

FAS 159 - WAKE UP CALL

by [Steve Brown](#)

FASB Statement #159, The Fair Value Option for Financial Assets and Financial Liabilities is a big wake up call for independent bankers. In the past few weeks, legions of salespeople at broker-dealers throughout the country have been aggressively calling independent banks and telling them FAS 159 offers a one-time opportunity to restructure TRUPs or HTM securities portfolios without recognizing any losses in earnings. The urgency for independent bankers is that since nearly all file audited financial statements on a calendar year, the opportunity to take advantage of early adoption Goes Away on April 30 2007 (after that, banks can no longer revalue their existing financial instruments). Understand that we are not providing ANY accounting advice and that the goal of this piece is to raise awareness and provide assistance to independent banks. We urge anyone considering early adoption to talk to their own banking regulators, auditors, tax specialists and the SEC (if public) for specific advice. So, what is the big deal about FAS 159 and specifically, early adoption? In essence, early adoption allows banks to "reach back" into their current balance sheet and "reset" assets (or liabilities) to fair value. Since stock prices are driven by earnings (more than a multiple of book value), this opportunity is significant for banks. For example, banks with fixed rate assets on their books carrying below-market coupons could reset the price on those assets to fair value and book any resulting loss through equity (retained earnings) and not through current earnings. While equity may be adjusted lower, the bank's earnings have effectively been reset to the current market, so future income rises (i.e. lower coupon assets have been removed from the balance sheet and higher coupon assets have now replaced them). Know also that individual assets and liabilities can be selected by the bank and that early adoption is optional. Essentially this gives banks an immediate opportunity to restructure certain underperforming assets (for coupon, credit or structure). Some of the most obvious reasons banks are considering early adoption include the ability to remove low coupon HTM and/or AFS securities (without tainting HTM) or refinance existing TRUPs (take the unamortized fees and/or prepayment penalties against retained earnings and lower the cost from perhaps Libor+300bp to Libor+150bp). Beyond these strategies, there are many others that are worthy of consideration (we have compiled a list of over 30 unique strategies bankers should consider). Banks should closely read both FAS 159 & 157 (requires simultaneous adoption) and seek immediate advice from auditors. Remember, the window slams shut on April 30 and early adoption is no easy task (it requires extensive analysis, documentation, policy changes, enhanced controls, board approval and additional disclosures). It is critical to understand the following - YOU ONLY HAVE TO MAKE THE ELECTION BY APRIL 30, YOU DO NOT HAVE TO IMMEDIATELY SELL ANYTHING. Many of the big banks have already elected early adoption, so we urge banks to take the time to review and understand this potential opportunity. Call us to get assistance.

BANK NEWS

Biz Customers

Evidence suggests most banks have audited financial statements on only about 15% to 20% of their small business customers. Bankers may want to consider negotiating a bulk price and forming an alliance with a small accounting firm to assist clients. Doing so not only can generate cross business, but is also cleans up customer financial statements and ensures someone with professional training is looking at the financial picture of small business loan borrowers (i.e. early warning system).

ID Theft

Visa USA reports that 40% of credit card numbers are stolen from restaurants – banks should warn their franchise and other such customers of the risk.

Possible M&A

Turmoil in the subprime and Alt-A markets have increased speculation First Horizon National Corp (the old First Tennessee) could eventually be sold. Interested bidders most often cited by analysts include such names as BB&T, Fifth Third, National City, Royal Bank of Canada, SunTrust and Wells Fargo.

Dim Outlook

According to a recent poll, 60% of Americans think a recession will happen within the next year. This popular view is more pessimistic than many economists, including Fed Chairman Bernanke. The same poll also found that most Americans are confident in the value of their home even though subprime problems have been reported to be lowering values.

Direct Deposits

Direct deposits rose 5.1% to 4.4B payments in 2005. This is a small percentage of what the number could be considering 74% of small businesses do not use direct deposit because they believe that they are too small to do it.

FHLB System

For 2006, the most profitable FHLB was San Francisco at \$542mm. Interestingly, SF made more money than the bottom 5 FHLB's combined (Seattle, Des Moines, Indianapolis, Dallas and Topeka).

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