



Consumer Federation of America

April 1, 2009



LETTER OF COMMENT NO.

292

Mr. Robert Herz
Chair, Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06865-5116



LETTER OF COMMENT NO.

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Re: FSP FAS 157-e: Determining Whether a Market is Not Active and a Transaction is Not Distressed; and FSP FAS 115-a, FAS 124-a and EITF 99-20-b: Recognition and Presentation of Other than Temporary Impairments (OTTI)

Dear Chairman Herz:

I am writing on behalf of the Consumer Federation of America to express our strong opposition to the above-referenced proposed staff positions regarding fair value accounting. Our opposition is based both on the substance of the proposals and on the troubling process under which they are being considered. The proposals deliver on two priorities for which struggling financial firms have lobbied aggressively: 1) giving firms greater flexibility to ignore market prices in valuing assets; and 2) making it easier for those same firms to hide losses in value on assets they plan to hold for the long term. Ironically, in giving financial institutions what they seek, FASB is undermining prospects for a quick economic recovery. Experience has shown that investors will be reluctant to commit capital to institutions whose valuations they don't trust and that financial institutions that only appear healthy as a result of accounting sleight of hand will be slow to return to the lending that is necessary to promote a broader recovery. Meanwhile, the credibility and viability of the independent accounting standard-setting process will have been dealt a severe, if not fatal, blow.

CFA does not have the resources, in the compressed time period allowed for comments, to provide a detailed, technical analysis of the proposals. Instead, this letter briefly highlights what we view as the primary concerns with both the substance of the proposals and the process under which they are being considered.

1) FASB's abuse of due process warrants consideration of structural changes to enhance the board's independence.

By rolling out these proposals in obvious direct response to congressional pressure, FASB has abandoned all pretence that it is an independent standard-setting body. By offering this radical change in policy with only a two-week comment period and with a vote scheduled for the following day, FASB has similarly abandoned any pretence that it is a body guided by expert analysis and a respect for due process. Some have defended FASB by noting that members of Congress had threatened to legislate the changes if FASB failed to act. Had FASB called their bluff, however, we believe all but the most brazen of the financial institutions' congressional allies would have quailed at the prospect of writing accounting standards through legislation under the critical eye of an angry public. Furthermore, there are responsible members of Congress, particularly in the Senate, who have a strong record of protecting the independence of the standard-setting process. FASB should have put more trust in these members' ability to stop efforts to legislate accounting standards and weaken FASB.

The harm FASB has done by caving in to political pressure goes beyond the immediate proposals on fair value accounting, bad as they are. In showing itself to be so easily manipulated, FASB has guaranteed that every future change in accounting standards that is opposed by a powerful special interest will be subject to a similar lobbying campaign and congressional interference. This is exactly the problem that Congress sought to address when it included provisions in the Sarbanes-Oxley Act to protect FASB's independence. It is unclear whether FASB's actions in this case reflect a problem with the current leadership of the board or a more fundamental lack of balance on the board. To address the latter problem, and to strengthen FASB's commitment to accounting transparency, we support a new requirement for recognition as an accounting standard-setting body that a majority of members of the board be investor representatives with the requisite accounting expertise and a commitment to protecting the public interest. We will be urging members of Congress to advance that goal as part of any regulatory reform plan.

2) The proposal for determining whether a transaction is distressed will lead to unrealistic asset valuations and accounting manipulation.

The proposed guidance for determining whether a transaction is a distressed is based on a false premise. It assumes that, in an inactive market, all transactions are distressed transactions whose prices can effectively be ignored by issuers in valuing their assets. As a result, even if you believe this proposal provides a reasonable basis for determining whether a market is inactive, it does not follow that it provides an appropriate means for valuing assets in such a market. In fact, we have yet to hear a good reason offered for abandoning the current method for valuing such assets, which allows issuers to make adjustments to market prices in an inactive market but requires them to disclose their basis for doing so. In light of the strong incentive financial institutions have to hide losses, giving issuers broad discretion to rely on subjective valuation models is a clear invitation to accounting manipulation. Based on their past record, and the equally poor record of financial regulators in holding them accountable, we have little doubt it is an invitation that will be eagerly accepted.

3) The proposal for recognition and presentation of other than temporary impairments takes a flawed policy and makes it worse.

FASB's second proposal would similarly weaken criteria governing when impairments to debt and equity securities have to be reflected in earnings – an area of accounting already given to inconsistent treatment. Under the current criteria, in order to claim losses as temporary, management must show it is able to hold the impaired asset until an anticipated recovery in its value is realized. This is particularly important for financial institutions that fund long-term obligations with short-term debt and may therefore be vulnerable to a liquidity crisis, an issue of direct relevance to the current crisis. Under the proposal, however, that standard would be replaced with a requirement that management simply assert that it is more likely than not that it will not have to sell the security before its recovery. The proposal contains an additional provision that allows managers to draw a distinction between impairments attributable to credit losses and those caused by other factors; only the former would have to be recognized in earnings, while the latter would be reflected in other comprehensive income. By weakening the standards for determining whether an impairment is temporary, this approach makes it far easier for financial institutions to paper over their losses on toxic assets and deprive investors and regulators of the information they need to assess the institutions' long-term health. With its completely unrealistic provision separating out the causes of impairments, it also provides a ready tool for those seeking to manipulate earnings.

4) Concerns about pro-cyclicality should be addressed through capital requirements.

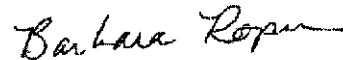
The justification given for weakening fair value accounting standards is that, in an inactive market, these standards require financial institutions to mark down the value of their assets to unrealistically low levels, thus triggering capital adequacy requirements at the very time when it is most difficult for financial institutions to raise capital. While we are sympathetic to those concerns, we believe they are best addressed through adjustments to capital requirements. We suggest this with some trepidation, knowing that financial regulators have shown themselves to be all too easily pressured by the institutions they purport to regulate and may prove irresponsibly lax in adjusting those requirements. However, we believe this is at least somewhat less likely to occur if fair value accounting standards remain intact, providing insight into the degree of regulatory adjustments being made. (In fact, this potential disciplining effect of fair value accounting could explain what would otherwise appear to be an irrational focus by policymakers on the messenger rather than the message.) Regardless of the potential pitfalls, addressing the problem of capital standards directly is clearly better than adjusting fair value accounting standards in a way that creates the impression that all is well when it is not. This is the route the Japan followed during its bank crisis, an approach that led to Japan's lost decade.

Conclusion

If adopted, these proposals will reduce transparency, undermine investor confidence, delay the economic recovery, and destroy FASB's credibility as an independent standard-setting body. Misguided and harmful as they are, these proposals might be excusable if we had not already lived through the savings and loan debacle, the Japanese banking crisis, and the Enron-era accounting scandals. But we have made these same mistakes before, with disastrous

consequences, and should have learned from the experience. Doing the same thing over and over again and expecting a different outcome is the classic definition of insanity. By that standard, these proposals are not only misguided and harmful, they are insane.

Respectfully submitted,



Barbara Roper
Director of Investor Protection

cc: Christopher Dodd, Chairman, U.S. Senate Committee on Banking, Housing and Urban Development
Richard Shelby, Ranking Member, U.S. Senate Committee on Banking, Housing and Urban Development
Barney Frank, Chairman, U.S. House Committee on Financial Services
Spencer Bachus, Ranking Member, U.S. House Committee on Financial Services
Mary Schapiro, Chairman, U.S. Securities and Exchange Commission
Luis Aguilar, Commissioner, U.S. Securities and Exchange Commission
Kathleen Casey, Commissioner, U.S. Securities and Exchange Commission
Troy Paredes, Commissioner, U.S. Securities and Exchange Commission
Elisse Walter, Commissioner, U.S. Securities and Exchange Commission