3900 Wisconsin Avenue, NW Washington, DC 20016-2892





LETTER OF COMMENT NO. 102

August 8, 2008

Director of Technical Application & Implementation Activities Financial Accounting Standards Board 401 Merritt 7 PO Box 5116 Norwalk, CT 06856-5116

Via Email to: director@fasb.org

Re: File Reference No. 1600-100: Proposed Statement of Financial Accounting Standards Disclosure of Loss Contingencies, an Amendment of FASB Statements No. 5 and 141(R)

#### Ladies and Gentlemen:

Fannie Mae appreciates the opportunity to comment on the proposed Statement of Financial Accounting Standards Disclosure of Loss Contingencies, an Amendment of FASB Statements No. 5 and 141(R). We appreciate the Board's response to the concerns of constituents that current loss contingency disclosures do not provide adequate information to assess the likelihood, timing and amount of future cash flows associated with loss contingencies. However, we believe the proposed statement will not achieve the Board's stated objective of improving the overall quality of disclosures about loss contingencies for financial statement users as the additional disclosures will not provide investors with useful information.

Financial reporting is not an end in and of itself. Rather, financial reporting is a means of communicating between an enterprise and its stakeholders regarding the financial condition, results of operations and cash flows of the enterprise. As the Board has recognized, "financial reporting should provide information that is useful to present and potential investors and creditors and other users in making rational investment, credit, and similar decisions."

Providing "useful information" in accounting and financial reporting necessarily requires estimates and judgment on the part of financial statement preparers and auditors. Statement of Financial Accounting Standard No. 5, Accounting for Contingencies, and AICPA Statement of Position 94-6, Disclosure of Risks and Uncertainties, already provide disclosure principles for loss contingencies that require management's judgment. When enterprises properly apply the principles underlying these standards, they communicate useful information to their stakeholders. While the Board has indicated that the proposed amendment is intended to address concerns

<sup>&</sup>lt;sup>1</sup> FASB Statement of Concepts No. 1. Objectives of Financial Reporting by Business Enterprises, ¶ 34

expressed by financial statement users, those concerns ultimately reflect a practice issue rather than a deficiency in the disclosure principles of these existing standards. As such, the practice issue would be better addressed by professional bodies such as the Center for Audit Quality rather than by amending the standards.

This letter sets forth the reasons that we do not agree that the proposed amendment is necessary or desirable.

# Disclosure of Maximum Possible Exposure to Loss Where No Claim Amount is Stated

The proposed standard would require companies to provide a "best estimate" of maximum possible exposure to loss where the complaint or demand does not state a claim amount. However, this disclosure is problematic because it does not provide useful information to investors and presents insurmountable operational challenges.

First, the proposed standard would not result in useful information because such an estimate certainly would not correlate to the actual losses, if any, that the company will realize. Simply stated, such an estimate would not reflect the reality of litigation. Litigation is inherently unpredictable, and estimates of exposures fluctuate significantly as new claims arise, courts dismiss them, and plaintiffs and defendants discover facts and develop defenses. In litigation, it is a certainty that all plaintiffs do not receive the maximum possible amount for every claim. Nevertheless, this disclosure proposal makes such estimates mandatory. In addition, this disclosure would not provide useful information because it would not correlate with the contingent loss amount that a company would recognize. The maximum possible exposure would certainly not be probable and, in many cases, would not be estimable. Consequently, the disclosure of maximum possible exposure to loss would not be useful information because it would reflect improbable but potentially significant contingencies without considering any mitigating factors.

Secondly, the proposed disclosure requirement is not operational because it requires a "best estimate" of a maximum possible loss exposure at the same time that attorneys have determined that the outcome itself is not reasonably estimable. In such instances, it would not be operational either for companies to prepare such an estimate or for auditors to audit it. This disclosure also carries the potential for abuse, as opponents could use this disclosure as a forced settlement tool (i.e. plaintiffs deliberately not stating a claim amount, then waiting to see what companies disclose). As a result, disclosing the maximum possible exposure to loss would place an unnecessary burden on the company's resources and expose the company to increased settlement demands.

## Disclosure of Loss Contingencies with Possible Severe Impact in the Near Term

The proposed standard would require disclosure of any loss contingency that is both likely to be resolved within the following year and could have a "severe impact" on the operations of the entity, regardless of the probability of loss. Accordingly, this would require disclosure of nuisance lawsuits that claim a very high amount of damages but are frivolous and which the company expects to successfully defend in a short period of time, such as on a motion to dismiss. Thus, the company would be required to disclose lawsuits it expects to win quickly and

decisively. Such information is not useful to investors. Furthermore, as noted in the summary of the exposure draft, this particular amendment would diverge from international accounting standards at a time when U.S. and international accounting standards should converge.

### Disclosure of Anticipated Timing of Resolution

Determining the anticipated timing for resolution is, in almost all cases, nearly impossible because the timing is not within the control of any single party to the litigation. Rather, the timing of resolution is dependant on a myriad of variables, which include, but are not limited to: the court's calendar and docket; schedules of parties to the litigation including attorneys, witnesses and experts; the number and complexity of claims and defenses; amount of discovery requested and any related disputes; willingness of parties to consider settlement; and the success/failure of motions to dismiss and motions for summary judgment. As a result, estimates as to timing of resolution are virtually guaranteed to require revision, possibly at each reporting date. Thus, the estimated timing of resolution would not be useful information because the frequent and significant changes would render it unreliable for any purpose.

## Potential Disclosure of Privileged and Prejudicial Information

The proposed requirement to provide additional qualitative disclosures, in particular, the entity's qualitative assessment of the most likely outcome of the contingency and any significant assumptions made in estimating the amounts disclosed, is not operational. This requirement is not operational because it would potentially put attorney-client privileged material and work product at risk of litigation disclosure and reveal a company's litigation strategy. For example, if the attorney's assessment of the most likely outcome of a matter included the intent to pursue early settlement, disclosure of such information would effectively provide a roadmap for opposing counsel. Such situations could result in unnecessary additional expenses for attorneys' fees and settlements. For this reason, we believe that the description of prejudicial information should be expanded to consider the potential detrimental impact of disclosure to related matters, such as the company's litigation strategy.

While we appreciate that the Board has observed that requiring companies to disclose sensitive information could be prejudicial, the proposed amendment has not mitigated the issue by its approach. Given that companies have diverse litigation portfolios, the proposed two-step process with a minimal exception for "rare" instances is insufficient. Aggregation at a higher level will not diminish transparency in many cases. In particular, when companies are involved in fewer overall cases but with larger potential claims and/or exposures on an individual case basis, certain prejudicial information would be discernable even when aggregated. In addition, specifying that such instances are presumed to be rare is likely to bring additional scrutiny upon the use of the exception, even when appropriate in the individual circumstances. As a result, neither providing a high-level aggregated disclosure nor permitting an exception from certain disclosure in rare instances provides sufficient relief.

## Disclosure of Settlement Offers

We support the Board's conclusion not to require disclosure of settlement offers, as we do not believe that such disclosure would provide relevant and useful information to investors. Offers of settlement may fluctuate significantly during the course of legal proceedings, as a result of discovery, rulings by judges on motions, or other developments. Any offer or counter-offer only reflects one party's perspective on the value of the case at one point in time. As a result, a settlement offer is not meaningful until it is actually accepted. Furthermore, in federal court, settlement negotiations are confidential, and thus are generally precluded from admission into evidence in litigation.<sup>2</sup> Requiring disclosure of settlement offers in a company's financial statements would provide a means for circumventing these provisions. Protecting the confidentiality of settlement negotiations encourages litigants to pursue settlement even while litigation is ongoing, because the parties are assured that settlement deliberations will not be revealed in court. Requiring disclosure would discourage settlement offers, thus removing or limiting a means to end litigation in a potentially cost-effective and/or timely manner. For these reasons, we support the Board's position on non-disclosure of settlement offers.

\*\*\*\*

We would like to continue to participate in the public discussions of this issue, and would be pleased to discuss any aspect of our letter with you to provide further assistance in your deliberations on the proposed guidance. Thank you for considering our views.

Sincerely,

Gregory N. Ramsey

Vice President - Accounting Policy

<sup>&</sup>lt;sup>2</sup> Federal Rule of Evidence 408