

COUNCIL OF INSTITUTIONAL INVESTORS

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Via Email

April 1, 2009

Russell Golden
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FASB
401 Merritt 7
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LETTER OF COMMENT NO.

324

Re: File Reference: Proposed FSP FAS 115-a, FAS 124-a, and EITF 99-20-b

Dear Mr. Golden:

I am writing on behalf of the Council of Institutional Investors (“Council”), an association of more than 130 public, corporate and union pension funds with combined assets of over \$3 trillion.¹ As a leading voice for long-term, patient capital, we appreciate the opportunity to provide comments in response to the proposed Financial Accounting Standards Board (“FASB” or “Board”) Staff Position (“FSP”) to amend FASB Statements No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, No. 124, *Accounting for Certain Investments Held by Not-for-Profit Organizations*, and EITF Issue No. 99-20, “Recognition of Interest Income and Impairment on Purchased Beneficial Interests and Beneficial Interests That Continue to Be Held by a Transferor in Securitized Financial Assets” (“Proposal”).² For the reasons set forth below, we strongly oppose the Proposal.

Council Policy Supports Independence of Standard Setting

At our fall 2008 meeting, the Council’s general membership approved an update to our policy on independence of accounting and auditing standard setting (“Policy”).³ The Policy continues to reflect our long-held view that the quality, comparability, and reliability of financial information contained in financial statements and related disclosures depends directly on the quality of financial reporting standards and the standard setters that develop them.⁴

¹ For more information about the Council of Institutional Investors (“Council”) and its members, visit our website at <http://www.cii.org/>.

² Recognition and Presentation of Other-Than-Temporary Impairments, Proposed FSP on Statement 115, Statement 124, and EITF Issue 99-20 at 9 (*Fin. Accounting Standards Bd. Proposed FSP FAS 115-a, FAS 124-a, and EITF 99-20-b Mar. 17, 2009*), http://www.fasb.org/fasb_staff_positions/prop_fsp_fas115-a_fas124-a_and_eitf99-20-b.pdf [hereinafter Proposal].

³ Council, Policies on Other Governance Issues, Independence of Accounting and Auditing Standard Setters (Updated Oct. 7, 2008),

[http://www.cii.org/UserFiles/file/council%20policies/CII%20Policies%20on%20Accounting%20and%20Auditing%2010-7-08\(1\).pdf](http://www.cii.org/UserFiles/file/council%20policies/CII%20Policies%20on%20Accounting%20and%20Auditing%2010-7-08(1).pdf) [Hereinafter Policy]. For more information about the Council’s policies, visit our website at

<http://www.cii.org/policies>.

⁴ See Policy, *supra* note 3, at 1.

The following criteria contained in the Policy appear particularly relevant to the Proposal:

- The . . . standard setter has demonstrated a clear recognition that investors are the key customer of audited financial reports and, therefore, the primary role of . . . financial reports should be to satisfy in a timely manner investors' information needs. . . .⁵
- The . . . standard setter has a thorough public due process that includes solicitation of investor input on proposals and careful consideration of investor views before issuing proposals or final standards⁶
- The . . . standard setter has a structure and process that adequately protects the standard setter's technical decisions and judgments (including the timing of the implementation of standards) from being overridden by government officials and bodies.⁷

Consistent with the Council's policy, we strongly oppose the issuance of the Proposal as a final standard for at least three fundamental reasons: (1) the proposed requirements are not consistent with the needs of investors; (2) the Board's due process will not likely be sufficiently thorough or involve a careful consideration of the views of investors; and (3) a final standard will likely be perceived as the flawed product of a Board that seems to have surrendered its independence in response to political pressures generated by the financial services lobby—whose clients are the key contributors to the ongoing financial crisis.

The Proposal Does Not Meet the Needs of Investors

The Council agrees with many other investors, accountants, and other market participants that the needs of investors and other consumers of financial reports are best satisfied by requiring that all financial instruments be accounted for at fair value accompanied by robust disclosures.⁸ We note that such an approach would eliminate the need for the Proposal because other-than-temporary impairment ("OTTI") models would not be necessary if all financial instruments were reported at fair value.

⁵ *Id.* Of note, this criterion is consistent with Recommendation 2.1 of the August 1, 2008, Final Report of the Advisory Committee on Improvements to Financial Reporting to the United States Securities and Exchange Commission which states, in part, "*investor perspectives should be given pre-eminence by all parties involved in standards-setting*" (footnote omitted), <http://www.sec.gov/about/offices/oca/acifr/acifr-finalreport.pdf>.

⁶ Policy, *supra* note 3, at 1.

⁷ *Id.* at 2.

⁸ *See, e.g.*, Letter from Cindy Fornelli et al., to The Honorable Christopher Cox, Chairman, Securities and Exchange Commission 1-2 (Nov. 14, 2008), <http://www.cfainstitute.org/centre/topics/comment/2008/pdf/081114.pdf>.

We also share FASB Chairman Herz's doubts about the usefulness of the information resulting from the application of OTTI models generally.⁹ Chairman Herz recently commented:

I think all of this impairment stuff is voodoo I see a lot of utility for understanding what's happening to particular instruments, market values, cash flows currently and projected. I don't see a lot of value to some of these calculations that get done now *under any of the impairment models*. . . . *For those who believe impairment is an important element of the accounting model, I invite them to try to persuade me.*¹⁰

Notwithstanding the questionable usefulness of the information resulting from the application of impairment models, until the goal of reporting all financial instruments at fair value is achieved, we would not necessarily oppose any effort by the FASB to align or improve disparate OTTI models for instruments with similar economics—at least to the extent that such alignment or improvement is directionally consistent with the ultimate goal.¹¹ The Proposal, however, clearly fails in that regard.

More specifically, the Proposal changes the existing OTTI model to move the reporting for financial instruments further away from fair value in two important respects. First, the Proposal abandons the existing OTTI requirement that permits nonrecognition of an impairment loss when an entity can assert its intent and ability to hold the instrument to recovery with a new and substantially weaker requirement that the entity assess whether it intends to sell the security or whether it is more likely than not that it will be required to sell the security before recovery of its cost basis.¹² In the Proposal's Alternative View, Board members Thomas J. Linsmeier and Marc A. Siegel explain how this proposed change poses potential dangers to investors, taxpayers, and the overall economy:

[A] potential result will be to reduce the amount of impairment loss recognized in the financial statements. A 1991 U.S. Treasury report cited delayed recognition of impairment losses as having an exacerbating effect on the length and ultimate cost of the savings and loan crisis. There are also parallels to the experience in Japan when delays in recognition of losses resulted in the so-called lost decade in the 1990s. Similarly, . . . to the extent the proposed FSP results in delayed recognition of impairment losses in earnings, there also may be a negative impact on investor confidence.¹³

⁹ Tammy Whitehouse, *FASB Racing Through Impairment Revisions*, Compliance Wk. 1 (Dec. 23, 2008), <http://www.complianceweek.com/article/5196/fasb-racing-through-impairment-revisions>.

¹⁰ *Id.* at 1 (emphasis added).

¹¹ Letter from Jeff Mahoney, General Counsel, Council to Russell Golden, Technical Director, FASB 3 (Dec. 24, 2008), [http://www.cii.org/UserFiles/file/resource%20center/correspondence/2008/December%2024,%202008%20Comment%20letter%20to%20FASB%20on%2099-20-a%20\(final\).pdf](http://www.cii.org/UserFiles/file/resource%20center/correspondence/2008/December%2024,%202008%20Comment%20letter%20to%20FASB%20on%2099-20-a%20(final).pdf).

¹² Proposal, *supra* note 2, at 9.

¹³ *Id.* at 9-10; *Cf.* Stephen G. Ryan, Fair Value Accounting: Understanding the Issues Raised by the Credit Crunch 16 (July 2008), [http://www.cii.org/UserFiles/file/resource%20center/correspondence/2008/CII%20Fair%20Value%20Paper%20\(final\)%20%20071108.pdf](http://www.cii.org/UserFiles/file/resource%20center/correspondence/2008/CII%20Fair%20Value%20Paper%20(final)%20%20071108.pdf) (“Because of its timeliness and informational richness, fair value accounting and associated mandatory and voluntary disclosures should reduce uncertainty and information asymmetry faster over time than amortized cost accounting would, thereby mitigating the duration of the credit crunch”).

The Proposal's other significant change that moves the existing OTTI model further away from reporting financial instruments at fair value is the proposed bifurcation of the fair value write down between earnings and other comprehensive income when it is determined that an other-than-temporary impairment should be recognized because a credit loss event has occurred.¹⁴ In commenting on this change, dissenting Board members Linsmeier and Siegel note that not only is the proposed change inconsistent with investors "preference . . . for fair value for financial instruments though earnings" but that it is unlikely that preparers will be able to provide investors a meaningful bifurcation of the impairment loss as presumed under the Proposal.¹⁵ More specifically, Linsmeier and Siegel have concluded that they *do not* believe that:

An incurred loss approach (as proposed in the FSP) can isolate the credit loss from other losses (particularly liquidity risk) as is advocated by those supporting this approach. In current market conditions, liquidity risk is inextricably intertwined with credit risk, representing the discount associated with the uncertainty of collection.¹⁶

We note that the dissenting views of Linsmeier and Siegel on both of these critical issues are shared by many investors and financial reporting experts, including Jack Ciesielski of the *Accounting Analyst Observer*.¹⁷ Ciesielski opines:

One has to ask: how does this accounting bring improved information to investors? Information will be less timely and relevant – two characteristics that matter to investors. Where impairments exist, they'll be delayed if companies only assert their intent to hold them; if they're finally forced to admit they won't receive full payment, part of the loss will be recognized, and part will be recognized on a delayed basis – long after the impairment occurred. It will merely add one more bookkeeping – driven smoothing device to the accounting literature, bringing no useful information to investors. It will merely add to the adjustments investors need to undo to make the firm's true performance more visible.¹⁸

¹⁴ Proposal, *supra* note 2, at 9.

¹⁵ *Id.* at 9-10.

¹⁶ *Id.* at 9.

¹⁷ Jack T. Ciesielski, *Double Mint: Gumming Up Fair Value*, *Analyst's Acct. Observer*, Vol. 18, No. 6 (R), at 2 (Mar. 23, 2009) (on file with Council) [Hereinafter *Double Mint*]; *see, e.g.*, Letter from Kurt N. Schacht, Managing Director & Gerald E. White, Chair, Corporate Disclosure Policy Council, CFA Institute to Mr. Robert Herz, Chair, Financial Accounting Standards Board to Mr. Robert Herz, Chair, Financial Accounting Standards Board 3 (Mar. 30, 2009) (on file with Council) (noting that the Proposal "effectively gut[s] the transparent application of fair value measurement").

¹⁸ *Double Mint, supra* note 17, at 2.

The Proposal's Due Process Is Insufficient

We note that the Proposal was issued for a fifteen day comment period ending on April 1, 2009¹⁹ and the Board is expected to make final decisions on the Proposal at its public meeting on April 2, 2009.²⁰ We do not believe that such a rushed schedule is consistent with having a thorough public due process that permits careful consideration of investor views.

We note that the FASB's "official" rules of procedure require comment periods of at least 30 days with the exception of narrow technical proposals that simply "clarify or elaborate upon an underlying standard."²¹ In those circumstances the comment period must be at least 15 days.²²

As indicated, the Proposal will clearly cause a major change in accounting practice for OTTI.²³ Thus, under the FASB's official rules of procedure a minimum of thirty days for public comment appears to have been required.²⁴

It is our understanding that rather than relying on its official rules of procedure, the FASB is relying on its "unofficial" rules of procedure in support of the fifteen day comment period for the Proposal. More specifically, the FASB appears to be relying on the following language contained on its website:

At the end of the exposure period, which is determined at the discretion of the Board but should never be less than 30 days (*except for proposed FSPs and EITF consensuses, which should never be less than 15 days*), all comment letters and position papers are analyzed by the staff.²⁵

Conceding that the FASB's unofficial rules of procedure permit a fifteen day comment period for a proposed FSP, we believe that providing only for the minimal allowable time period for public comment on this Proposal is inconsistent with a thorough public due process given (1) the significance of the proposed changes to financial reporting; and (2) the FASB's plans to make a final decision on the proposed changes only hours after the comment period ends.

On the second point, it is our understanding that historically, many, in some cases, most, of the comment letters received by the FASB in response to proposals are received on the last day of the comment period. Thus, in this case, FASB members will likely have only minutes, perhaps only seconds, to read and consider the Council's comment letter and many other comment letters received in response to the Proposal before making a final decision on the proposed changes at the April 2nd public Board meeting.

¹⁹ Proposal, *supra* note 2, at 1.

²⁰ FASB.org, Notice of Open Meetings, <http://www.fasb.org/calendar/index.shtml> (last visited Apr. 1, 2009).

²¹ Rules of Procedure 13-18 (Fin. Accounting Standards Bd. Amend. & Restated through Dec. 1, 2002) (on file with Council).

²² *Id.* at 17.

²³ As further evidence of the significance of the proposed requirements, the Proposal contains ten pages of amendments to the existing literature for other-than-temporary impairments. Proposal, *supra* note 2, at ¶¶ A1-A4.

²⁴ See Rules of Procedure, *supra* note 21, at 14-16.

²⁵ FASB, Facts about FASB, <http://72.3.243.42/facts/index.shtml> (last visited Apr. 1, 2009) (emphasis added).

As noted by long-time FASB observer Floyd Norris of the *New York Times*:

The process this time has been different in almost every respect. The board allowed only 15 days for comments, and said it would act after taking just a day to review the comments.²⁶

The Proposal Will Impair the Independence of the FASB

In our view, if the FASB agrees to a finalize the Proposal at its April 2nd public Board meeting, that action will likely impair the independence of the FASB and damage its ability to effectively pursue its mission going forward. On this point, we agree with the following recent comments of former United States Securities and Exchange Commission Chairman Arthur Levitt:

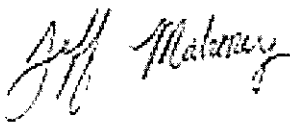
The FASB was created to stand apart from partisanship and momentary shifts in public opinion precisely because of the value of accounting standards comes in the consistency of their application over time and circumstance. Chairman Herz acquiesced, it appears, in order to keep Congress from invading FASB turf. Yet in seeking to protect its independence, the board has surrendered some of it in the bargain.

. . . Independence from public pressure has a value, and when you give some of it away, you've lost something that takes years to rebuild.²⁷

Consistent with Chairman Levitt's views and Council policy, we believe that when an independent accounting or auditing standard setter is pressured by Congress or other governmental bodies to make changes to standards that are clearly inconsistent with the needs of investors there is but one appropriate response to those requests—"No." Fortunately, tomorrow provides the FASB with another opportunity to provide the appropriate response and retain for the benefit of investors, the capital markets, and the U.S. economy, the FASB's most valuable asset—its independence.

We again appreciate the opportunity to provide our comments on the Proposal. Please feel free to contact me at 202.261.7081 or jeff@cii.org with any questions or if any additional information about the Council's views on the Proposal or related matters would be helpful to your redeliberations.

Sincerely,



Jeff Mahoney
General Counsel

²⁶ Floyd Norris, *Banks Set to Receive More Leeway on Asset Values*, N.Y. Times 2 (Mar. 31, 2009), <http://www.nytimes.com/2009/04/01/business/01place.html?ref=global>.

²⁷ Arthur Levitt, *Weakening a Market Watchdog*, Wash. Post 2 (Mar. 26, 2009), <http://www.washingtonpost.com/wp-dyn/content/article/2009/03/25/AR2009032502805.html>.