



## Investors Technical Advisory Committee

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Via Email



23 May 2008

LETTER OF COMMENT NO. 2

Mr. Robert Herz  
Chairman  
Financial Accounting Standards Board  
P.O. Box 5116  
Norwalk, Connecticut 06856-5116

Sir David Tweedie  
Chairman  
International Accounting Standards Board  
30 Cannon Street  
London, EC4M 6XH  
United Kingdom

Re: Fair Value Measurement for Financial Instruments

Dear Chairman Herz and Chairman Tweedie:

On more than one occasion, the FASB and the IASB have jointly reaffirmed their formal commitment to achieving fair value measurement for financial instruments. The ITAC<sup>1</sup> supports this objective and has expressed its view in letters to the two boards as well as in separate meetings. The ITAC believes that clear, complete, objective, and timely information, measured as accurately as market conditions and information permit, that is, fair value measurement, is of fundamental importance to financial statement users and the functioning of markets at all times.

The ITAC's position is further supported by a recent survey of its membership by CFA Institute, a global organization of investment professionals. Of the 2,000 respondents, 79 percent said that fair value measurement requirements for financial institutions improve transparency and contribute to investor understanding of the risk profiles of the

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<sup>1</sup> This letter represents the views of the ITAC and does not necessarily represent the views of its individual members, or the organizations by which they are employed. ITAC views are developed by the members of the Committee independent of the views of the FASB and its staff. For more information about the ITAC, including a listing of the current members and the organizations in which they are employed, see [http://www.fasb.org/investors\\_technical\\_advisory\\_committee/itac\\_members.shtml](http://www.fasb.org/investors_technical_advisory_committee/itac_members.shtml)

institutions. It is also telling that 74 percent thought fair value requirements improve market integrity in general.

The ITAC believes that it is especially critical that fair value information be available to capital providers and other users of financial statements in periods of market turmoil accompanied by liquidity crunches such as we're now experiencing. In the absence of timely fair value information, uncertainty increases, further exacerbating market instability and causing investors to withhold investable funds or demand a hefty uncertainty premium. A cornerstone of the restoration of investor confidence must be to provide the information investors need to make risk-based decisions.

The ITAC has been gratified that not only financial reporting standard-setters and investors, but regulators of financial institutions across the spectrum have endorsed fair value measurement for financial instruments. Regulators recognize that fair value measurement is an essential tool in their oversight and monitoring of the risk management practices and risk profiles of financial institutions, and ensuring that the institutions' capital provisions are adequate to support the risks embedded in the financial instruments and other assets the institutions hold and the financing used to support those assets.

Given this widely-recognized critical importance of providing relevant, high-quality financial information to the markets, the ITAC has been dismayed to learn that a few managers of major financial institutions, along with representatives of industry organizations representing some financial institutions, are now calling for a suspension of fair value reporting for financial instruments.<sup>2</sup> They argue, in effect, for a return to the old financial reporting model for financial instruments in effect decades ago with its out-of-date historical cost reporting and lack of transparency, particularly for embedded financial risks.

However, in today's markets with their reliance on rapid financial innovation, complex structured finance, and global distribution of securities, such a system would allow problems to develop and spread unhindered throughout the global financial system. This is the reason why an increasing number of regulators who have analyzed the factors that led to the current crisis are calling for even more frequent, up-to-date, complete, and transparent financial reporting for financial instruments, and especially fair value measurement and disclosures. They recognize that such information not only enables financial markets to better serve as efficient and effective pricing and disciplining mechanisms, but as well it provides an early warning system for developing problems, allowing timely regulatory intervention that can reduce the risk of future financial crises.

Recently, some have attempted to shift the blame for the current crisis from the poor business and investment decision-making, including the flawed underwriting, securitization, risk management, and disclosure practices in which they engaged, to fair

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<sup>2</sup> It is noteworthy that some of those who take this position have reported major write-downs of sub-prime mortgages and derivative instruments based on those mortgages. Indeed, some of the firms have had to seek outside capital to remain solvent.

value financial reporting, a “shoot the messenger” argument. This reasoning is both perplexing and misleading. In fact, the current requirement to report financial instruments at fair values was instrumental in the uncovering of the deep and widespread problems in the markets. The long-term solution to the problems relies heavily on the retention of the requirement to provide fair value information to investors and regulators: the higher the quality of fair value information that is provided, the faster will be the necessary market adjustments to the problems.

In a similar vein, much has been made of the supposed “pro-cyclical” characteristics of fair value measurement. Those positing such an effect argue that fair value measurement and the recognition of losses results in a positive feedback loop that propels values downward. However, closer inspection of this argument reveals it to be a strangely one-sided complaint that ignores the basic economic functioning of markets. It is the job of capital markets and investors in those markets to receive information, analyze and process the information, and form pricing judgments for assets based upon the analyses. When the information provides “good news” that the market had not previously expected and impounded, prices rise. When negative surprises arrive, prices fall. It is worth noting in this context that the supposed pro-cyclical characteristic of fair value measurement does not draw similar criticism when news is good and prices rise.

What those making the argument fail to recognize is that these are not abnormal features of the measurements, *per se*, but rather characteristics of the normal functioning of markets as investors reassess risks and rewards and liquidity disappears for poor quality securities and investments with little transparency. Some downward price revisions will inevitably result in the triggering of covenants that the original purchasers of securities or lenders demanded as a condition of investing in the securities and agreeing to the terms upon which the capital was provided to issuers. Again, these triggers are a normal part of the contracting process and designed to protect the investors, including lenders. The fact that the triggers were activated is not an indictment of the measurement system but rather is a direct function of the poor or deteriorating quality of the investments. Arguing that by not recognizing the poor or deteriorating quality of the investments we will somehow solve the problem is not only inappropriate but is a variant of the “shoot the messenger” argument: Pull the covers over the problems and maybe they will just go away.

Investors, standard-setters, regulators, and legislators share a common interest: Ensuring the stability and the efficient and effective functioning of the financial markets. This can only happen when all market participants have the information they require to make risk-based financial decisions: clear, complete and up-to-date fair value information. Consequently, we encourage the financial reporting standard-setters and regulators to remain firm in their resolve to require that such information be provided to investors.

Thank you for your consideration of our views on fair value reporting for financial instruments which we consider to be critical in shoring up the foundation of a robust financial reporting system designed to be useful to investors. If you need further clarification or require additional information, please feel free to contact any member of

ITAC's Fair-Value Subgroup. We would be pleased to discuss our proposal and recommendations with members of the Board or its staff.

Sincerely,



Rebecca McEnally  
Member  
Investors Technical Advisory Committee

CC: Chairman Christopher J. Dodd, Committee on Banking, Housing, and Urban Affairs  
Senator Richard C. Shelby, Ranking Member, Committee on Banking, Housing, and Urban Affairs  
Chairman Jack Reed, Securities, Insurance and Investment Subcommittee of the Committee on Banking, Housing, and Urban Affairs  
Senator Wayne Allard, Ranking Member, Securities, Insurance and Investment Subcommittee of the Committee on Banking, Housing, and Urban Affairs  
Chairman Barney Frank, Committee on Financial Services  
Representative Spencer Bachus, Ranking Member, Committee on Financial Services  
Chairman Paul E. Kanjorski, Capital Markets, Insurance and Government Sponsored Enterprises Subcommittee of the Committee on Financial Services  
Representative Deborah D. Pryce, Ranking Member, Capital Markets, Insurance and Government Sponsored Enterprises, Committee on Financial Services  
Chairman Christopher Cox, United States Securities and Exchange Commission  
Commissioner Paul S. Atkins, United States Securities and Exchange Commission  
Commissioner Kathleen L. Casey, United States Securities and Exchange Commission  
Chairman Robert Pozen, Securities and Exchange Commission Advisory Committee on Improvements to Financial Reporting