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Mr. Russell G. Golden
FASB Technical Director
Financial Accounting Standards Board
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File Reference: Proposed FSP FAS 157-d

Dear Mr. Golden:

The American Bankers Association (ABA) appreciates the opportunity to comment on the Financial Accounting Standards Board's (FASB) Proposed FASB Staff Position (FSP), FSP FAS 157-d. We appreciate the FASB's work on the proposed FSP. We have concerns about the proposal that we strongly encourage you to address prior to issuing the proposal as final. ABA brings together banks of all sizes and charters into one association. ABA works to enhance the competitiveness of the nation's banking industry and strengthen America's economy and communities. Its members – the majority of which are banks with less than \$125 million in assets – represent over 95 percent of the industry's \$12.7 trillion in assets and employ over 2 million men and women.

We understand that the objective of the proposed FSP was to clarify application of SFAS 157 in situations where markets are inactive and that it emphasizes the use of judgment when weighing the available inputs (whether observable or unobservable) to a valuation. The ABA believes that this clarification is necessary based on current market conditions.

It is the ABA's position that the final FSP should more directly address what we believe is a bias toward observable market data when the quality or usefulness of that data is questionable. It is our belief that in practice this bias is resulting in exit values being derived from the lowest point in a potential range of values. Our members have indicated that the proposed FSP has not tempered some audit firms' extreme positions and views about the impact of current market conditions and distressed transactions on fair value measurements. We request that the FSP provide clarification on the use of reasonable judgment.



LETTER OF COMMENT NO.

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Background

Paragraph 21 of SFAS 157 states that "valuation techniques used to measure fair value shall maximize the use of observable inputs and minimize the use of unobservable inputs." This principle of maximizing observable inputs may be appropriate in normal markets; however, when applied to dislocated markets without adequate consideration of the quality and usefulness of those observable data, it is inappropriately interpreted as requiring that excessive weight be placed on the use of these less than reliable or relevant observable data.

In fact, in the current illiquid markets, while all of the data referenced in paragraph A32D have some level of observability (as they are derived from market information or provided by a third party), they do not represent actual observable transactions in an orderly market. For instance, the proposed FSP suggests that a non-binding quote, not represented by actual transactions, is an observable input and therefore is interpreted by some to be of higher quality than other inputs. This seems to us to contradict the guidance recently stated in the joint SEC/FASB release.

In addition, the proposed FSP uses the term "market participant", but does not provide guidance for consideration of the implications when historically typical market participants are not participating in the market for an investment class. Though some believe a drastically reduced alternate investor class represents new market participants, we believe such situations might often reflect that the market is not functioning normally (i.e., with participants on both sides of the transaction that are not *compelled* to transact).

Recommendations/Observations

We concur that the fair value determinations should reflect credit risk, premiums for uncertainty of return, and premiums for liquidity in uncertain markets. However, these considerations should be appropriately weighted, and there should be emphasis on the application of reasonable judgment.

We are also concerned that the illustrative example provided is of a sub-prime investment security and does not include a higher quality investment security that is not experiencing any observable market transactions in seized and illiquid markets. The point of the illustration should be, nevertheless, to indicate how a fair value is determined for all classes of securities.

While we understand that the proposed FSP and the SEC's Clarifications on Fair Value Accounting, issued September 30, 2008, are intended to be read together, we recommend that the FASB staff include explicit language on how to evaluate observable data. Consistent with the comments above, the ABA believes that the nature of observable data will differ in "normal" versus "dislocated" markets. While observable information may be based on a high volume of actual transactions in a normal market, this will not be the case in dislocated or illiquid markets. The quality of the observable data will have to be assessed in consideration of many factors, some of which include:

- Number of broker quotes
- Consistency across the broker quotes

- Nature of the quotes (i.e., indicative or binding)
- Where the broker quotes are being obtained and from whom
- Number of recent transactions
- Collateral considerations
- Nature of the transaction (distressed or forced liquidation)

We believe that where the quality/nature of the observable data is limited, the emphasis of these data should also be limited in the overall valuation. For example, the level of reliance on broker quotes should focus on whether the quotes are supported by actual transactions as well as the volume and nature of any supporting transactions (i.e., whether they distressed). It should also be emphasized that the appropriate point in a range of valuations requires the need to apply reasonable judgment and should not simply default to the "observable" information.

Similarly, reasonable judgment should be applied in determining what a representative liquidity premium would be <u>for a functioning market</u>, so that the liquidity premium is not distorted based on the illiquidity of a frozen market.

Finally, we believe the proposed FSP would be more helpful if it included guidance for determining when observable evidence represents market participants not forced or compelled to transact.

Other Than Temporary Impairment Considerations

In addition to the specific observations on the FSP, it is important to address a valuation issue with equal urgency—the application, in practice, of Other Than Temporary Impairment (OTTI). Consistent with the complexity of applying SFAS 157 in illiquid markets and the observed bias towards estimating the most conservative liquidity premium in dislocated markets, which therefore results in extremely low valuations, there also exists in practice a bias to presuming that unrealized losses on debt securities are evidence of an adverse change or shortfall in cash flow without appropriate consideration of how much of that discount is due to the liquidity premium.

SFAS 115 states that an entity will record OTTI when it is probable that it will not collect all amounts due according to the contractual terms of a debt security not impaired at acquisition. However, in practice, it is interpreted that if an unrealized loss exists and that loss was estimated in accordance with the SFAS 157 and EITF 99-20 market participant concepts, then that loss becomes supportable evidence of a shortage in cash flows. An unrealized loss in itself is not sole evidence that the cash flows of a security have been adversely affected. Additionally, a liquidity premium is not relevant for determining whether it is probable that all amounts due will be collected according to contractual terms. The ABA believes that a rigorous cash flow analysis is necessary to evaluate impairment and does not believe a fair value bias should trump such cash flow analysis. Moreover, "estimates a market participant would use in determining the current fair value of the beneficial interests," assumes a functioning market. When observable market data are not

reflective of a functioning market, management could appropriately use internal cash flow models as key determinants in determining OTTI.

In addition, forcing companies to record OTTI in situations where fundamental cash flow analysis would not indicate impairment is not an improvement in financial reporting. Such adjustments reset the cost basis and could result in outsized yields going forward.

We recommend the proposed FSP include guidance helpful to applying the concept of "near term prospects" in SAB 59. Audit firms are using various internally constructed benchmarks for anticipated recoveries of potential OTTI charges. Some have specifically indicated a bright line application of 6 to 9 months as being the term in which a forecasted recovery would need to occur in order to avoid an OTTI charge. We do not believe "bright lines" should be used. We believe the determination should be made based on the financial condition of the issuer based on all available issuer-specific evidence. For example, where an issuer continues to perform within a range of historical results, and the issuer's securities have historically recovered following market cycles, we believe allowing a period of time typical of historical market cycles would be appropriate before requiring impairment under the guidance.

Finally, it is important that this guidance be clear that it clarifies SAB 59 and EITF 99-20.

We understand the objective of the proposed FSP is to address third quarter 2008 concerns in a timely manner, and we appreciate that. We believe further guidance and examples may be necessary subsequent to the final FSP on the most appropriate fair value when a market is so illiquid that neither observable prices, nor observable inputs, are reflective of market participants as contemplated in Statement No. 157 (i.e., sellers who are not forced or compelled to transact). Issues such as the following may need to be included: What is a distressed sale? What is a forced liquidation? When is a market so seized that it is appropriate to conclude any sales are distressed/forced? What level of evidence is needed in a principal-to-principal market with no public data?

We have noted that the number of comment letters posted to date with the FASB are not commensurate with the enormous level of interest that the banking industry has with regard to this proposal. We believe this is for many reasons, including the understandably short time frame for comments and not for lack of interest. There are 52 banks of varying sizes on our drafting working group and 400 on our larger working group that are concerned about this issue. This letter should be viewed as representing our members, which include institutions of all sizes, and which strongly hold the views expressed in this comment letter.

We are very eager to work with you on this project. Please do not hesitate to contact me (202-663-5318; dfisher@aba.com).

Sincerely,

Donne J Fisher

Donna Fisher

cc: Conrad Hewitt, Securities and Exchange Commission
Jim Kroeker, Securities and Exchange Commission
Charles Holm, Federal Reserve Board
Arthur Lindo, Federal Reserve Board
Jeffrey Geer, Office of Thrift Supervision
Zane D. Blackburn, Office of the Comptroller of the Currency
Robert F. Storch, Federal Deposit Insurance Corporation