



Letter of Comment No: 90
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Mr. Lawrence W. Smith
Director, Technical Application and Implementation Issues
File Reference No. 1200-0001
Financial Accounting Standards Board
of the Financial Accounting Foundation
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

RE: Proposal on Fair Value Measurement

Dear Mr. Smith:

The Conference of State Bank Supervisors (CSBS)¹ is pleased to have the opportunity to comment to the Financial Accounting Standards Board (FASB) on Proposed Statement of Financial Accounting Standards on *Fair Value Measurement* (Proposal), which would replace any current guidance on the subject.

The Proposal seeks to establish a framework for measuring fair value that would apply broadly to financial and nonfinancial assets and liabilities, improving the consistency, comparability, and reliability of measurements. The Proposal would also expand current disclosures to focus on the methods used for the measurements and would apply whether the assets and liabilities were measured at fair value in all or some periods.

CSBS is concerned that the Proposal would broaden the fair value measurement standards to both financial and non-financial assets and liabilities and that it would establish valuation methodologies that could increase the exposure to the risk of financial statement manipulation. In addition, it is not entirely apparent that the Proposal would accomplish its goal of more consistent and transparent reporting.

Hierarchy of Fair Value

The Proposal defines fair value as the price at which an asset or liability could be exchanged in a current transaction between knowledgeable, willing and unrelated parties.

¹ CSBS is the national organization of state officials responsible for chartering, regulating and supervising the nation's 6,343 state chartered commercial and savings banks and over 400 state-licensed branches and agencies of foreign banks.

Our concerns generally relate to the lower levels of the hierarchy of fair value measurement established in the Proposal. The Proposal establishes a hierarchy of assets and liabilities for selecting inputs that should be used in valuation techniques to estimate fair value. The inputs differ depending on whether assets and liabilities are identical, similar or otherwise comparable. The hierarchy of fair valuation is described in the guidance as follows:

- At the highest level are assets and liabilities for which a market or exchange price exists (bid prices for long positions (assets) and ask prices for short positions (liabilities)). These types of assets and liabilities are generally already measured in fair value on most balance sheets.
- Subordinate to these assets and liabilities are those that require adjustment of a market or exchange price, due to non-standard conditions or features. This level would require bank management to formulate a minor judgment of value.
- The third level in the hierarchy framework requires varying degrees of judgment in the selection and application of valuation techniques and inputs. Because each valuation is unique, the judgments applied will differ by institution. These estimates would generally consist of appraised values based on an analysis of cost, market and income approaches.
- Finally, there are valuations based almost wholly on estimates by management.

There is a practicality exception to the fair value measurement standards which allows institutions to exclude the fair value reporting requirements. However, the threshold of this exception is so high that it is of limited practical use.

Areas of Concern in the Proposal

Prior to finalizing any fair value measurement standards, CSBS requests that FASB consider the following concerns raised by state bank regulators.

- **Cost of Implementation** -- CSBS is concerned that financial institutions, brokerage firms, insurance companies and other entities that have large volumes of transactional accounts and non-standard assets and liabilities will be faced with very high implementation costs to comply with these standards. Although FASB notes that it endeavors to create a measurement where the costs imposed to meet the standard are justified by the overall benefits, we question whether this goal has indeed been met. For those banking assets and liabilities that are generally not currently measured by fair value, institutions would need to use multiple valuation techniques for assets where a publicly traded valuation is not available. The cost of making ongoing comparisons between assets being traded and those currently on the institution's balance sheet could become time consuming and expensive, especially for smaller community banks. The cost consideration would vary depending on whether such fair value measurements would be required for interim reporting as well as annual reporting.

- **Availability of Accurate Information** -- While certain assets and liabilities that are exchange traded would be relatively easy to value, there are legitimate concerns that accurate information does not exist to value many assets and liabilities on a bank's balance sheet. We are concerned that, without more specific guidance, adjustments made to determine estimated fair market valuation could be of questionable accuracy, not subject to verification, and potentially inconsistently applied across the financial services industry.
- **Susceptibility to Management Bias** -- For assets which lack readily available market information, there is also a strong concern that assigned valuations could be subject to greater management bias, whether unintentional or intentional, than historical cost data. This would allow a greater potential for misstatements by management of earnings and equity contained in financial statements to avoid balance sheet volatility.
- **Usefulness of the Information** -- While it may be helpful to have fair value information in support of the financial statements, its usefulness would most likely be limited to financial statement users. Furthermore, the comparability of this information from one period to another could be limited. Determining whether the extent of balance sheet adjustments were due to changes in general market conditions versus institutional performance would be more difficult with this Proposal.
- **Complexity of Methodologies** -- CSBS is concerned about the degree of understanding of these measurements. As we noted above, our concerns relate to the accuracy of measurements on the lower levels of the hierarchy framework based on the lack of market information and the judgments required by senior management. However, the potentially inconsistent and complex methodologies applied across the financial industry would likely not help end users assess the financial information. Simply put, if the goal of the implementation of fair value accounting is increased financial transparency to the statement user, we question whether the Proposal achieves this goal.

Recommendation

CSBS has serious concerns about FASB's current fair value measurement proposal. We recommend that the FASB delay issuing a final rule on this issue until it has held various roundtable discussions across the country with financial institutions and their state and federal regulators. We also suggest that FASB conduct a thorough cost-benefit analysis of its Proposal. As we highlighted previously, many of the assets and liabilities on banks' balance sheets would be included on the lower levels of the hierarchical framework used in the Proposal. Accordingly, most of these items will require various and complex methodologies to compute the fair value measurements. The frequency of reporting assets and liabilities on the lower level hierarchies was not specified in the Proposal; however, complex interim reporting of fair value would become unduly burdensome and costly for financial institutions, especially smaller community banks. After further review, FASB may

want to consider allowing these assets and liabilities to be reported on a fair value basis only annually.

In addition, we believe FASB needs to provide additional guidance to institutions regarding how to develop fair value estimates at the lower level hierarchies. Otherwise, we do not believe the goal of better consistency and transparency will be accomplished. We do, however, support the additional disclosures required in the Proposal that describe the fair value measurement methodologies used in the financial statements so long as those disclosures do not become overly complex and burdensome.

Conclusion

CSBS understands that the FASB plans to hold public roundtable discussions with financial industry officials. To the extent that such roundtables are held in the future, CSBS strongly urges the FASB to invite at least one representative from the state banking departments to participate. Commissioners at the state level have a broad range of experience and expertise. Generally, state regulators are responsible for the examination of a wide range of financial institutions, including banks, thrifts, credit unions, securities firms, and other financial service providers. CSBS and various state bank regulators have worked with the FASB in the past and stand ready to contribute our expertise in the future.

Thank you for the opportunity to provide these comments. We look forward to further discussion on this and other topics in the future.

Best personal regards,



Neil Milner
President and CEO