industry prior to such a major step toward fair value.

Timing of the Exposure Draft/Comment Period

Although we understand the need to issue the proposal sooner rather than later, we are concerned that the FASB will not receive sufficient responses from industry on

this important proposal. As mentioned earlier in this letter, many of the FASB's constituents have not focused on the significance of the proposal – primarily because it has been discussed by many as a way to repair SFAS 133 rather than as a major step to fair value. Additionally, it was issued immediately after the close of calendar year 2005, and the comment period ends as companies are wrapping up reporting for first quarter 2006. Thus, banks and other companies have not had an appropriate amount of time to comment on this important proposal. We believe the result will be a low volume of comment letters, which does not reflect the high level of concern that financial institutions and others have about fair value.

Concurrent Documentation

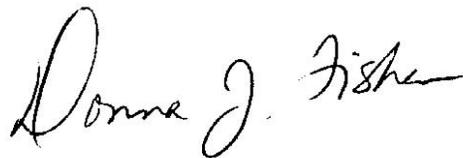
The proposal requires either the concurrent documentation or a pre-existing documented policy for automatic election to support the election the fair value option for a financial asset or financial liability. We feel that the requirement for concurrent documentation may be too burdensome for practical application, in the same mold as that of SFAS 133, especially upon adoption when there could be large numbers of elections. Further, a pre-existing policy might serve to unintentionally limit the application for instruments with fact circumstances that do not fit a pre-determined policy, even in situations where the election make sense. In fact, the flexibility and reduced administrative burden are two of the most attractive features of the proposal, and any perceived potential for abuse through retroactive election is misconstrued. We feel that this also facilitates the application of an already optional accounting method.

Conclusion

The marketplace is not currently prepared for a fair value accounting model, which has also not been sufficiently studied. Much more discussion with industry and users is needed prior to fair value for financial instruments – even elective fair value. Our alternative solution is to repair some of the major problems that currently exist with SFAS 133.

Thank you for the opportunity to comment on these matters, and we trust that you will give our views serious consideration.

Sincerely,

A handwritten signature in black ink that reads "Donna J. Fisher". The signature is written in a cursive, flowing style.

Donna Fisher