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Financial Accounting Standards Board
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Exposure Draft – Proposed Statement of Financial Accounting Standards-The fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115

Dear Ms. Bielstein:

Thank you for the opportunity to comment on the proposed statement referenced above.

From the immediate perspective of reporting firms, discretionary fair value election represents a welcome expansion of flexibility with little or no offsetting disadvantage. This flexibility, however, obscures the proposal's significance as a major watershed event on the path toward a compulsory fair value regime. Although a comprehensive 'asset-liability approach' has recently been advocated within FASB circles as a successor to the traditional accounting framework, the issue requires far broader exposure and debate than it has heretofore received. Our research efforts on industry attitudes thus far suggest that the broader financial community is just beginning to assess the significance of the standard for the future financial reporting framework.

We are of the view that introducing fair value elements of accounting into the traditional USGAAP historical cost/historical purchasing power accounting framework with its central

emphasis on the earnings generating cycle, only serves to distort financial accounting information by introducing spurious intertemporal volatility to reported earnings and owners' equity, in particular reported Tier 1 Capital. In our view fair value (FV) should be combined with the traditional USGAAP accounting model when no better option is available, for instance in the measurement and recognition of a bundle of assets and liabilities acquired in a purchase transaction or the valuation of options issued as part of some broader transaction.

For some users, the Fair Value Option (FVO) will usefully expand access to risk management strategies. However, comparable benefits might also be achieved by more focused application of fair value treatment and by ongoing refinement of the existing framework, for instance facilitating the dynamic hedging of liabilities. In our view, inadequate consideration has been given to more targeted measures that meet user needs without raising the comparability issues inherent in a broadly applicable FVO.

We ask you to also consider the following comments specific to aspects of the standard:

The proposal does not provide clear guidelines or mechanisms to enforce similar accounting treatment for similar activities. The documentation and policy requirements leave broad issues of application open to interpretation. Different circumstances and incentives among reporting firms will inevitably result in uneven application of the standard. Without clear, enforceable application principles, readers of financial statements will lack the means to interpret and reconcile the mixed-mode accounting outcomes produced by the standard.

The standard's disclosure requirements anticipate some of the interpretive challenges raised by the blending of FV and accrual based results. However, we question whether it will be possible for reporting firms to meet the broad mandate, set forth in section 12(b), to disclose... "Information sufficient to allow users of financial statements to understand the effect on earnings... of changes in the fair values of the financial assets and financial liabilities subsequently measured at fair value as a result of a fair value election."

Parsing effects between fair value and traditional earnings sources will prove difficult in practice. For example, 'net interest income', traditionally a central element of financial institution income, is inextricably linked to amortization of fees, interest accruals, and other established earnings conventions. Such notions are completely foreign to the FV measurement paradigm, which addresses only the instantaneously determined present value of all anticipated future cash flows. The explicit mandate to disclose interest and dividend measurement methods (12d) anticipates particular challenges in these areas. We expect that the fundamentally distinct character of accrual and FV approaches will frustrate attempts at effective interpretive disclosure in realistically complex reporting contexts.

Fair value election has significant implications for vital metrics such as the magnitude and volatility of regulatory capital and net income. We cannot expect managers to exercise discretion allowed under the standard in ways that might adversely affect these critical outcomes for their companies. Incentive-based asymmetries, in our view, raise distinct challenges to comparability and transparency of financial reporting under the proposed standard.

The standard is being proposed for implementation in advance of the Board's final guidance on FV measurement. The FASB's FV measurement guidance is an ambitious attempt to address difficult valuation questions. Nevertheless outstanding issues remain, and even well informed persons can only speculate as to its effectiveness in application under the drastically elevated stakes of fair value reporting.

Some recent academic literature finds support for the usefulness of fair value based reporting. However, the research designs are intrinsically so narrowly focused as to preclude conclusive policy implications. Research emphasis on the risk informativeness of fair value income seems to ignore the power of alternative metrics such as "Value at Risk". Moreover, support for the informativeness of fair value in no way diminishes the well proven utility of traditional USGAAP accounting information

In conclusion, none of these specific concerns is nearly as important as the proposal's role in the FASB's broader vision for the financial reporting framework. This surely needs clear elucidation. The Board cannot be unaware of the threat posed by optional Fair Value election to the comparability and transparency of financial reports. We see two basic alternatives for resolving the endemic conflict between the fair value and accrual approach: Replacing the current framework with a comprehensive asset-liability approach, or developing a system for parallel reporting of fair value along with accrual based results. In our opinion, the latter approach better serves the needs of the investing community by preserving the transparency and integrity of the distinct information conveyed by each approach to accounting measurement. We urge the FASB to prioritize the full and explicit communication of its vision for the future, so that watershed events such as the FVO do not proceed without the informed, broad based consent of the financial community.

Thank you once again for the opportunity to comment on this important proposal.

Sincerely,

Morris McInnes

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