

TO: FASB

From: David Polson, AXA Investment Managers

Subject: Recent Proposals on Accounting for Financial Instruments

Date: September 1, 2010

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Below are my answers to the questions from the May 26<sup>th</sup> exposure draft on the Accounting for Financial Instruments. The answers are my own and are not intended to reflect the opinions of my firm.

- 1) I strongly disagree with the scope of financial instruments that are proposed to be measured at fair value (FV). I think the current system whereby most financial instruments that are to be held to maturity (HTM) are measured at amortized cost (AC), and those available-for-sale (AFS) are measured at FV, while perhaps always could be improved, is in fact very sensible and makes this current initiative totally unnecessary and counterproductive. I also think it makes sense that firms can use a "modeled" FV of a financial asset if there is no active market for such an asset, based on discounted expected cash flows. It is also very informative that banks show reserves for underperforming loans in accordance with regulatory guidance, and as analysts we can judge the value of loans as shown today by a firm against such reserves.

Perhaps a brief and general discussion in the notes to the statements on the effect of applying FV accounting to HTM assets would be interesting, as well as a discussion on how the firms come to the determination of including the assets in either the HTM or AFS bucket.

Among the main reasons for my opposition is that, to me, FV is either more subjective or misleading than the current system. Subjective, because management has to use significant judgment to determine what the FV of so many loans or illiquid securities are. If all the firms widely used such judgment then I think that these firms' balance sheets would not be comparable to each other. Misleading, because market volatility will cause the published values to change radically from period to period (positive and negative), so any one period's values will not be meaningful to me. As a result, in the proposed system *I will have to take a lot of time and effort to adjust most of the values back to what I think are amortized cost or par values*, so as to make the firms comparable and to remove the unnecessary noise.

When it comes right down to it, I want to know as an analyst of a bank or similar firm what amount of actual money the firm is owed by customers, not a distorted value dictated by the whims of the marketplace or by the judgment of management.

- 2) This is a strangely worded question – following from my answer to question 1, I certainly do not believe any HTM loans should be measured at FV. While there may not really be a "maturity" for revolving credit, perhaps some kind of FV could be provided if they are AFS.

- 3) I as well strongly disagree with the proposal to measure deposits and related liabilities at FV. This proposal to me is madness. A FV for a deposit would be bizarre and meaningless to me, based on the short-term whims of the financial markets and the judgment of management. As an analyst I want to know the amount of actual deposit money that the bank owes to customers.
- 4) I agree with the change, but think the total criteria should be different. Criteria (a) is fine. I disagree with (b), (c) , (e), and (f) and believe they should be removed. Criteria (c) is fine to me only if “or former” is taken out.
- 5) No I do not think it provides useful information and the process creates “noise” that I will have to end up backing out to get to a more useful answer for net assets. A brief and general discussion by the company in the notes would be helpful for us to understand the potential for liabilities to change in various market environments.
- 6) No, I believe the FVs will be based on management judgment and stem from inordinate volatility that will have to be removed by me to get to arrive at a more useful balance sheet. A brief and general discussion by the company in the notes would be helpful for us to understand the potential for liabilities to change in various market environments.
- 7) I have never liked the FV method for most liabilities from the start and look forward to the day that it ends.
- 8-11) Given that I am opposed to the FV proposals, these questions are more or less irrelevant to me.
- 22) No, this process creates excessive noise based on management judgment and capital market whims, and I think a general discussion of how changes in interest rates could affect asset values is more than sufficient.
- 23) Since I answered no for question 22 I certainly feel the same for question 23.
- 24) While seeing FV next to AC would be “interesting” to me, it would not be particularly meaningful to me as a user. In fact, I think putting FV on the face of financial statements would promote a misleading and distortive picture of a firm’s financial health.
- 25) If a hybrid is AFS, FV into net income is fine. Otherwise I suggest no change to the current system.
- 26) I do not understand the question, so I abstain.
- 27) Short-term payables and receivables are fine at amortized cost.
- 32) Since I am against the FV proposal, I abstain from the question.
- 33) Since I am against the FV proposal, I abstain from the question.
- 34) Since I am against the FV proposal, I abstain from the question.

35) Since I am against the FV proposal, I abstain from the question.

36) Since I am against the FV proposal, I abstain from the question.

37) I do not understand the question, so I abstain.

38) I am against the proposal for loans. To my knowledge, banks are required to put up a reserve for a loans of various levels of substandard quality (even if the loans are paying and there are no expectations of a near-term default), so I do not see how this proposal improves user information value, and in fact I think the reserving system is sophisticated and conservative. With regards to HTM debt securities, I think there is some wisdom in the proposal to the extent that the reporting firm would be a little more conservative in the assessment of how it marks down securities with particularly poor credit, but there should be clear guidance on what the thresholds are for judging the decision to impair.

39) I agree since changes in foreign exchange rates, prepayment rates and variable interest rates can volatile and temporary so impairments from such trends would not be meaningful in each period.

40) I abstain from the question since I am not familiar with specific methods for evaluating historical loss rates for pooled assets.

41) I would be fine with that technique.

42) Hard to answer - if the asset "has no indicators" of being impaired, does that mean it's uniquely performing well? If so then certainly I think there should not be a use of "similar" assets to judge impairment.

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44) I would prefer the expected-loss method that includes assumptions of various future outcomes.

45) I do not understand the proposal.

48) No, I do not think interest income should be adjusted based on fair value adjustments for the asset itself. Marking down an asset based on some lesser probability of receiving cash flows at some point should not be accompanied by further judgment by management on what an "effective" interest is that would be different than what the firm is actually receiving. I think this is a confusing and strange proposal.

49) Since I am against the fundamental proposal, I abstain from the question.

50) Since I am against the fundamental proposal, I abstain from the question.

51) Since I am against the fundamental proposal, I abstain from the question.

52) No, see answer to 48.

53) No, see answer to 48.

54) No, see answer to 48.

55) No, the fair value given for the asset should capture the judgment about future interest to be received. If they are actually receiving interest, they should accrue it.

56) I do not agree with the proposal because I did not see in the FASB exposure draft any guidance about what constitutes a “reasonably effective” hedge. Without guidance then different firms’ statements will not be comparable due to different management judgments as to what is “reasonable.”

57) The effectiveness valuation should be reexamined regularly and the hedge benefit should be removed if the hedge is found to be no longer effective.

58) I do not know

59) I am confused by the proposal – why would management institute hedge accounting if they have to report all the fair value changes anyway? Perhaps my confusion has something to do with my opposition to FV for HTM (or at least long held) assets.

60) I abstain from the question since I am confused by the overall proposal.

65) Since I am opposed to the vast majority of proposals, then I disagree in principal with most of the disclosure requirements.

66) What would be useful to me would be a general presentation and discussion by the firm, in the statement notes, as to the amounts of purchased financial assets the firm has on the balance sheet, the amounts purchased in the recent period, and the methodology behind their valuation. Beyond this, I would not be particularly interested in the details behind the methodology for each asset.

68-71) Since I am opposed to the vast majority of proposals I abstain from these questions.