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LETTER OF COMMENT NO. 75

**File Reference: Proposed FSP FAS 157-d**

First Commonwealth appreciates the opportunity to comment on Proposed FASB Staff Position No. FAS 157-d, “Determining the Fair Value of a Financial Asset in a Market That is Not Active.” First Commonwealth is a \$6.2 billion NYSE listed financial institution headquartered in Indiana, Pennsylvania. First Commonwealth is particularly interested in this proposal since, not only are we an issuer of financial statements, but as a financial institution we are members of one of the largest users of financial statements, being creditors.

Paragraph 9a of FSP FAS 157-d states, “A fair value measurement represents the price at which a transaction would occur between market participants at the measurement date.” We believe this definition does not adequately take into account the seller’s position in markets that are in turmoil and the seller’s ability to hold these investments until fair values recover.

We believe FSP FAS 157-d should include a statement that users of financial statements should be careful not to over rely on valuations by third party pricing services for determination of OTTI in inactive markets. The inactivity of the markets will lead to the utilization of more assumptions and could reduce the comparability with other holders of the instruments and its reliability.

Under normal market conditions, both interest rate risk and credit risk factor into determining fair value. Liquidity risk plays a lesser role in determining fair value and is generally not used in discounted cash flow models because it is insignificant. Paragraph 5 of FAS 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. We believe that incorporating a liquidity component is contrary to the “orderly transaction” intentions of FAS 157 and fair value accounting. To introduce a liquidity factor is inconsistent with the concept of an orderly transaction.

Measuring liquidity risk in an inactive market will require the use of outside consultants at considerable expense to financial institutions. FSP FAS 157-d specifically states that “all available market information that could be obtained should be considered without undue cost and effort.” Yet translating liquidity risk into basis points to be included in the discount rate of a cash flow model is a difficult and costly endeavor amid the market turmoil that exists. We believe the determination of a liquidity component is a complex and inexact science, and after incurring substantial costs to identify will result in output that provides little benefit to the users of financial statements.

It would be more beneficial to see liquidity risk eliminated from FSP FAS 157-d. If liquidity risk is not eliminated from the FSP, FASB should provide specific guidance on measuring this risk component in an



illiquid market that does not involve “undue cost and effort.” We also believe that if liquidity risk is identified it would be more appropriate to include it’s affect as part of Other Comprehensive Income with appropriate footnote disclosures, instead of through earnings.

Paragraph A32F defines liquidity risk as “compensation that a market participant receives for buying an asset that is difficult to sell under current market conditions.” We suggest better wording would be to change “current market conditions” to “normal market conditions” particularly when the holder of the investment has the intent and ability to hold to maturity. We believe this would be consistent with the intention of FAS 157 and fair value accounting.

According to FSP FAS 157-d, “in some cases an entity may determine that observable market data (level 2) require significant adjustment based on unobservable data and thus would be considered a level 3 fair value measurement.” If a company is using level 3 inputs to determine fair value in a discounted cash flow model and they disclose their methodology in the financial statements as required, they should not have to incorporate level 2 inputs into the valuation technique. The level 2 inputs (nonbinding broker quotes) have not been found to be consistent or reliable in an inactive market. We believe the inclusion of market data in level 3 was not the intention of FAS 157. Additionally, a more meaningful approach to determining fair value in an inactive market would be to use the present value of discounted cash flows as described in EITF 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.”

*The intent of FASB in issuing FAS 157, “Fair Value Measurement,” was to provide increased consistency and comparability in fair value measurements and to provide expanded disclosures about fair value measurements. Not only do we believe that FSP FAS 157-d has not accomplished this, but fair value accounting in general has resulted in inconsistent application and measurement of financial instruments on the financial statements of both buyers and sellers.*

In conclusion, we believe that FSP FAS 157-d does not provide the consistency and comparability for financial statement users that the FASB desired to achieve. We believe that the proposal needs to better define a market participant; include a statement that users of financial statements should be careful not to over rely on valuations by third party pricing services for determination of OTTI in inactive markets; eliminate liquidity risk or alternatively provide specific guidance on measuring this risk component; incorporate normal market conditions rather than current market conditions in fair value measurement; and give the present value of discounted cash flows as described in EITF 99-20 more credibility in measuring fair value. Indications are that both external audit costs as well as internal costs to comply with this proposal will increase and exceed the intended benefits.

We appreciate the opportunity to comment on the proposed FSP and would be pleased to discuss our comments with Board members or the FASB staff. If you have any questions, please contact Ed Lipkus at (724) 463-4724, or at the above address.

Sincerely,

Edward J. Lipkus III  
Executive Vice President and Chief Financial Officer