



October 12, 2009

OTC Valuations (OTC Val) Response to the Financial Accounting Standards Board (FASB) Exposure Draft on Proposed Accounting Standards Update to Fair Value Measurements and Disclosures (Topic 820), Improving Disclosures about Fair Value Measurements

RE: File Reference No. 1710-100

Dear Technical Director,

As a full-service provider of securities and derivative valuation reports to a wide range of clients internationally, we welcome the opportunity to provide our thoughts on the aforementioned Exposure Draft, as related to valuations specifically. Below we present the Issues as written in the Exposure Draft, each followed by our comments.

In summary, we agree in principle that the increased transparency in financial reporting will outweigh the costs of complying with new requirements for stress testing valuation results for a given set of inputs. However, we do have concerns that the proposed provisions may not be the most effective way to achieve this transparency, and thus provide alternative suggestions below.

***Issue 1:** With respect to the disclosure of the effect of changes in reasonably possible, significant, alternative inputs for Level 3 fair value measurements for each class of asset and liabilities (sometimes also referred to as sensitivity disclosures), the Board is seeking input from:*

- 1. Financial statement preparers about the operationality and costs*
- 2. IFRS financial statement preparers about the approach they plan to use to comply with a similar disclosure requirement in IFRS 7*
- 3. Financial statements users about their usefulness – more specifically, a discussion of how they would benefit from, and use, such disclosures.*

The cost of implementing any sensitivity figures should be marginal for those organizations that are already calculating fair value for financial products, such as OTC derivatives and securities, utilizing Level 3 (and Level 2) inputs. This is because the valuation techniques, including mathematical models and methods, normally do not require significant technical or operational enhancements to produce these statistics. The greatest challenge for organizations will be in determining which inputs to stress and by what amounts. Those that already comply with IFRS 7 would almost seamlessly be able to comply with that aspect of the Exposure Draft that requires sensitivity disclosures.

To assist with the above challenge and for sensitivity disclosures to be useful, which we consider would mean making them comparable across asset classes, organizations, and time, we would recommend the FASB establish a standard set of criteria that will outline the required change in inputs for specific securities and derivatives. Without such criteria, significant judgment will be required by each organization to establish, and defend possible, significant, and alternative inputs; this could not only lead to a drastically different range of



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valuations for the same or similar financial products across organizations, but significantly greater workload for the auditor community to assess each unique valuation instance.

While this is not raised in the Exposure Draft, the FASB may also consider asking organizations to report financial instrument fair valuations based on quoted bid and offer [Level 1] inputs given the prevalence of mid market pricing which is not normally representative of an exit price.

Issue 2: *With respect to reconciliation (sometimes referred to as a roll forward) of fair values using significant unobservable inputs (Level 3), the amendments in the proposed Update would require separate disclosure of purchases, sales, issuances, and settlements during the reporting period. Is this proposed requirement operational? If not, why?*

We do not have a specific position on the above issue.

Issue 3: *Is the proposed effective date operational?*

We believe it is reasonable to expect Level 3 (and possibly Level 2) sensitivity disclosures to be effective for interim and annual reporting periods ending after March 15, 2010.

In conclusion, we agree that users will benefit from increased transparency gained from improved disclosures surrounding sensitivity measures of Level 3 (and Level 2) inputs for securities and derivatives.

While the costs to implement an in-house valuation process will vary based on the organization, the costs to outsource the delivery of valuation reports is quite standard for a defined set of securities and derivatives. For example, annual fees associated with delivery of scheduled reports for products such as interest rate swaps and single asset credit default swaps can range from \$200 to \$500 per swap. For more complex or illiquid products, the annual fees can be two to three times the above cost per product for scheduled valuation reports. Adding sensitivity measures to existing valuation reports would not increase these costs materially.

To promote comparability of financial statements between periods and across organizations, we would recommend establishing a standardized set of inputs that would need to be “stressed” by a predefined set of parameters pertaining to Level 2 and 3 related financial securities and derivatives. For example, the sensitivity to all OTC interest rate swaps could be subject to standardized shifts in the yield curve inputs used to price the swaps. While the proposed amendment to paragraph 820-10-50-2-f specifically states that “a reasonably possible change in inputs shall not include remote or worst case scenarios,” such scenarios could be of use should they be standardized for specific financial instruments across asset classes for all organizations.

The proposed amendment to paragraph 820-10-50-1 requiring the disclosure of information not only to the inputs to the valuation process but also the valuation techniques should result in the organization gaining a



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better understanding of valuation models and methods, whether they are conducted in-house or outsourced to a third party. Such disclosure would also lead to greater comparability of valuations across organizations or at least insights into why valuations differ.

Yours sincerely,
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