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Markit Valuations
Bridge House
4 Borough High Street
London, SE1 9QQ
United Kingdom

Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk
Connecticut, 06856-5116
United States of America

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Dear Sir / Madam

We are responding to your request for comments on the Proposed FASB Staff Position No. FAS 133-a. As this standard is inextricably linked to the Fair Value Measurement standard FAS No.15X, we have also included comments on that standard.

BACKGROUND

Totem was established in early 1997 to establish "fair value" market levels in over-the-counter derivatives markets. The basic principle of our service is one where multiple participants submit their best estimate of mid-market price for the assets or liabilities they hold in their trading books. We collate all contributions across multiple, related asset classes and create a single composite price. These prices are rigorously tested to ensure they are appropriate given other pricing levels and market inputs.

Today, all the major investment banks, broker dealers and commodities traders use Markit's services to assist them in the process of determining the fair value of their trading books. A large number of US and international banks incorporate Markit's independent price information in the preparation of their financial accounts.

Over the past years Markit Valuations has accumulated a significant amount of knowledge and data on the derivatives markets and we feel that we are well placed to comment on the issues surrounding FAS 133-a and the associated Fair Value Measurement issues.

Please find below a summary of our comments on FAS 133-a and FAS 15X:

FAIR VALUE

We were encouraged to see that FASB had incorporated many of the comments and views expressed by derivative users and market participants regarding the exposure draft on Fair Value Measurement. It appears that significant progress has been made to ensure that the accounting view does not differ significantly from the economic view.

We entirely concur that a single definition of fair value, together with a framework for measuring fair value, should result in increased consistency and comparability in financial accounts.

TRANSACTION PRICE PRESUMPTION CONCERNS

The acknowledgement that derivative trades are performed with an element of profit is a significant step in reconciling the accounting view with the economic reality. The relaxation of the requirement to mark long positions to bid and short positions to ask is also, in our view, appropriate.

However, we continue to be concerned by the strong emphasis on the Transaction Price Presumption and that it is the best representation of fair value. The ability to rebut the Transaction Price Presumption is welcome but it needs to be recognised that even trades in the Reference Market will retain a level of profit – indeed, if they did not, there would be no bid/offer and simply a single transaction price.

We see three key issues with the Transaction Price Presumption:

Firstly, it is an assumption that all trade levels are underpinned by the same trade rationale. This is not the case. At the simple level, those that are long will trade at a different level to those that are short. This is further complicated by market participants who are trading one instrument as part of a larger strategy. In these instances instruments can trade "off market" as the spread between this asset and another, rather than its absolute price, is the key level being traded. Finally, even a moderately volatile market can produce very different trading levels across the day resulting in the transaction price being misleading when compared to the accepted closing price.

Secondly, an entity will face a dilemma if they are holding an asset and complete a further transaction in that asset. Should they mark the entire holding using the Transaction Price Presumption or do they mark the existing holding to, say, a Level 3 estimate and mark only the new holding to transaction price? Conceptually marking using the Transaction Price Presumption would work for a single position, but the effective deferral of the economic Day 1 P&L to Day 2, when the new trade can be marked to a Level 3 estimate, will give rise to a mismatch in the accounting and economic viewpoints.

Thirdly, by making the Transaction Price Presumption the unquestionable fair value there are two issues: (i) controllers and auditors will tend not to question or investigate pricing based on the Transaction Price Presumption and (ii) it will clearly open the route to misuse and fraud: a trader could easily create a Transaction Price through a pre-arranged trade that might be significantly off market, but could hold this price up to his controllers and auditors as the correct price to value that asset.

We believe that your statement that: "In the absence of a transaction involving the entity, the estimate of fair value is determined by reference to a hypothetical transaction for the asset or liability at the measurement date" moves closer to best practice. However we would amend this to state that "Whether or not a transaction may be observed involving the entity, the estimate of fair value etc." In other words, we believe that all positions should be marked to fair value at the close of each business day, using a fair value that represents a hypothetical transaction for the asset or liability.

FAIR VALUE HIERARCHY CONCERNS

Although in theory the hierarchy of inputs should give consistency, we are still concerned that there is the implication that a Level 1 input will always be more appropriate than Level 2-5 inputs.

Any Level 1 input that has a timestamp that differs from the time of closing of the books of record shall have to be adjusted and thus become a Level 3 input automatically. Level 1 inputs in different market conditions have different "shelf lives" (ie in volatile markets, a Level 1 input is not likely to be appropriate for long, whereas in a benign market environment it may be appropriate all day) and the determination as to whether or not each input is stale requires significant work and a great deal of subjectivity.

We accept that Level 1 inputs ought to be better than Level 3 inputs but this is not always the case; in some cases it may well be that Level 3 inputs are more appropriate than Level 1. For example the closing prices of any exchange-traded instrument can be heavily influenced by a single dealer and would thus not be representative of the market as a whole. As discussed above, the emphasis on Level 1 inputs opens the whole concept of fair value to abuse and risk that auditors will not look further into all the available evidence.

We have many examples of our clients asking us to extend the Totem service to cover option strikes and maturities that correspond with those traded in the listed markets, as our clients have not been able to rely on the quality, reliability and robustness of quoted prices. Derivatives exchanges use our consensus-based data to improve their published, Level 1, settlement prices.

Further, we believe that Level 2 inputs are indeed of a lower quality than all Level 3 inputs. Prices found in an inactive market are likely to be very inaccurate and the subjectivity involved in correcting this will be very high. We believe Level 2 inputs should be given a lesser status than Level 3 inputs.

DISCLOSURES

We welcome the new directives on disclosures although we remain concerned at the practicalities of disclosure, particularly those in paragraph 35 of FAS 15X. This requires every entity to record where within the Fair Value Hierarchy the fair value of each derivative was obtained.

Operationally entities would need to split their trading books into 'disclosure buckets'. There is a danger that exchange traded options would reside in a Level 1 disclosure bucket and be automatically marked to exchange closes without further review of the exchange closing price. Entities would accept the occasional mis-mark in return for simplification of the disclosure process.

Any entity active in derivatives markets will have large positions in over–the-counter markets valued using Level 2-5 Inputs. These will be perfectly hedged by equal and opposite positions in exchange-traded markets valued using Level 1 Inputs. Such strategies may involve interest rate swaps held against listed interest rate futures or equity swaps against shares. It would not seem appropriate that the financial accounts represent such strategies as containing significant pricing risk.

CONCLUSION

We believe that the most appropriate method in establishing fair value is to combine all available information sources and to weigh up the validity of each source. We recommend that the FASB allow entities to use a single, appropriate valuation technique that incorporates all the available evidence. For a wide range of assets and liabilities, including all derivatives portfolios, an entity would use Level 3 techniques and inputs that are thoroughly tested against Level 1 and Level 2 inputs.

We refer the FASB to the IAS 39paragraph 48A that states: "The best evidence of fair value is published price quotations in an active market". The definition of an active market is then further clarified in AG71 where it is stated: "A financial instrument is regarded as quoted in an active market if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis". We believe this evidence-based approach to fair value clearly encompasses the appropriate balance required.

Finally we believe that, where available, a high quality price benchmarking service, such as that provided by Markit Valuations, will add significant weight to the validity of the fair value estimates by market participants.

We hope that the Board finds our perspective on the issues interesting and beneficial to their work. Please do not hesitate to contact us directly if you would like us to expand on any of the points raised.

Yours faithfully

Tim Barker
EVP
Markit Group Limited
www.markit.com