



Investors Technical Advisory Committee

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Via Email

October 9, 2008



LETTER OF COMMENT NO. 89

Russell G. Golden
FASB Technical Director
Financial Accounting Standards Board
P.O. Box 5116
Norwalk, Connecticut 06856-5116

Re: Proposed *FSP FAS 157-d*

Dear Mr. Golden:

The Investors Technical Advisory Committee (ITAC) appreciates the opportunity to provide comments on the Financial Accounting Standards Board's (FASB) proposed amendment to FASB Statement No. 157, *Fair Value Measurements*.¹ While we support this clarification and its intent in general, we will propose some additional disclosures that we believe will be essential to provide sufficient transparency, and to prevent investors from possibly being misled by the measurements preparers use for financial statements when markets for certain securities are deemed by the preparers to be inactive.

Paragraph 8 of the proposal states the FASB's objective in developing this amendment:

*This FSP clarifies the application of Statement No. 157 in an **inactive market** and provides an illustrative example to demonstrate how the fair value of a financial asset is determined **when the market for that financial asset is not active**. [Emphasis added]*

Paragraph 9a of the proposal cites paragraph 30 of Statement 157:

...[I]n situations in which there is little, if any, market activity for an asset at the measurement date, the fair value measurement objective remains the same; that is, the price that would be received by the holder of the financial asset in an orderly transaction that is not a forced liquidation or distress sale at the measurement date.

¹ This letter represents the views of the Investors Technical Advisory Committee (ITAC) and does not necessarily represent the views of its individual members, the organizations in which they are employed, or the views of the Financial Accounting Standards Board (FASB) or its staff. For more information about the ITAC, including a list of the current members and the organizations in which they are employed, see http://www.fasb.org/investors_technical_advisory_committee/.

Paragraph 9b restates additional guidance that is **already provided in Statement 157** regarding measurement methods to use when “**relevant** observable market data **do not exist.**” Presumably, the phrase “...little, if any, market activity for an asset at the measurement date,” is meant to provide guidance to preparers and their auditors in determining when a market is “inactive” as stated in paragraph 8.

We assume that the intent of the Board in restating these sections of Statement 157 was to reaffirm the fundamental guidance already established in that standard, with which we concur. Obviously, the crux of the issue is whether or not a market is, in fact, inactive, as envisioned by Statement 157. Indeed, this circumstance is more or less recognized in proposed paragraph A32B of the illustration, Example 11:

*Since June 30, 2008, the market for collateralized debt obligation securities has become increasingly inactive. The inactivity was evidenced first by a **significant widening of the bid-ask spread** in the brokered markets in which collateralized debt obligation securities trade and then by a **significant decrease in the volume of trades** relative to historical levels as well as other relevant factors. [Emphasis added]*

The information of most relevance for investors in this example is that “a significant widening of the bid-ask spread” has occurred. What this means is that bids were available in the market but that for whatever reason (e.g., inadequate regulatory capital, debt covenants, possible resulting decline in stock prices, possible failure to meet performance targets) the company managers chose to not accept the bid prices for securities they held and to realize the losses that would result from selling. Put slightly differently, in economic terms, it is highly likely that **some losses have already occurred but managers chose to continue to hold the securities in the hopes of a recovery at some time in the future.** In this regard, we believe that this example is a reasonable reflection of the behavior we currently observe in the markets. So, the question is what recognition and disclosure guidance will provide adequate transparency and best serve the needs of investors?

Given these circumstances, we believe it is imperative that the following disclosures be **required to be provided** to investors so that they will not be misled by the measurements that are being recognized in the balance sheet and income statement:

1. The full reconciliation of beginning and ending balances for the asset as currently provided for Level 3 measurements in Statement 157, including clear disclosure of transfers into and out of the Level 3 category, fair value changes already recorded, and catch-up adjustments or revisions to prior estimates resulting from experience that was different from that which had been assumed;

2. The range of discount rates the preparer considered in developing the Level 3 measurements and the reason for selecting the one used;
3. The specific values of any observable market input(s), such as discount rates or transaction prices, that the preparer chose to ignore or modify in developing the measurements, and the effect(s) on the valuation(s) that would have occurred if the preparer had chosen to use the observable input(s).
4. The sensitivity of the measurements to the discount rate the preparer selected;
5. The method the preparer used for forecasting the expected future cash flows used in the measurements and key assumptions critical to an understanding of the value measured, such as the effect of changing trends;
6. The current (actual) annualized yield realized on the securities based upon the current cash flows received during the period on the asset; and
7. **Any** market prices, including market transactions and broker quotes, that were available for the same or similar securities during the period, and the reasons why the preparer decided to reject them.
8. The extent to which the company has experienced recent transactions that demonstrate a recovery in value, and therefore that valuations in prior financial statements may have understated asset values.

We applaud the recent staff positions which were designed to improve disclosures for credit derivatives. However, recent revelations in the markets have made clear that a serious lack of disclosures continues to exist regarding the effects that valuations of these contracts can have on future cash flows of the entity.

In the case of AIG for example, there were collateral agreements that resulted in huge calls on liquidity, the potential magnitude of which could not have been understood by investors. In addition, it has now been disclosed that there were serious differences of opinion regarding valuations between AIG and the counterparties. Ultimately the counterparties' valuations prevailed, the collateral was required to be posted, and a serious disruption in the liquidity of the company occurred. These events led to the government's emergency action to advance in excess of \$120 billion to the company with a significant decline in the value of the company's stock held by investors.

It has also been learned, that while companies may have back up credit lines for borrowings needed in such circumstances, borrowing against those credit lines may result in a downgrading of the company's debt. A downgrade may have made it difficult to use those credit lines, or worse yet, triggered additional liquidity problems and a significant effect on valuations being performed. As a result, we would urge the FASB to bring much greater transparency to those arrangements, including:

1. Disclosure of credit derivative collateral arrangements including the range of potential collateral that may be required.
2. The current best estimate of the collateral required using current valuations.
3. Whether or not counterparties have disagreed with valuations of credit derivatives.
4. Whether the use of back up lines of credit may trigger downgrades in the credit ratings of the company's debt or other adverse events.

The ITAC appreciates this opportunity to provide comments on the proposed amendments to Statement No. 157 in FSP FAS 157-d. Should the Board or staff wish further clarification of our views, we would be pleased to respond.

A handwritten signature in cursive script that reads "Rebecca McEnally". The signature is written in black ink and is positioned above the typed name.

Rebecca McEnally

Member, ITAC

cc: Hilary Eastman, Project Manager, IASB