



Via Email

October 16, 2009

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

Re: File Reference No. 1710-100: Exposure Draft on Improving Disclosures about Fair Value Measurements

Dear Chairman Herz:

The Investors Technical Advisory Committee (ITAC) appreciates the opportunity to express its views on the Financial Accounting Standard Board's (FASB) August 28, 2009 Exposure Draft (ED), *Improving Disclosures about Fair Value Measurements*. Our input is based upon our perceptions as users of financial statements, with a goal toward improving the clarity, completeness and usefulness of financial reports.<sup>1</sup> Based on our review of the document, as well as our conversations with other users of financial information, ITAC supports the disclosures proposed by the FASB in the ED. While we support the proposal and its intent in general, we propose some additional disclosures that we believe are essential to providing sufficient transparency. We believe investors and other users of financial information would have practical application uses for these new and enhanced disclosures.

**ITAC Had Asked for Increased Disclosures for Fair Value Measurements**

ITAC has consistently taken the position, as presented in multiple comment letters, that fair value is the most useful and relevant measurement method for financial instruments that meets the needs of investors.<sup>2</sup> Nonetheless, we have also previously expressed our

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<sup>1</sup> This letter represents the views of the Investors Technical Advisory Committee (ITAC or Committee) 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 Financial Accounting Standards Board (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).

<sup>2</sup> See, e.g., Letter from Michael Moran, Member, ITAC, to Robert H. Herz, Chairman, FASB, and Sir David Tweedie, Chairman, International Accounting Standards Board 1 (Sept. 17, 2008), <http://www.iasb.org/NR/rdonlyres/A76C7FF2-E5F0-4585-8322-E7C44539E025/0/CL29.pdf> ("As

view that disclosures around fair value measurements have been somewhat lacking. As one example, in a September 17, 2008 comment letter to the Chairmen of the FASB and the International Accounting Standards Board (“IASB”), we stated:

*[I]t is apparent that current disclosures surrounding fair value measurement have been inadequate. Investors must be able to ascertain how fair value measures were developed, and what the implications of these sources and methods are for their analyses. In this regard, we emphasize the necessity for the Boards to develop both a comprehensive disclosure framework and to revamp performance reporting; both would enable users to understand key performance drivers and to distinguish among realized and unrealized components of profit and loss.<sup>3</sup>*

We highlight that we have not been alone in asking the Board to enhance disclosures around fair value measurement.<sup>4</sup> The Securities and Exchange Commission’s (SEC) December 2008 report on mark-to-market accounting concluded that fair value accounting should not be suspended, but that improvements could be made.<sup>5</sup> Improvements recommended by the SEC included: “*Enhancing existing disclosure and presentation requirements related to the effect of fair value in the financial statements.*”<sup>6</sup>

In addition, other investors and investor-related groups have indicated in comment letters submitted to the FASB the need for increased disclosures in this area.<sup>7</sup> While many of these letters have been submitted over the past year given the intense focus on financial instrument valuation during the credit crisis (in particular the valuations around Level 3), we note that even during the development of FAS 157, well before the crisis was underway, investors emphasized the need for robust disclosures in this area. Finally, the FASB’s own Valuation Resource Group (VRG) also has, in the past, called for additional disclosures regarding fair value measurements.

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indicated in several comment letters previously submitted to both Boards, ITAC . . . supports the goal of achieving full fair value measurement for financial measurements (footnote omitted).”

<sup>3</sup> *Id.* at 3 (emphasis added).

<sup>4</sup> *See, e.g.*, Stephen G. Ryan, Fair Value Accounting: Understanding the Issues Raised by the Credit Crunch 15 (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) (Proposing that the FASB “should require firms to disclose their significant level 3 inputs and the sensitivities of the fair values to these inputs for all of their material level 3 model-based fair values).

<sup>5</sup> Office of the Chief Accountant, Division of Corporation Finance, United States Securities and Exchange Commission, Report and Recommendations Pursuant to Section 133 of the Emergency Economic Stabilization Act of 2008: Study on Mark-To-Market Accounting 202 (Dec. 2008), <http://www.sec.gov/news/studies/2008/marktomarket123008.pdf>.

<sup>6</sup> *Id.* (emphasis added).

<sup>7</sup> *See, e.g.*, Letters from Kurt N. Schacht and Gerald I. White, CFA Institute Center for Financial Market Integrity, to Mr. Robert Herz, Chairman, FASB 12-13 (Mar. 30, 2009), <http://www.cfainstitute.org/centre/topics/comment/2009/index.html>.

As such, we applaud the FASB's efforts to provide users with improved disclosures and increased transparency in financial reporting with respect to fair value measurements. We also recognize that these enhanced disclosure requirements would more closely align US GAAP with the disclosure requirements for financial instruments under International Financial Reporting Standards (IFRS), given the IASB's amendment to IFRS 7 in March 2009.

Below we provide our thoughts on the three new disclosure requirements in the proposal as well as the clarification of the two existing disclosure requirements.

### **Proposed New Disclosure Requirements:**

#### *1. Effect of reasonably possible alternative Level 3 inputs*

Financial instruments classified as Level 3 are often complex assets where multiple unobservable inputs are used in the determination of fair value. The valuation of such assets is, therefore, inherently subjective. For some financial institutions, Level 3 assets represent a material percentage of tangible common equity, further magnifying the focus of investors on the values assigned to these securities by corporate managers.

Investors have emphatically expressed the need to obtain greater insight into how corporate managements are valuing these securities and how those values might change under varying scenarios. We strongly support the requirement for sensitivity disclosures as they would greatly help investors assess the variability in significant unobservable inputs and, consequently, the variability in the fair value of the instruments. Investors not only need the fair value measurements, but also the assumptions used to derive such fair value measurements and how the value changes when the assumptions change.<sup>8</sup> In this realm, we have recommended the following additional disclosures:

- The range of discount rates the preparer considered in developing the Level 3 measurements and the reason for selecting the one used.
- The specific values of observable market input(s), such as discount rates or transaction prices, that the preparer chose to ignore or modify in developing the measurements, and the effect(s) on the valuation(s) that would have occurred if the preparer had chosen to use the observable input(s).

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<sup>8</sup> Stephen G. Ryan, *supra* note 4, at 15; cf. Letter from Elizabeth Mooney, Member, ITAC, to Mr. Russell Golden, FASB Technical Director, FASB 9 (July 31, 2009), <http://www.fasb.org/cs/BlobServer?blobcol=urldata&blobtable=MungoBlobs&blobkey=id&blobwhere=1175819374919&blobheader=application%2Fpdf> (Commenting on proposed disclosures about the credit quality of financing receivables and the allowance for credit losses and noting that "having the significant assumptions would be far more useful if the loan value sensitivities to the significant assumptions were provided"); cf. also Letter from Janet Pegg, Member, ITAC, to Russell G. Golden, FASB Technical Director, FASB 5 (Jan. 15, 2009), [http://www.fasb.org/cs/ContentServer?c=Document\\_C&pagename=FASB%2FDocument\\_C%2FDocument\\_Page&cid=1176156443670](http://www.fasb.org/cs/ContentServer?c=Document_C&pagename=FASB%2FDocument_C%2FDocument_Page&cid=1176156443670) (Commenting on proposed disclosures about certain financial assets and noting that "we believe entities should disclose the key assumptions underlying the incurred loss amounts and the sensitivity to these assumptions").

- Any market prices, including market transactions and broker quotes, that were available for the same or similar securities during the period, and the reasons why the preparer decided to reject them.<sup>9</sup>

Sensitivity information would provide greater transparency and help investors identify areas requiring further investigation. The disclosures would enable investors to be able to ask more informed questions of management in order to understand factors that could influence variability and risk. Such information would assist investors in their critical evaluations of projected future cash flows, earnings, capital requirements, and compliance with debt covenants.

Moreover, enabling investors to analyze trends in fair value amounts and disclosures adds considerable value to investors. For instance, if the range of the increase or decrease in fair value due to changes in reasonably possible alternative assumptions changes over time for a particular asset class, that disclosure could provide valuable information to investors as to management's view of the range of reasonably possible alternative assumptions and, therefore, the inherent volatility of the asset values.

## *2. Transfers in and/or out of Levels 1 and 2*

We support the proposal to mandate disclosures of movements across all three levels of the fair value hierarchy. Such disclosure would provide a more complete picture of activity across categories. Movements from one category to another often provide information about the stability of the market for a particular asset. Investors and other users of financial information would benefit from such disclosures as they develop a comprehensive picture of an entity's financial instruments. For these disclosures to be effective, they must be made on a gross rather than net basis.<sup>10</sup>

In addition, it is important that there be adequate disaggregation to provide information about which types of securities are being reclassified. There is valuable information communicated to investors when they can identify specific markets/assets in transition. Tables and associated disclosures about the reasons for these transfers would allow analysts to see if other institutions are making similar reclassifications for similar instruments. Such analysis can help investors have a better understanding of embedded risks that arise from holding certain assets.

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<sup>9</sup> Letter from Rebecca McEnally, Member, ITAC, to Russell G. Golden, FASB Technical Director, FASB, 3 (October 9, 2008), [http://www.fasb.org/cs/ContentServer?c=Document\\_C&pagename=FASB%2FDocument\\_C%2FDocument\\_Page&cid=1176156443728](http://www.fasb.org/cs/ContentServer?c=Document_C&pagename=FASB%2FDocument_C%2FDocument_Page&cid=1176156443728).

<sup>10</sup> *Cf.* Letter from Elizabeth Mooney, *supra* note 8, at 4 (Commenting on proposed disclosures about the credit quality of financing receivables and the allowance for credit losses and noting that “the netting of transfers into and out of impaired loans obscures trends in improving or declining credit quality and such flows should be reported gross on the rollforward reconciliation”).

### *3. Activity in Level 3 fair value measurements*

The current net disclosure of purchases, sales, issuances, and settlements does not allow investors to understand the degree to which an entity may be turning over its book. Given the relative opaqueness of Level 3 assets, providing more information regarding the activity in this bucket would be appropriate and would allow investors to better appreciate the risks associated with such instruments.

A useful rollforward, presented in a table format, would include disclosure of transfers into and out of the Level 3 category, fair value changes already recorded, and catchup adjustments or revisions to prior estimates resulting from experience that was different from that which had been assumed.<sup>11</sup> We recommend a detailed rollforward schedule for Level 1, 2, and 3 buckets going from last year's balance sheet date to this year's balance sheet date in order to give investors a more substantive understanding of a firm's activities.

#### **Proposed Clarifications to Existing Disclosure Requirements:**

##### *1. Level of disaggregation*

We support the proposal to provide fair value disclosures by “class” as opposed to “major category” in order to provide investors with a more granular and more appropriate level of detail regarding these measurements. The disclosures we currently often encounter are at such a high level as to be of limited usefulness to investors.<sup>12</sup>

For example, during the period leading to and throughout the financial crisis, it would have been helpful to identify firm-specific exposures to many of the particular subsets of the securitization markets as those markets began to break down. If investors do not have adequate information to analyze exposure to specific markets, they react by making assumptions about holdings. Markets act more efficiently and more rationally when investors have decision-useful information.

##### *2. Disclosures about inputs and valuation techniques*

Investors need to understand what assumptions underpin the fair value measurements and what models and techniques are being used to derive such measurements. This information provides investors with a starting point for determining the relative conservativeness or aggressiveness of management's measure, as well as the potential of the value moving higher or lower based on the application of reasonably possible alternative assumptions.<sup>13</sup>

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<sup>11</sup> Letter from Rebecca McEnally, *supra* note 9, at 2.

<sup>12</sup> Letter from Elizabeth Mooney, *supra* note 8, at 6 (Commenting on proposed disclosures about the credit quality of financing receivables and the allowance for credit losses and noting the FASB acknowledgment “that too much aggregation of certain data can obscure important information that would be material to investors”).

<sup>13</sup> See Stephen G. Ryan, *supra* note 4, at 15; cf. Letter from Elizabeth Mooney, *supra* note 8, at 9; cf. also Letter from Janet Pegg, *supra* note 8, at 5.

We would also add that many investors in financial institutions have expressed frustration at the lack of consistent disclosures between institutions as well as over time, thereby impeding comparative analysis. The disclosures outlined in the ED would help investors by providing improved consistency and structure, such as with the tabular disclosures on sensitivity.

**Additional Proposed Disclosure Requirements:**

While the proposed disclosure requirements offered in the ED improve disclosure quality surrounding fair value information, we have additional suggestions to achieve sufficient transparency and usefulness that the Board may want to consider in a final standard.

*Primary Market Matrix*

During the credit crisis, a significant issue was that some markets’ liquidity deteriorated at shocking speeds. A lesson learned is that Level 1 classification on one day provides no assurance for continuance of classification (i.e., when markets dry up). While it may be difficult to identify which markets are prone to a high risk of deterioration of liquidity and depth, it is a straightforward process to identify the infrastructure characteristics of the market.

Below is a basic example of the type of disclosure we feel would prove beneficial by outlining the market types by each category of securities held. The primary market categories would need to be defined in a principles-based way to segregate the information by substantively different market infrastructures.

By disaggregating the information by primary market categories, investors are provided with a sense of which particular types of instruments trade on established exchanges with vast infrastructure and which other instruments are more susceptible to the risk of unstable market infrastructure which could translate to a greater potential to become illiquid. The disaggregation principle should specify that instruments traded in distinct markets should be disclosed separately.

**Primary Market:**

	No Formal Market	OTC	Regional Exchange	National Exchange	International Exchange	Total
Equity securities		25			200	225
Commercial MBS		100				100
Consumer Mortgage	100					100

We appreciate the opportunity to share our views on the Exposure Draft. Should you or your staff wish to discuss any of our views, please feel free to contact the undersigned or any member of ITAC.

Sincerely,

Investors Technical Advisory Committee

By:

A handwritten signature in black ink, appearing to read "Michael Moran". The signature is written in a cursive style with a horizontal line at the end.

Michael A. Moran  
Member, ITAC

cc: Mr. Peter Clark, IASB Director of Research