

David Schraa
Director, Regulatory Affairs Department



April 1, 2009

Mr. Russell G. Golden
FASB Technical Director
Financial Accounting Standards Board
P.O. Box 5116
Norwalk, CT 06865-5116, U.S.A



* F S P F A S 1 5 7 E *
LETTER OF COMMENT NO.

259

Cc: iasb@iasb.org (in response to Request for views from the IASB)

File Ref.: Proposed FASB Staff Position FAS 157-e, *Determining Whether a Market Is Not Active and a Transaction is Not Distressed*

Dear Mr. Golden:

The Institute of International Finance Senior Accounting Group appreciates the invitation to comment on the proposed FASB Staff Position amendment to FAS 157 to provide additional guidance for fair-value measurements in determining whether a market for a financial asset is inactive and a transaction is not distressed. The Senior Accounting Group is pleased to comment on this issue and, of course, stands ready to provide any additional clarifications or explanations that may be needed.

Fair-value accounting is an important measurement attribute for financial assets and has clear benefits for investors and financial institutions, reinforcing market discipline and enhancing transparency under many circumstances. Given the continuing issues around inactive markets and distressed transactions, we welcome the direction of the proposed amendments to Statement 157 and believe that they can, subject to comments below, contribute to improvements on the application and practice of fair-value measurement called for by the SEC's Study on Mark-To-Market Accounting.

In general, IIF members have indicated that the proposed changes to the guidance will be useful in analyzing current market conditions and determining the reliability and relevance of observed market prices for certain asset classes. The guidance appears to reemphasize the importance of the use of judgment by management in deriving fair value measurements. As is well recognized, the ability of firms to use their reasonable judgment is critical, but there have remained doubts about the scope of allowable judgment in the view of auditors, standard-setters and, especially, the securities regulators,

so clarity on use of judgment is extremely important. Buy-in to the proposed guidance by the securities regulators will be crucial to its success.

Two-step process

The Senior Accounting Group finds that the proposed approach provides elements of a reasonable guidance framework to analyze whether a market is inactive and a transaction is not distressed. The factors indicated in the proposed FSP are useful and constructive for preparers to consider.

However, we do think that there may be certain application inconsistencies among constituents with respect to the determination that a market is inactive. For example, depending on the characteristics of their involvement in that market, market participants will have varying levels of insight and transparency as to the level of activity in the market for particular assets. Market makers and firms intensively involved in multiple product and geographic markets clearly have access to more information regarding transaction volume and spread levels than do one-way market participants. This may result in two firms, transacting in economically identical assets, arriving at different conclusions with respect to the level of activity in the market, and thus their ability to utilize market-based inputs in the valuation technique. The proposed guidance could yield very different procedures at the same time for the two firms. This may be somewhat unavoidable in the short run, but in the medium term, additional indicative factors of inactive markets may be available from the “macroprudential” process now being developed at the behest of the G20. While the exact process is as yet unclear, it seems likely that the IMF and FSF globally and, in domestic markets, the central banks and regulators best positioned to gauge macroeconomic factors and developments in particular markets will provide useful input that firms can use in making these determinations. While the ultimate conclusion with respect to inactive markets should be made by the reporting entity, such considerations developed through the “macroprudential” process should be taken into account as backdrop to that judgment.

With respect to step two of the two-step process, there is an underlying presumption that, when a market is inactive, a transaction is assumed to be distressed unless specified evidence to the contrary exists. That presumption implies a direct and strong correlation between market inactivity and transactions’ being distressed. This presumption poses difficulties and is, in fact, at odds with the analysis of forced transactions that was addressed by the IASB’s Expert Advisory Panel on *Measuring and disclosing fair value of financial instruments in markets that are no longer active*. There, the Panel asserted that “Even when a market has become inactive, it is not appropriate to conclude that all market activity represents forced transactions” (par. 22). The proposed FSP guidance effectively reverses the burden of proof on whether or not an individual transaction is distressed when a market is inactive, which creates two issues.

First, as discussed in the last section of this letter, there appears to be a likelihood of at least temporary divergence between US GAAP and IFRS in a crucial area of

interpretation, and second, new guidance should not create new rigidities in the place of the interpretative problems it aims to correct.

As to the latter issue, use of the term “must” in paragraph 13¹ is too prescriptive and is inconsistent with the notion of encouraging the use of judgment by management. We believe that the guidance should be more flexible in allowing management to conclude, whether or not a transaction is distressed when a market is inactive, after considering all relevant facts and circumstances, with the benefit of revised guidance and also with reference as appropriate to the work of the Expert Advisory Panel, and, as well, other FASB guidance (e.g. FSP FAS 157-3 par. 9).

Paragraph 15² of the proposed FSP similarly states that, if the reporting entity does not have evidence that both factors in paragraph 13 exist and thus determines that a transaction is distressed, the reporting entity “*must*” use a valuation technique other than one that uses the quoted price without significant adjustments. IIF members have some concern regarding the mandated determination of which valuation technique the reporting entity is to utilize. This approach again appears to be too prescriptive and is inconsistent with the overall notion of allowing management the use of judgment in determining its fair-value measurement approach, as communicated in paragraph 9(b) of FSP FAS 157-3, and the degree of judgment used to determine whether markets are active, as communicated in paragraph 12 of the proposed FSP.

A mandatory requirement to switch between valuation approaches may be overly burdensome depending on the facts and circumstances for valuations of particular assets in particular circumstances, or for some constituents who may not have the capacity and expertise to implement a secondary valuation technique. It would also mandate issuers to derive prices from *hypothetical*, active markets, which would require them to develop models of such markets using audit-subjected assumptions that may prove difficult and operationally burdensome. The FASB should reconsider the use of the term “must” and we propose the use of something along the lines of the following phrase: “the reporting entity should consider the use of a valuation technique other than the one that uses the quoted price, as appropriate under the facts and circumstances”.

Convergence

Given the timeframe in which the proposed guidance is intended to be issued, the highly abridged process used in proposing and in vetting it, and the impact it would have on the definition and measurement of fair value by firms, there may be material inconsistencies compared to the IASB guidance. Members are seriously concerned that

¹ Paragraph 13 of the proposed FSP states that “If the reporting entity concludes in step 1 that the market for the asset is not active, then the reporting entity will proceed to step 2. In step 2, the reporting entity **must** presume that a quoted price is associated with a distressed transaction unless the reporting entity has evidence that (a) there was sufficient time before the measurement date to allow for usual and customary marketing activities for the asset and (b) there were multiple bidders for the asset!” (emphasis added).

² Paragraph 15 of the proposed FSP states that “the reporting entity **must** use a valuation technique other than one that uses that quoted price without significant adjustment” (emphasis added).

these differences have the capacity to undermine the credibility of both standards and increase confusion. Yet there are several firms that also feel the need for this guidance in the immediate term is critical in addressing what is a very pressing financial reporting need. It should be a top priority of the FASB to work with the IASB to mitigate this problem as expeditiously as possible.

We are particularly concerned by the fact that the IASB has extended the deliberations on its proposed adoption of similar guidance. As one of the major goals of the G20 is convergence of global accounting standards – a goal that we consider fundamental – any substantial timing gap between implementation dates would be most unfortunate.

Even more importantly, it is essential that the final guidance be completely consistent across the major accounting standards, and different development schedules give rise to the danger of divergent positions, which could lead to unlevel playing field problems or even accounting arbitrage opportunities. Of course, the converged guidance should also be constructed in such as way as to minimize possible divergences of interpretation. We assume that the IASB's guidance will be revised in a consistent manner, and will comment to the IASB to that effect.

Authoritative Statement Needed

Finally, as already indicated, the messages of the guidance must be authoritative, clear and strong to overcome the traditional bias of preparers, auditors, and securities regulators toward using the “last traded price”, emphasizing management’s ability to use judgment, particularly when markets are inactive, to derive fair-value measurements. The guidance should not, however, force management to change its chosen valuation approach; rather, it should be more principles-based in nature.

Should you have any questions about this comment letter, please contact the undersigned (dschraa@iif.com; + 1 202 857 3312) or Eran Meishar (emeishar@iif.com; + 1 202 857 3633).

Very truly yours,

A handwritten signature in black ink, appearing to read "David Schraa", with a long horizontal line extending to the right.