

FEDERAL HOUSING FINANCE AGENCY

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Office of the Chief Accountant

December 30, 2008

Mr. Russell Golden Technical Director Financial Accounting Standards Board 401 Merritt 7 P.O. Box 5116 Norwalk, CT 06856-5116

LETTER OF COMMENT NO. 284

File Reference: Proposed FSP EITF 99-20a

Dear Mr. Golden:

The Federal Housing Finance Agency (FHFA) is pleased to comment on FASB's proposed FSP on EITF Issue 99-20 (FSP EITF 99-20a). As the supervisor of the Federal Home Loan Bank system and the supervisor and conservator of Fannie Mae and Freddie Mac, we are deeply interested in transparency and disclosure in financial reporting as a means of fostering market discipline for both GSEs and financial institutions more generally.

We support FASB's goal of achieving a more consistent determination of whether other-thantemporary impairment (OTTI) has occurred. We are concerned, however, that proposed FSP EITF 99-20a would unduly diminish the use of market-based information, including fair values, in making OTTI decisions. We believe that any revised guidance should retain a connection to market participants' views in order to inform and regulate the exercise of management judgment assessing impairment for financial instruments that are not carried at fair value.

In paragraph 4 to the appendix of proposed FSP EITF 99-20a, FASB notes that some constituents believe OTTI is essentially automatic under EITF 99-20 in a disrupted market. We disagree and believe that credit spreads and liquidity premiums can lower asset values without deterioration in expected cash flows. At some point, however, the likelihood that an asset's price decline is due solely to the price of risk becomes improbable, and it becomes probable that some portion of its impairment reflects the market's expectations that future cash flows will be reduced.

In paragraph 4 FASB also remarks that OTTI may be recognized under the current EITF 99-20 for securities whose underlying assets are still performing. We concur and believe that is sometimes appropriate. For example, securitized negative-amortization mortgage loans that are close to their recast date may be performing now, but market participants may expect that defaults will increase substantially after the recast date. For securities with similar underlying collateral, we do not believe the proposed amendment would improve financial reporting if it allows an entity to wait to recognize OTTI until the underlying collateral materially defaults. In this example it is reasonable to expect entities to consider market consensus views regarding the future performance of the underlying collateral in making OTTI determinations.

The explicit link to market participant expectations in EITF 99-20 helps foster disciplined judgments in evaluating OTTI for instruments within its scope. Indeed, we believe that GAAP impairment models would be better aligned by introducing a similar link into the FAS 115 impairment analysis. This would also improve consistency with FAS 157 and would echo the approach taken by FASB in its guidance in FSP No. FAS 157-3 Determining the Fair Value of a Financial Asset When the Market for That Asset is Not Active.

OTTI analysis and fair value measurement are closely intertwined. SEC SAB Topic 5M states, in part, "...management should consider all available evidence to evaluate the *realizable value* of its investment" (emphasis added). The SEC elaborated that determining the realizable value of a security should begin with its contemporaneous market price as that price reflects the market's most recent evaluation of the total mix of available information, and that objective evidence is required to support a realizable value in excess of the contemporaneous market price. The SEC has indicated that this rationale applies to both marketable debt and equity securities.

Hence, an impaired security's fair value is a fundamental consideration in OTTI analysis. To determine fair value under FAS 157, one must consider "the assumptions that market participants would use in pricing the asset or liability." The proposed changes to EITF 99-20 could allow management, which purchased and holds impaired securities, to substitute its judgments for the inferred assumptions of market participants who are willing to purchase or sell similar securities. This change would be directionally inconsistent with FAS 157 would not advance the goal of providing transparent, objective information to financial statement users. To the extent that the final guidance clarifies that management may reasonably judge that fair value changes for securitized instruments may not always reflect changes in expected cash flows, we do not object. However, the final guidance should retain a connection to market participants' views or it risks diminishing the reliability and relevance of the underlying judgments to financial statement users.

While we acknowledge that management judgment must be exercised in the determination of fair value, particularly in today's illiquid market, we believe that a connection to market participants' views regarding expected performance of financial securities is still needed in GAAP. Without such a link, management judgments regarding the collectability of a security's contractual cash flows will not be connected to those of potential investors and other market participants as expressed in security prices, opinions expressed by rating agencies, and other information reflecting market participants' views. EITF 99-20's explicit requirement that management, in evaluating impairment, link its cash flow analysis to the assumptions of market participants provides discipline. Without such discipline cash flow analyses based on unobservable inputs could trump observable market information about similar securities.

¹ SEC Accounting and Auditing Enforcement Release No. 309, In the Matter of Fleet/Norstar Financial Group, Inc. ² SEC Accounting and Auditing Enforcement Release No. 443, In the Matter of Presidential Life Corporation.

³ Statement of Financial Accounting Standards No. 157, Fair Value Measurements, paragraph 11.

Alternative Action

Rather than amending EITF 99-20 to delete its use of a market-participant frame of reference, we believe financial reporting would be better served by adding an example to EITF 99-20 to clarify that management can in some circumstances judge that market participant's views as expressed in fair values and other market information may not reflect an expectation of reduced cash flows. Similarly, FASB should consider amending the probable loss illustration in FAS 115 to include a market participant reference point.

Also, we understand there is diversity in practice regarding whether securities that are downgraded below a credit rating of AA subsequent to purchase then fall within the scope of EITF 99-20. We do not see the benefit to requiring bonds that were originally issued below a credit rating of AA having one OTTI treatment, while bonds that were downgraded having a different OTTI treatment. In this regard we encourage FASB to consider greater consistency by making what is now dissimilar treatment more uniform under EITF 99-20.

Finally, we offer no comment on the proposed effective date other than to note our general belief that standard setting is most effective when adequate time is allotted for thoughtful consideration of the impact of proposed changes.

Sincerely,

Wanda I. DeLeo

Senior Associate Director and Chief Accountant

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