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31 March 2009

Proposed FSP FAS 157-e, *Determining Whether a Market is Not Active and a Transaction Is Not Distressed*, and the proposed FSP FAS 115-a, FAS 124-a, and EITF 99-20-b, *Recognition and Presentation of Other-Than-Temporary Impairments*

Dear Mr. Golden:

We appreciate the opportunity to comment on the proposed FSP FAS 157-e, *Determining Whether a Market is Not Active and a Transaction Is Not Distressed*, (proposed FSP 157-e) and the proposed FSP FAS 115-a, FAS 124-a, and EITF 99-20-b, *Recognition and Presentation of Other-Than-Temporary Impairments*, (proposed FSP 115-a).

We believe the current economic crisis has led to extraordinary market conditions that raise important issues about the measurement of fair value and the use of that measurement in financial reporting, as well as the recognition of asset impairments. These issues must be carefully and deliberately considered by accounting standards setters. We commend the FASB for taking on those challenging issues.

We understand the concerns raised by various industry groups (e.g., banks and insurance companies), their regulators, and members of Congress, regarding the effect of fair value accounting on regulatory capital of financial institutions and the issue of pro-cyclicality from a public policy perspective. We support addressing such concerns through changes in the impairment model as outlined in proposed FSP 115-a and provide additional commentary on that proposal in Appendix A. Proposed FSP 157-e, however, would appear to allow companies to recognize financial assets at amounts that could not be realized in current market conditions, a result that we find inconsistent with the fundamental objective of fair value accounting. We continue to believe that investor confidence is a critical component of any market recovery and that any actions that serve to reduce the transparency afforded investors through financial reporting will prove detrimental to this objective.

We are concerned that the guidance in proposed FSP 157-e as currently drafted appears to represent a departure from the concept that fair value represents an exit price that could be realized in a transaction between market participants on the measurement date. Proposed FSP 157-e seems to introduce a concept of an exit price that could be achieved in a hypothetical active market that, in the circumstances in which the proposed FSP would apply, does not exist on the measurement date. Accordingly, it is not clear that the entity could realize that exit price in current market conditions, regardless of the time and effort expended to market the assets. As drafted, we believe proposed FSP 157-e would represent a fundamental change to the principles of FASB Statement No. 157, *Fair Value Measurements* (Statement 157), that could have significant implications for the measurement of many assets and liabilities. As such, we believe this potential change deserves more careful consideration than is possible during the accelerated timeframe contemplated by the FASB.

Consistent with the above described views, we urge the FASB to reconsider the guidance in proposed FSP 157-e, with a focus on the broad implications associated with changing the objective of a fair value measurement. While we believe that the changes in proposed FSP 115-a are generally useful in that they would provide greater information to investors and result in reported net income or loss that is more consistent with management's expectations about the expected cash flows of its financial assets, we do have certain recommendations about that proposal that are described in Appendix A to this letter. For example, we believe further guidance is necessary on evaluating equity securities for other-than-temporary impairment, particularly with respect to the interaction of the amendments in proposed FSP 115-a with the assessment of the severity and duration of a decline in value.

Ernst & Young has continually and strongly supported independent standard setting free of undue political or regulatory pressure, but subject to appropriate oversight and constituent input, as the only means to successfully achieve high quality standards that provide the most useful information for investors. There is oftentimes a tension in due process between the need for immediate action on the one hand and the benefit obtained from seeking appropriate input from affected constituents and the subsequent thoughtful analysis of the issues on the other. We appreciate the magnitude of the issues the FASB is addressing, the extraordinary nature of current market conditions, the concerns of certain constituents and the pressure placed on the FASB to respond to those concerns. However, in this particular standard-setting exercise, we believe the FASB has overemphasized the need for speed and runs the risk of issuing guidance that does not sufficiently consider substantive input and that could lead to unintended consequences. While we commend the FASB in its efforts under the circumstances to maximize the period for constituents to provide comments on these important proposals, we question the extent to which constituent feedback can be adequately considered in the very brief period in which the Board is trying to address these issues. The abbreviated due process is disturbing as it may compromise efforts to issue high quality accounting standards. We encourage the FASB to resist these pressures and proceed deliberately and thoughtfully before issuing a final standard.

We are troubled by the FASB's decision to unilaterally address these issues in an era in which convergence between U.S. Generally Accepted Accounting Principles and International Financial Reporting Standards established by the International Accounting Standards Board (IASB) is a key objective. We believe that unilateral actions by either the IASB or FASB could lead to opportunities for accounting arbitrage as well as for pressure on one standard setter to match changes made by the other standard setter; potentially resulting in piecemeal, competing changes that would not result in high quality standards for the accounting for financial instruments and could, in fact, result in a "race to the bottom" with respect to the quality of accounting standards.

As discussed in our comment letter on the IASB's and FASB's joint discussion document, *Reducing Complexity in Reporting Financial Instruments*, we believe that it is vital that the IASB and FASB work together to develop a consistent accounting model for financial instruments, and we are pleased that the IASB and FASB recently announced their plans to begin such a project soon. We believe that this model should provide a more consistent recognition and measurement framework for all financial instruments, whether in the form of loans or securities.

We believe that the primary objective of general-purpose financial statements is to provide current and potential investors with the information necessary to make their investment decisions. This focus is consistent with recent recommendations of the SEC's Advisory Committee on Improvements to Financial Reporting (CIFiR) as well as the conclusions of the SEC staff in its recent *Study on Mark-To-Market Accounting*. We continue to believe that fair value measurements provide the most useful and transparent information to investors. However, as discussed further below, we understand that there may be circumstances in which those measurements are considered so unreliable by the FASB and IASB (e.g., when transactions for certain classes of assets have effectively ceased because of vastly divergent expectations of willing buyers and willing sellers regarding an appropriate return on the assets) that users' needs may be best served by disclosing fair value information in the notes to the financial statements, including the range of potential values, but recognizing and measuring those instruments on a different basis. However, we believe any such exceptions to fair value measurement should only be provided after careful consideration and due process.

In general, we believe that it is inappropriate to develop accounting standards for general purpose financial statements with a primary objective of promoting financial stability, certain economic outcomes or political objectives. To best serve investors, general-purpose financial statements must provide transparent information without bias. Introducing a bias in financial reporting to reduce any "pro-cyclical" effects will, in our view, only serve to reduce investor confidence in financial statements by increasing uncertainty about reported financial information, thereby increasing the cost of capital. Prudential regulators have a critical role in the proper functioning of our economy. However, they have information needs that may differ from those of investors and also have the ability to obtain additional information that is generally not available to investors. Accordingly, we believe that prudential regulators should adjust financial information reported under US GAAP as necessary to establish and monitor the capital positions of financial institutions. We believe that the proposed model for other-than-temporary impairments will provide prudential regulators with the information necessary to make any necessary adjustments, without the need to alter the objective of a fair value measurement.

Additional comments about the proposals are provided below.

General Comments

There is little doubt that illiquidity in the current market environment has made estimating the fair value of many financial assets very difficult. Estimating an 'equilibrium price' that balances the demands of willing buyers and willing sellers presents a challenge when the expectations of these two groups differ dramatically. While secondary markets for many of the securitized assets held by companies today may never have been as active as some believed, the steady flow of new issuances prior to 2008 served to provide an indication of the prices investors in these types of securities were willing to pay. However, the recognition by many institutions of the need to deleverage, coupled with the uncertainty pertaining to the economy as a whole, has led to a repricing of risk in the capital markets. In some instances, this has resulted in a general lack of demand for certain types of assets in their current form (e.g., certain securitized loans). In other instances, factors such as regulatory capital requirements and cost of carry considerations have resulted in a change in the likely willing buyers for certain asset classes. These and other factors have resulted in many companies significantly writing down (either through earnings or other comprehensive income) the value of certain of their financial assets for financial reporting purposes. While either treatment of decreases in values results in a reduction of a company's book equity, assets written down through earnings (e.g., because the assets are classified as trading or because the impairment is deemed to be other than temporary) also have a negative effect on the capital adequacy of regulated financial institutions such as banks.

One of the primary concerns expressed by constituents with respect to the current framework regarding accounting for financial instruments relates to the reporting of other-than-temporary (OTT) impairment on debt securities. Under the current framework, companies have had to recognize significant non-cash charges for debt securities for which the impairment was deemed to be OTT (i.e., it was probable the investor would be unable to collect all of their contractual or expected cash flows). In many cases, the amounts of these non-cash charges were well in excess of actual incurred credit losses. This issue stems from the requirement that, once an impairment is deemed OTT, the security be written-down to its fair value with the write-down reported as a charge to earnings. In some cases impairments were deemed OTT simply because the entity was not able to assert the intent and ability to hold the impaired security to recovery. In markets that are illiquid, these write-downs reflect not only changes in fair value resulting from incurred or expected credit losses, but also changes stemming from various other factors affecting the fair value of the asset, including lack of market demand, adjustments for uncertainty, increased cost of carry and other issues affecting liquidity. As a result, regulatory capital of financial institutions has been reduced for unrealized losses in excess of incurred or expected credit losses, with the excess of the total charge over the amount of incurred or expected losses accreted back through earnings (for banks, through the interest margin measure) over the remaining life of the security. Here too, many have questioned the usefulness of an interest margin measure that includes the effect of the accretion of previously recognized non-credit losses.

In our view, the consideration of a reporting entity's intent is at the heart of the current fair value debate. Many have questioned the requirement to report an asset at its current exit price, thereby considering market participant adjustments for liquidity and uncertainty, when the reporting entity does not intend to the sell the asset in the current environment and therefore will presumably never be forced to realize the perceived decrease in the value of the asset related to these factors. Those who oppose the use of fair value argue that the requirement under Statement 157 to estimate an exit price at the measurement date is often inconsistent with the reporting entity's business model and at odds with the presumption that the entity is a going concern. Said differently, they appear to believe that an entity would never willingly sell into a buyers' market. While the debate regarding reporting entity intent is likely to continue, we believe the issue of intent is best dealt with through consideration of the appropriate measurement objective to be used, not in the context of how a required measurement objective is estimated. Therefore, it is our view that the issue of intent can be more effectively addressed in the short term through guidance associated with the impairment model, not fair value measurements. Under the guidance in proposed FSP 115-a, unrealized losses stemming from factors other than incurred credit losses would generally be recognized in earnings only when (i) the reporting entity intends to sell an impaired security or when it is more likely than not the reporting entity will have to sell the security, (ii) the security is classified as trading (or the fair value option was voluntarily elected), or (iii) when the reporting entity follows specialized guidance that requires the use of fair value accounting (e.g., broker-dealers and investment companies). In each of these instances, recognizing changes in the full fair value of the asset through earnings would seem to be generally consistent with the business model of the reporting entity.

As such, we believe the guidance in proposed FSP 115-a would significantly reduce the downward pressure being exerted on financial institutions' regulatory capital, and the corresponding pro-cyclicality concerns, without reducing investor transparency. In addition, proposed FSP 115-a would serve to reduce complexity in financial reporting by better aligning the impairment accounting for loans and debt securities.

Comments regarding proposed FSP 157-e

While we support the Board's efforts to provide additional guidance to further assist constituents in determining when a market is not active and when a transaction is not orderly, we have significant concerns about the guidance in proposed FSP 157-e. We do not believe proposed FSP 157-e clearly articulates the measurement objective for financial assets in markets that are not active. In the illustrative example provided, the entity looks to two data points in estimating the appropriate discount rate to use in estimating the fair value of an asset whose market is no longer active and in which quoted prices are determined to be distressed: (i) the estimated rate of return for the illiquid instrument in a "hypothetical active market", and (ii) bid-level yields adjusted for a reasonable risk premium. It is unclear to us whether either of those data points, as described, is intended to (or even could) be based on actual market data. If the example is intended to imply that a reporting entity should look to transactions in active markets to estimate the price a willing seller would like to receive for the asset and to transactions (presumed to be distressed) in inactive markets to estimate the price a willing buyer would like to pay for the asset as a means to establish a hypothetical bid-ask spread, we suggest that this point be articulated more clearly. In addition, while the example clearly makes use of the practical expedient allowed for in paragraph 31 of Statement 157 to price assets at the midpoint between the bid and ask prices, we question whether the FASB believes this approach is appropriate regardless of the size of the implied bid-ask spread. For example, if the possible rates of return in the illustrative example were 6% - 30%, would a discount rate of 18% be considered a reasonable input? Without additional clarification, the FSP could be interpreted to advocate a "split the difference" approach that would result in liquidity adjustments being reduced by 50% upon the adoption of proposed FSP 157-e. If a "split-the-difference" approach was not what the Board intended, additional clarity should be provided regarding the degree of flexibility management would have in estimating fair value at any point within the hypothetical bid-ask spread.

It would appear to us that the primary objective of proposed FSP 157-e is to deemphasize the use of observable market transactions and quoted prices in estimating fair value when markets are not active. On various occasions, the FASB and others have indicated a belief that, despite the guidance provided in FASB Staff Position No. 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset is Not Active* (FSP 157-3), an inappropriate bias towards the use of so-called last transaction prices continues. However, we believe that preparers and auditors generally have made a good faith effort to apply the guidance in Statement 157 and FSP 157-3 based on the best information available. The Board has also indicated that proposed FSP 157-e does not amend the objective of a fair value measurement, but rather solely provides application guidance "for making fair value measurements more consistent with the principles presented in FASB Statement No. 157."[1] We disagree with this assertion as the measurement described in proposed FSP 157-e, as drafted, does not appear to be representative of a current exit value.

We believe the guidance issued in October 2008 in FSP 157-3 provided useful clarification on a number of central issues regarding the application of Statement 157 in markets that are not active. FSP 157-3 highlighted the need for preparers and auditors to consider the 'relevance' of market data in assessing the priority of inputs under the fair value hierarchy and was clear that observed transactions in inactive markets are not necessarily determinative of fair value. Although observable, these data points may not be relevant and, therefore, could require significant adjustments rendering them Level 3 measurements.

While FSP 157-3 reiterated the need for constituents to use professional judgment when estimating fair values in illiquid markets, it explicitly noted that the fair value objective remained the same regardless of the level of activity in a market – the price that would be received by the holder of the asset in an orderly transaction at the measurement date. That is, fair value is the exit price that would be received in a transaction that was not forced (or distressed) but is executed *in the current market*, even when that market is not active at the measurement date. Under this objective, the exit price contemplates a *hypothetical orderly transaction* in which the asset is exposed to the market for a usual and customary period of time prior to the measurement date and market participants are motivated but not compelled to transact. Conversely, the guidance in proposed FSP 157-e seems to contemplate not merely a hypothetical transaction, but a *hypothetical market*. As noted above, the proposed amendments to paragraph A32F of Statement 157 discuss "an estimated rate of return....in a hypothetical active market at the measurement date." In addition, the required presumption in proposed FSP 157-e that transactions in inactive markets are distressed would seem to imply that orderly transactions generally occur only in active markets.

We do not believe a fair value measurement that presumes an exit price in an active market that does not exist at the measurement date is consistent with the principles outlined in Statement 157. Instead, factors associated with the current market for the asset being measured that could influence its exit price need to be considered in a fair value measurement, including the willing buyers that currently exist for the asset (even when different from those that had historically existed), and supply and demand dynamics, to name a few. This view seems consistent with a May 2008 FASB article, "Some Facts about Fair Value,", which stated that "[Statement] 157 clarifies that the fair value estimate is intended to convey to investors the value of the asset or liability at the measurement date (a current value), not the potential value of the asset or liability at some future date (for example the amount a reporting entity expects to realize on settlement or maturity)." Therefore, in our view, guidance clarifying that a fair value estimate contemplates not only a

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[1] March 17, 2009 FASB press release "FASB Issues Proposals to Improve Guidance on Fair Value Measurements and Impairments"

hypothetical transaction, but also a hypothetical market at the measurement date, does not constitute application guidance, but, rather, a fundamental change in what preparers are attempting to measure. In addition, the measurement approach outlined under proposed FSP 157-e would appear to create inconsistencies with the views expressed in the IASB Expert Advisory Panel paper, *Measuring and Disclosing Fair Value of Financial Instruments in Markets That are No Longer Active.*[2] These inconsistencies would reduce comparability among financial institutions globally and could result in a reporting entity that prepares financial statements under both US GAAP and IFRS recognizing the same asset at different "fair values."

Finally, we have significant concerns about the ability of constituents to apply the requirements of proposed FSP 157-e in the extremely limited timeframe suggested by the FASB. As noted above, the Board appears to be changing for all entities the measurement objective for assets that do not trade in active markets. We believe constituents will require time to adjust their valuation processes to meet the revised objective. In particular, we believe the extent to which the proposed guidance will affect an entity's ability to utilize pricing service information and broker quotes in estimating fair value for assets that don't trade in active markets needs to be better understood. While additional analysis is required, the presumption that quoted prices in inactive markets are distressed unless the reporting entity has evidence to prove otherwise is likely to require the use of model valuations for many more assets. While certain large financial institutions may have these models in place for specific asset classes, many other constituents do not and will struggle to meet the requirements of proposed FSP 157-e in the allotted time for adoption. Accordingly, we do not support an effective date that would require mandatory adoption of FSP 157-e for periods ending after 15 March 2009.

Alternative Considerations

While not our preference, if the Board determines to go beyond proposed FSP FAS 115-a, we believe limiting the use of fair value is preferable to characterizing a measurement as a fair value measurement when it does not to represent a current exit price. Inconsistent use of the term "fair value" will distort and confuse the meaning of the measurement. If the Board determines that recognizing and measuring financial assets at their estimated exit price in an orderly transaction assumed to occur in the current market at the measurement date is too unreliable in certain circumstances (e.g., when the market is not active and transactions in these markets imply large liquidity risk premiums), we believe users' needs may be better served by disclosing fair value information, including the range of potential values, but recognizing and measuring those instruments on a different basis. As such, the Board could consider an approach that limits the use of fair value measurement for securities subject to Statement 115 to those financial instruments that trade in an active market (as determined using Step 1 of proposed FSP 157-e), and those that management intends to sell in a current inactive market. Under this approach, financial instruments not subject to recognition and measurement guidance in Statement 115 (e.g., derivatives, investments accounted for under specialized industry guidance that requires the use of fair value,

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[2] For example, paragraph 19 of the IASB Expert Advisory Panel paper states the following: "When a market is not active, an entity measures fair value using a valuation technique. The technique chosen should reflect current market conditions. Therefore, a transaction price in the same or a similar instrument should be considered in the assessment of fair value as a current transaction price is likely to reflect current market conditions."

and instruments subject to the fair value option) would continue to be measured at fair value.[3] In our view, this approach, while not our preference, is preferable to suggesting that the measurement described in proposed FSP 157-e is a fair value measurement for the following reasons:

- We continue to believe that investor confidence is a critical component to any market recovery and that any actions that serve to reduce the transparency afforded investors through financial reporting will prove detrimental to this objective. If investors are not provided fair value information they believe to be reliable through the financial reporting process, it is likely they will determine their own estimates of fair value that could include even greater adjustments for uncertainty. Under this alternative, investors would continue to be provided with fair value measurements for financial assets and liabilities determined in accordance with the principles of Statement 157 through the disclosure requirements of FASB Statement No.107, *Disclosures about Fair Value of Financial Instruments* (Statement 107). In addition, proposed FSP 157-b and APB 28-a, *Interim Disclosures about Fair Value of Financial Instruments,* which the Board is currently redeliberating, would require these disclosures to be provided when interim financial statements are issued (e.g., on a quarterly basis for public companies).

- Changing the objective of a fair value measurement when markets are not active and transactions are distressed will have broad implications. For example, investment companies (such as mutual funds and hedge funds) would be required to mark their assets to the measurement prescribed in proposed FSP 157-e, even though they would likely not be able to exit the positions in the current market at these prices. For entities that provide ongoing liquidity to their investors (via subscriptions and redemptions at a net asset value determined in accordance with GAAP), recognizing financial assets at an amount in excess of a current exit price could have serious repercussions. The effect on other operational areas, such as margining, is also cause for concern, as we question whether an entity's risk management policies would allow for marking collateral based on the guidance provided in the proposed FSP 157-e.

- As currently drafted, it would appear to us that the guidance in proposed FSP 157-e would provide entities with a disincentive to sell certain assets. Proposed FSP 157-e provides entities with a great deal of flexibility in valuing financial assets when quoted prices are determined to be associated with distressed transactions. This approach is predicated on the presumption that quoted prices in markets that are not active are distressed unless the reporting entity has evidence to refute this presumption. Based on the lack of transparency in many inactive markets, it is likely to be uncommon that many entities will have such evidence. However, in situations in which the reporting entity is the seller of the asset, the entity is more likely to have access to available evidence indicating: (i) there was sufficient time before the measurement date to allow for usual and customary

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[3] To address concerns about hedge accounting and similar issues, the Board could consider providing entities with the ability to elect the fair value option for those instruments that are no longer considered to trade in active markets and, therefore, would no longer be subject to fair value measurement under the proposed revisions to Statement 115.

marketing activity for the asset and (ii) there were multiple bidders for the asset, and, therefore, the transaction was not distressed. In addition to the potential for recognizing a realized loss on sale, transactions not determined to be distressed may be a relevant observable input that would need to be considered in estimating the fair value of the entity's remaining positions. The knowledge of that potential outcome may cause entities to avoid selling financial assets, thereby inhibiting the flow of transactions and participation in the Troubled Asset Relief Program and similar initiatives. Further, it is not clear what effect transactions under those programs will have in either determining fair value or assessing whether markets are active. The potential for such unintended consequences underscores the need for thoughtful and deliberate consideration of the substantive input FASB receives.

If, however, the Board is not persuaded by the above concerns and decides to move ahead with proposed FSP 157-e, we strongly suggest that this measurement be characterized for what it would be - something other than fair value - and that appropriate disclosures be provided. In addition, we recommend that a number of clarifications be made in order to make the guidance more understandable and operational. These recommendations are provided in Appendix B to this letter.

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We would be pleased to discuss our comments with the Board members or the FASB staff at your convenience.

Very truly yours,

Ernst & Young LLP

Specific recommendations related to proposed FSP 115-a

As discussed above, we support the basic concepts in proposed FSP FAS 115-a. We believe proposed FSP 115-a would result in more useful information for investors and a reported net income or loss measure that is more consistent with management's expectation about cash flows for its financial assets. Our support notwithstanding, we have concerns about certain aspects of the proposed FSP that we believe need further clarification or amendment. Specifically, we believe the proposed FSP should be revised to:

- Clarify whether the second assertion to avoid considering an impairment to be other than temporary should be "it is more likely than not that it will not sell the security before its recovery" or "it is more likely than not that it will not *have to* sell the security before its recovery" [Emphasis added]

- Clarify the impairment guidance for equity securities

- Clarify the definition and application of the terms "credit risk" and "credit loss" as referenced in the amendments to paragraph 15(b) of FSP FAS 115-1 and FAS 124-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments,* (FSP FAS 115-1/124-1)

- Recognize only the amount related to credit losses for held-to-maturity securities, which would be reported in earnings. That is, the portion of the other-than-temporary impairment not attributable to credit losses (i.e., related to "all other factors") should not be recognized or included in other comprehensive income as outlined in the proposed FSP

- Permit reversals of other-than-temporary impairments or, alternatively, amend the transition provisions and require entities to recognize a cumulative effect of a change in accounting principle (e.g., between retained earnings and other comprehensive income) for all debt securities on which impairments previously were recognized so that investments in the scope of proposed FSP 115-a and their cost bases are accounted similarly under the proposed impairment guidance

These concerns and recommendations are further discussed below.

Impairment indicators

Paragraph 2 of proposed FSP 115-a states "The Board believes it is more operational for management to assert that (a) it does not have the intent to sell the security and (b) it is more likely than not it will not *have to* sell the security before its recovery." [Emphasis added] We observe that identical "have to" wording is used in the "Notice for Recipients." In addition, paragraphs A3(i) through A3(n) and paragraph A4(c) use the phrase "...not be required..." However, paragraphs 12, 13, and A3(c) do not use the phrases "have to" or "required to." Rather, these paragraphs simply state "...more likely than not that the investor will sell the security before recovery..." We believe the phrase "it is more likely than not that the investor will sell the security before recovery" is different than the phrase "it is more likely than not the investor will have to sell the security before recovery" because they represent different thresholds. That is, the former would have a broader application and focuses on an investor's intent (which already is addressed in criterion (a) above), while the latter would have a narrower application and focuses on an investor's ability. We believe the latter (i.e., will have to sell) would be more operational for preparers to apply and for auditors to assess. Accordingly, we recommend the Board amend proposed FSP 115-a to consistently use the phrase "have to."

Application of proposed FSP 115-a to equity securities

We observe that the scope of proposed FSP FAS 115-a includes both debt and equity securities. We also note in paragraph 7 of proposed FSP FAS 115-a that the severity and duration of the impairment and near-term prospects of the issuer are factors that still must be considered in determining whether a security is other-than-temporarily impaired. However, proposed FSP FAS 115-a does not provide further guidance on evaluating equity securities for other-than-temporary impairment when an entity does not have an intent to sell or when it is more-likely-than-not that the entity will not be required to sell the equity security. Accordingly, we recommend the Board amend proposed FSP FAS 115-a to include additional guidance about equity securities, including factors such as the severity and duration of the decline in value, that should be considered, individually or in combination, to determine whether an impairment is other than temporary.

Definition and application of credit risk and credit losses

The amendments to paragraph 15(b) of FSP FAS 115-1/124-1 require a reporting entity to separate an impairment loss into "(1) the amount of the total impairment related to *credit losses* [Emphasis added] and (2) the amount of the total impairment related to all other factors." Paragraph 15(b) of proposed FSP FAS 115-a continues and states that in determining the amount of the total impairment related to credit losses that the reporting entity should "use its best estimate of the amount of the impairment that relates to an increase in the credit risk associated with a specific instrument" and that "one way of estimating that amount would be to consider the measurement methodology described in paragraphs 12-16 of FASB Statement No. 114, *Accounting by Creditors for Impairment of a Loan*." We believe proposed FSP 115-a, as written, uses the terms credit losses and credit risk interchangeably. In our view, these terms denote differing concepts and measurement attributes.

We consider the term credit losses to be analogous to incurred losses, as described, for example, in Statement 114. However, the term credit risk refers to the uncertainty of a holder receiving all contractual amounts promised in a debt arrangement and, in pricing, relates to the premium over risk-free rates that an investor requires, among other considerations, to take on the uncertainty of repayment. Thus, as used in proposed FSP 115-a, it would suggest that the amount that should be recognized in earnings is the portion of the unrealized loss relating to changes in the risk premium rather than estimates of the actual estimated incurred losses at the reporting date. The use of both terms in the proposed FSP is confusing and, as a result, it is unclear how the credit-related portion of the impairment loss should be determined. Additionally, we recognize that many contend that credit risk (as described above) cannot be calculated separately. Therefore, we believe the use of the incurred loss approach outlined in Statement 114 should be required for determining the credit portion of an impairment loss for debt securities, with the exception of beneficial interests in securitized financial assets that are within the scope of EITF 99-20. For these securities, we believe the amount of total impairment related to credit losses should be determined in accordance with paragraph 12(b) of EITF 99-20, as described in proposed FSP 115-a. We believe such an approach would result in greater consistency in the accounting models applicable to debt securities and loan assets under US GAAP.

Impairment recognized in OCI for HTM securities

For held-to-maturity securities, we observe that proposed FSP 115-a will require the portion of the other-than-temporary impairment not related to credit to be recognized in other comprehensive income and subsequently amortized through other comprehensive income over the remaining life of the debt security. However, we believe it would be preferable to recognize only the amount related to credit losses for held-to-maturity securities, which would be reported in earnings. That is, we believe the portion of the other-than-temporary impairment not attributable to credit should not be recognized or included in other comprehensive income as outlined in the proposed FSP. This approach would avoid the additional effort to record and amortize the non-credit loss component in other comprehensive income, which we believe would not provide meaningful information to financial statement users. Rather, we believe the proposed requirements to disclose the key inputs used to measure the portion of the total impairment that relates to credit, as described in paragraph A3(h) of the proposed FSP, along with a requirement to disclose the fair value of any other-than-temporarily impaired held-to-maturity securities, will provide adequate information about such securities. Additionally, such an approach - that is, recognizing only the credit loss component - that would be aligned with IAS 39, *Financial Instruments: Recognition and Measurement*.

Reversals of other-than-temporary impairments

We observe that Statement 115 prohibits the recognition of a subsequent reversal of other-than-temporary impairment losses for securities within its scope. Rather, subsequent increases in fair value of available for sale securities are included in other comprehensive income. Conversely, impairments of loans held for investment and measured under Statement 114 and Statement 5 are allowed to be reversed in subsequent periods by adjusting the valuation allowance. Additionally, IFRS permits reversals of previously recognized impairment losses of debt securities in a subsequent period if the amount of the impairment loss decreases and the decrease can be objectively related to an event occurring after the impairment loss was recognized in earnings.

We note that the Board announced at its 15 December 2008 meeting its intention to consider at a future meeting whether an entity should be permitted to reverse, through earnings, a previously recognized other-than-temporary impairment loss when evidence exists that a loss has reversed. At that 15 December 2008 meeting, the Board decided that the scope of the project should include all debt securities classified as held-to-maturity and available-for-sale and that such a change should be coordinated with the IASB to allow for consistency of accounting standards internationally. We encourage the Board to consider permitting reversals of impairments as part of proposed FSP 115-a so that entities that previously recognized impairment losses will be placed on the same footing as those that recognize impairment losses after adoption of the FSP. We believe such reversals would result in greater consistency in the accounting models applicable to debt securities and loan assets under US GAAP and reduce differences between US GAAP and IFRS.

If it is not feasible to provide for reversals of other-than-temporary impairments in the time contemplated by the FASB for issuance of a final FSP, we recommend that the FASB consider permitting the adoption of proposed FSP 115-a through a cumulative effect of a change in accounting principle (effectively permitting entities to reverse previously recognized impairment losses to the extent that they would not be recognized upon application of the model in proposed FSP 115-a) and continue with its separate project in the short-term and complete it as soon as practicable.

Also, as part of the IASB and FASB's joint project on reducing complexity, in conjunction with considering when to recognize an other-than-temporary impairment on an equity security, we recommend that the Boards consider whether to permit reversals of other-than-temporary impairments on equity securities.

Presentation of other comprehensive income

Under current US GAAP, changes in fair value from period to period are generally reported either in income or in accumulated other comprehensive income, depending on the nature of the item. When *presenting other comprehensive income*, FASB Statement No. 130, *Comprehensive Income*, does not require a specific format except for the display of net income as a component of comprehensive income. Although there is no required format, Statement 130 does provide three example formats that can be used: (i) a one statement approach with other comprehensive income items added to the bottom of a Statement of Income after net income, (ii) a two statement approach with a Statement of Income and a separate Statement of Comprehensive Income presented, and (iii) a Statement-of-Changes-in-Equity approach that displays net income in such a way that it can be added to the components of other comprehensive income to arrive at total comprehensive income.

Based on our observations, most entities present other comprehensive income using the Statement-of-Changes-in-Equity approach, which we believe provides the least visibility to the comprehensive income effects of items reported at fair value. Accordingly, we encourage the Board, either as part of its recently announced financial instruments project or its project on Financial Statement Presentation, to continue to consider amending Statement 130 to increase the prominence of other comprehensive income. Such a change would enhance transparency and provide a more consistent framework for reporting both impairment losses and all changes in the carrying amount of all items measured at fair value in a single financial statement.

Transition and effective date

While the challenges of implementing proposed FSP 115-a likely will not be as great as those associated with implementing proposed Statement 157-e, we nonetheless believe that the fact that a final standard will not be issued until after 31 March 2009 will make it difficult for many public companies to implement proposed FSP 115-a in the first quarter of 2009. Accordingly, we recommend that mandatory adoption be delayed at least one quarter.

Specific recommendations related to proposed FSP 157-e

As discussed above, while we support the FASB's efforts to provide clarifying guidance on determining when markets are not active and transactions are not orderly, we are concerned that the measurement described in proposed FSP 157-e is not consistent with the definition of fair value in Statement 157 and do not support issuance of the FSP as drafted. However, if the FASB proceeds with an FSP similar to proposed FSP 157-e, we recommend that the Board address the following items to make proposed FSP 157-e more understandable and operational.

Scope

The scope of proposed FSP 157-e is limited to financial assets. We recommend the scope be expanded to include financial liabilities. While we understand that the FASB is currently deliberating guidance on measuring the fair value of liabilities more broadly, we question whether that guidance will adequately address the issue of liquidity when measuring financial liabilities in markets that are not active (e.g., certain derivative contracts). We generally do not believe there should be different measurement objectives for derivative assets and derivative liabilities, or for individual derivative contracts that can "flip" from an asset to a liability or vice versa.

Factors that indicate a market is not active

Paragraph 11(e) indicates that "abnormal (or significant increases in) liquidity risk premiums or implied yields for quoted prices when compared with reasonable estimates (using realistic assumptions) of credit and other nonperformance risk for the asset class" may indicate that a market is not active. Likewise, paragraph 11(f) refers to "abnormally wide bid-ask spreads" as another indicator. We believe that the use of terms "abnormal" and "realistic" without further clarification will not prove operational. For example, should one evaluate abnormality based on changes from historical levels? How should one determine when assumptions being made by participants in the current market environment are deemed to be "unrealistic?" As such, we recommend the Board provide additional clarification of these terms.

Consideration of quoted prices associated with distressed transactions

The Board should explicitly clarify the extent to which distressed transactions are to be considered in estimating fair value. While it is clear distressed transactions are not determinative of fair value, some believe that distressed transactions should be ignored completely. However, the illustrative example provided seems to imply a distressed transaction may represent one of "the goal posts" in estimating the hypothetical bid-ask spread that exists between willing buyers and willing sellers. In order to avoid confusion we suggest the Board explicitly clarify whether (i) distressed transactions should be completely ignored (i.e., "thrown out") when estimating fair value or (ii) distressed transactions represent a data point constituents need to consider but a fair value measurement would require significant adjustments be made to this data point.

Relevant inputs when estimating fair value

In addressing the determination of fair value in markets that are not active, we believe it is important for the Board to reemphasize the notion that relevant observable data may be obtained from active markets for similar assets or liabilities.[4] When active markets exist for similar assets and liabilities, quoted prices from these markets may represent relevant observable inputs that should be considered in estimating fair value. While these prices would need to be adjusted for any differences between the instruments, they should not be ignored even when the two-step approach outlined in proposed FSP 157-e results in the reporting entity using an alternative valuation technique. For example, even though the secondary market for various securitized assets may be inactive, reporting entities should not ignore pricing information associated with the initial issuance of similar assets. Likewise, market multiples determined from quoted prices for public equities that trade in active markets should not be ignored when estimating the fair value of similar private equity holdings.

Fair value based on other valuation techniques

Paragraph 15 of proposed FSP 157-e states that when a quoted price is determined to be associated with a distressed transaction, "the reporting entity must use a valuation technique other than one that uses that quoted price without significant adjustment." Some have suggested this guidance could be read to preclude an entity from estimating fair value using another valuation technique (e.g., income approach using a model) that produces a fair value result that is substantially similar to the quoted price presumed to be distressed. We believe the FASB should clarify whether that is the intent of the guidance. That is, could a model-based estimate that results in a value that is not significantly different from a quoted price presumed to be distressed represent a reasonable estimate of fair value?

Broker quotes and pricing services

Proposed FSP 157-e's presumption regarding distressed transactions applies to quoted prices, thereby encompassing pricing information received from brokers and pricing services. Paragraph 9(c) of FSP 157-3 provides guidance for assessing the relevance of pricing information provided by brokers or pricing services, noting that when "weighing a broker quote as an input to a fair value measurement, an entity should place less reliance on quotes that do not reflect the result of market transactions." However, under the guidance in proposed FSP 157-e, lacking evidence to assert otherwise, broker quotes and pricing service information that reflect the results of market transactions in inactive markets would be presumed to be associated with distressed transactions. As such, one could assert that broker (or pricing service) quotes determined using models may provide more relevant information than quotes based on actual transactions that occur in inactive markets. In order to avoid confusion and potential diversity in practice, we suggest the FASB clarify its guidance for assessing the relevance of broker quotes and pricing service information in light of the proposed guidance in FSP 157-e.

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[4] Paragraph 28a of Statement 157 specifically states that Level 2 inputs include quoted prices for similar assets or liabilities in active markets.

Multiple Bidders

Proposed FSP 157-e notes that the presence of multiple bidders for an asset is one of the factors required to rebut the presumption that a quoted price in an inactive market is distressed. In order to make its guidance more understandable and operational, we recommend the FASB clarify whether the multiple bidder criteria would be satisfied if the asset were simply exposed to a number of potential buyers or instead requires firm bids to be received from multiple buyers.