CUNA
Credit Union National Association
601 Pennsylvania Ave., NW | South Building, Suite 600 | Washington, DC 20004-2601 | PHONE: 202-638-5777 | FAX: 202-638-7734
cuna.org

Statement of the
Credit Union National Association

Mark-to-Market Accounting: Practices and Implications

House Committee on Financial Services
Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises
March 12, 2009

Mr. Chairman, on behalf of the Credit Union National Association, thank you very much for the opportunity to submit this statement for the record of the hearing on Mark-to-Market accounting. This issue is critical to achieving stability in the financial marketplace, and we appreciate your calling this hearing to review mark-to-market rules and consider whether there is a need for changes to the standard. CUNA represents nearly 90% of America's 8,000 credit unions and 92 million credit union members.

Like other financial institutions, federally insured credit unions over $10 million in assets are required to follow U.S. Generally Accepted Accounting Principles (GAAP). Also like other financial institutions, credit unions have been both directly and indirectly affected by the application of mark-to-market accounting in this current dislocated market. While natural person (or retail) credit unions are restricted in what they can invest in and as a result do not directly hold many assets required to be marked to market, corporate (or wholesale) credit unions have broader authority to invest directly in certain available-for-sale securities that must be valued using mark-to-market accounting. Due to the cooperative structure of credit unions, the financial strain experienced by the corporate sector is felt throughout the entire credit union network, including the National Credit Union Share Insurance Fund.

Mark-to-market accounting requires assets be valued at current market prices. Many critics of the accounting method argue that it forces assets to be marked down to artificially low prices due to the current absence of a market for many asset classes, such as mortgage-backed securities (MBS). Furthermore, these critics claim that basing the value of an asset on the price it could currently fetch in the open market is inappropriate in instances where the owner has the intent and ability to hold onto the asset past the current reporting period.

Conversely, proponents of mark-to-market feel that disclosure of an asset's underlying qualities is paramount and in order to maintain investor confidence the accounting standard must remain intact.

Whether one is for or against mark-to-market, most agree that when it was developed its drafters did not consider its application in markets such as the current illiquid one. This standard, originally intended to enhance accuracy of publicly-disclosed financial information, is having the opposite effect in the present economic environment when applied to certain instruments.

Just two days ago, at the Council on Foreign Relations, Federal Reserve Chairman Ben Bernanke stated that:

> [D]etermining appropriate valuation methods for illiquid or idiosyncratic assets can be very difficult, to put it mildly. As a result, further review of accounting standards governing valuation and loss provisioning would be useful, and might result in modifications to the accounting rules that reduce their procyclical effects without compromising the goals of disclosure and transparency.

Chairman Bernanke's statement echoes the concerns felt by much of the financial services industry, including credit unions.

While credit unions are not asking Congress to set accounting standards, we are asking that it direct the appropriate standard-setting body—whether the Financial Accounting Standards Board (FASB) or the Securities and Exchange Commission (SEC)—to address the problems these standards have created and to develop an approach that will promote greater accuracy in financial statements in light of the current market. This can be achieved by focusing on how investments such as MBS should be reported in the current economic environment.

The SEC recently conducted a study on the effects of mark-to-market and the FASB has since issued guidance on applying Statement of Financial Accounting Standards No. 157, Fair Value Measurements. However, the SEC's recommendations and the FASB's guidance do not go far enough in addressing the fundamental problem of applying mark-to-market accounting in an illiquid market. The FASB has announced several upcoming projects that will address some of the issues; however, any results will not be seen until late this summer or early fall. This problem cannot wait, and we urge Congress to address these matters with the SEC and the FASB now.

We understand that the subcommittee intends to focus today on the issue of whether impairment of an asset due to credit losses could be separated out from losses due to liquidity. We believe that such separation would be immensely beneficial and have supported this approach in our comment letters on this issue. From an investor perspective, it would provide a more accurate depiction of how the underlying credit portion of the asset is performing; for holders of such assets, it would more closely reflect the asset's true economic worth.

In addition, mark-to-market impacts the application of accounting standards to assets that must be treated as other-than-temporarily impaired (OTTI), such as MBS. This is because GAAP requires OTTI assets to be written down for the entire difference between their original cost and their fair market value. Because of the current illiquid market conditions, the difference in these values can be substantial and result in charges to earnings that represent unnecessary and overstated capital reductions. We urge Congress to direct the SEC and the FASB to again address OTTI and to recognize the differences between credit losses and liquidity losses due to inactive markets.

Furthermore, we encourage this subcommittee to include in its discussion a review of auditor practices under fair value accounting. Our concern is that auditors have shown little flexibility in how assets may be reflected under fair value and mark-to-market principles. In some instances auditors have encouraged institutions to be more conservative in the process by which they value these assets in their financial statements. More accurate financial statements demand greater auditor consistency.

Finally, we are encouraged by and welcome the introduction of H.R. 1349 by Representatives Perlmutter and Lucas. This legislation would establish the Federal Accounting Oversight Board. We hope Congress will thoroughly consider this legislation. However, in light of the magnitude of the crisis we face, we believe that in order to best address the complex principles of fair value accounting and mark-to-market, an expert panel should be established with the exclusive purpose of examining these issues.

On February 26, CUNA sent a letter to President Obama urging him to form a Presidential Task Force on Fair Value Accounting. Such a task force would bring together the accounting profession, government policy makers, and representatives of credit unions and others in the financial sector to develop feasible recommendations to enhance financial statement accuracy through more appropriate recognition of the present uncertain market. We strongly believe that a task force with the narrow directive to address the issues presented in this statement is vital to resolving the current economic strains on many of our nation's financial institutions.

Time is critical in resolving these issues, and we strongly urge this subcommittee and the House Financial Services Committee to expedite its review and quickly put into place the pieces that are necessary to bring about a timely resolution.

Mr. Chairman, thank you very much for calling this hearing and providing us the opportunity to submit this statement for the record.