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30 December 2008

LETTER OF COMMENT NO. 206

Mr. Robert Herz
Chair, Financial Accounting Standards Board
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06865-5116

File Reference: Proposed FSP EITF Issue No. 99-20-a

Dear Mr. Herz,

The CFA Institute Centre for Financial Market Integrity (CFA Institute Centre),[1] in consultation with its Corporate Disclosure Policy Council (CDPC)[2], appreciates the opportunity to comment on proposed FSP EITF Issue No. 99-20-a.

CFA Institute represents the views of its investment professional members, including portfolio managers, investment analysts, and advisors, worldwide. Central tenets of the CFA Institute Centre mission are to promote fair and transparent global capital markets, and to advocate for investor protections. An integral part of our efforts toward meeting those goals is ensuring that the quality of corporate financial reporting and disclosures provided to investors and other end users is of high quality. The CFA Institute Centre also develops, promulgates, and maintains guidelines encouraging the highest ethical standards for the global investment community through standards such as the *CFA Institute Code of Ethics* and *Standards of Professional Conduct.*

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[1] The CFA Institute Centre for Financial Market Integrity is part of CFA Institute. With offices in Charlottesville, VA, New York, Hong Kong, and London, CFA Institute is a global, not-for-profit professional association of more than 96,000 investment analysts, portfolio managers, investment advisors, and other investment professionals in 133 countries, of whom nearly 83,000 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 136 member societies in 57 countries and territories.

[2] The objective of the CDPC is to foster the integrity of financial markets through its efforts to address issues affecting the quality of financial reporting and disclosure worldwide. The CDPC is comprised of investment professionals with extensive expertise and experience in the global capital markets, some of whom are also CFA Institute member volunteers. In this capacity, the CDPC provides the practitioners' perspective in the promotion of high-quality financial reporting and disclosures that meet the needs of investors.

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Executive Summary

- CFA Institute does not support the proposed changes to amend EITF Issue No. 99-20 because it moves the measures for certain beneficial interests away from fair values, increases subjectivity in the determination of reported values, and reduces comparability.

- We strongly support the development and use of a single impairment model for financial assets until fair value is used to recognize and measure changes in such assets, but we believe that the proposed amendment does not achieve this goal and the model proposed for elimination is the one that actually results in the more realistic reporting of assets at fair value.

- CFA Institute strongly endorses a comprehensive project that would propose standards to require the use of fair value for all financial instruments with changes in fair values included in the determination of net income. Such a project would eliminate the need for subjective impairment evaluations. In light of the current economic climate, we believe that the FASB and the IASB should work diligently to complete such a project in the coming year.

- If the FASB adopts the proposed FSP, we ask that it also adopt the disclosures discussed in the *Financial Instruments Disclosures* proposal announced at its December 15, 2008 meeting.

General Comments

CFA Institute has strongly advocated that the FASB and the IASB require companies to record all financial instruments (both assets and liabilities) at fair value since this method provides the best representation of economic reality[3]. We also believe that changes in fair value should be reflected on the face of the income statement. Fair value measurements reflect the most current and complete estimates of the values of both assets and obligations, including the amounts, timing, and riskiness of their future cash flows.

Impairment models are by their nature inconsistent with fair value financial reporting models. While impairment models may be temporarily acceptable for asset classes with severe measurement problems (e.g. goodwill and other intangible assets resulting from acquisitions), they are inherently subjective. Impairment accounting reduces comparability as different preparers may make different judgments even when economic facts are identical. Consequently, we believe that the standard setters should be seeking a comprehensive solution to the accounting for financial instruments rather than making patch-work changes to the impairment models for financial instruments that effectively move financial reporting away from fair value.

[3] See CFA Institute website regarding response to the current global financial crisis. http://www.cfainstitute.org/centre/news/turmoil.html?intCamp=centre_box_news_market_turmoil

Under the current mixed-attribute system, investors who rely on fair value measurements for decision making must expend considerable effort attempting to restate to fair value those decision-relevant financial statement items that are measured at historical cost and subject to periodic impairment evaluation. Central to the success of this effort is the sufficiency of disclosures and the reliability of the measurements contained in the disclosures. Most, if not all, of this effort would be eliminated if the financial reporting standards required companies to record these assets and liabilities at fair value at inception with periodic revaluation. We strongly endorse a comprehensive project that would propose standards to require the use of fair value for all financial instruments with changes in fair values included in the determination of net income. Such a project would eliminate the need for subjective impairment evaluations. In light of the current economic climate, we believe that the FASB and the IASB should work diligently to complete such a project in the coming year to improve investor confidence in financial reporting.

We strongly support efforts to reduce complexity and simplify the number of accounting models used to report financial instruments. Moreover, we recognize that it is impracticable to complete a comprehensive project of the nature discussed above in a few short weeks, and most certainly not without sufficient and open due process. Consequently, if the FASB is to make any changes to create a single model for measuring impairment, it should only do so if those changes result in *an outcome that is more closely aligned with the application of fair value.* Accordingly, we do not support the proposed changes to amend EITF Issue No. 99-20 because it moves the measures for certain beneficial instruments away from fair values, increases subjectivity in the determination of reported values, and reduces comparability. We believe that the proposal would further erode investor confidence as it moves the impairment trigger away from core fair value principles that require management to consider market participant assumptions.

Management may have the best insight on factors such as collections, collateral values, defaults, modifications and foreclosures for financial instruments that it originates. However prioritizing management assumptions over market participant assumptions is inconsistent with the core Statement No. 157 fair value principles. In either case, ignoring current market indicators about adverse trends in those factors and recognizing losses based only on historical evidence would create a misleading view of the results of operations and financial position. The financial markets use fair value to measure the sale or exchange of financial instruments. Allowing management to override the market view is likely to result in different companies measuring the same investments at differing amounts, which reduces comparability.

Financial markets depend heavily on fair value measurements. Some business enterprises may choose to believe that fair values do not matter if they are not recognized in the financial statements but that belief ignores economic reality. Allowing companies to use alternative measures impedes the functioning of financial markets and reduces investor confidence in financial statements (and thereby increases the risk premium).

Furthermore, EITF Issue No. 99-20 considers marketplace participant assumptions consistent with Statement of Financial Accounting Concepts No. 7 *Using Cash Flow Information and Present Value in Accounting Measurements,* which states:

An estimate of fair value should include the price that marketplace participants are able to receive for bearing the uncertainties in cash flows-the adjustment for risk- if the amount is identifiable, measurable, and significant. An arbitrary adjustment for risk, or one that cannot be evaluated by comparison to marketplace information, introduces an unjustified bias into the measurement.[4]

EITF Issue No. 99-20 is also consistent with Statement No. 157 *Fair Value Measurements*, which states:

The fair value of the asset or liability shall be determined based on the assumptions that market participants would use in pricing the asset or liability.[5]

In the event the FASB adopts the proposal, we strongly recommend adding a disclosure that would require management to explain why market participant assumptions would have produced a misleading measurement of the affected debt securities.

The Board asserts that it has decided that similar instruments should be subject to the same impairment model. It is not clear to us that the proposed amendment would achieve this objective (for example, beneficial interests subject to AICPA SOP 03-3, *Accounting for Certain Loans or Debt Securities Acquired in a Transfer* continue to be excluded from the scope of this issue – see paragraph 10). Current GAAP contains a significant number of different impairment models. The proposed amendment is limited to securities subject to EITF Issue No. 99-20. We believe that dislocated markets are far more pervasive than securities subject to EITF Issue No. 99-20. The selection of EITF Issue No. 99-20 for amendment will do nothing to further the objective of transparent and relevant financial statements.

We strongly support the development and use of a single impairment model for financial assets as interim step until fair value is used to recognize and measure changes in such assets; but, we believe that the proposed amendment does not achieve this goal and the model proposed for elimination is the one that actually results in the more realistic reporting of assets at fair value. Market participant assumptions regarding future cash flows are an essential component for determining fair values. Disregarding market participant assumptions in favour of a model that favours management judgement will weaken fair value reporting. A more practical approach would be to consider strengthening the requirements of Statement No. 115 rather than weakening EITF Issue No. 99-20.

We disagree with the arguments made in paragraph 4 of the proposed FSP. Dislocated markets, such as those experienced in recent months, make fair value reporting more relevant rather than less as financial markets focus on solvency and liquidity. And the fact that an investment is currently performing does not contradict the fact that its value has declined and part of the decline is attributed to market expectations of credit losses. Risk premia widened in the second half of 2008, raising the effective interest rate on all but the safest assets. Impairment accounting is not representationally faithful under those conditions.

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[4] Statement of Financial Accounting Concepts No. 7 paragraph 62.

[5] Statement of Financial Accounting Standards No. 157 paragraph 11.

If the FASB adopts the proposed FSP, we ask that it also adopt the disclosures discussed in the *Financial Instruments Disclosures* proposal announced at its December 15, 2008 meeting. The proposal will require enhanced disclosures for debt securities classified as held-to-maturity and available-for-sale under Statement No. 115, and loans other than those classified as held-for-sale. We remain hopeful that this disclosure proposal will provide necessary information that is essential to investors' understanding and analysis of the economics underlying the information contained in the financial statements.

If you, other Board members or your staff have questions or seek further elaboration of our views, please contact either Matthew Waldron, CPA, by phone at +1.434-951-5321, or by e-mail at matthew.waldron@cfainstitute.org, or Patrick Finnegan, CFA, by phone at +1.212.754.8350, or by e-mail at patrick.finnegan@cfainstitute.org.

Sincerely,

/s/ Kurt N. Schacht

Kurt N. Schacht, CFA
Managing Director

/s/ Gerald I. White

Gerald I. White, CFA
Chair, Corporate Disclosure Policy Council

cc: Corporate Disclosure Policy Council