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File Reference No. 1810-100
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This is my second comment letter on File Reference No. 1810-100. The first comment letter sent on June 17, 2010 was on the ED's proposals. This letter provides comments on the "Alternative Views" contained in paragraphs BC244-BC252.

I encourage the reader of this second comment letter to read the first comment letter, especially the section called "My Perspective, Bias and Beliefs."

Because the writers of the Alternative Views state that they dissent to the ED Approach "primarily because it would introduce fair value accounting for some nonmarketable, plain-vanilla debt instruments that are held for collection (long-term investments), and most liabilities held for payment . . .", my comments will focus on this issue. I do share some of the concerns raised in the Alternative Views, including the proposals on core deposit liabilities.

Flawed Assertions

I believe the Alternative Views with respect to loans and mortgages (I believe these are the plain-vanilla debt instruments noted by the writers) are based on flawed assertions made by the writers of the Alternative Views or repeated from what the writers state they heard from the users that they listened intently to.

These assertions seem to forget that many loans and mortgages are converted into securities. These securities, called CMOs, CDOs, asset-backed securities, etc. are many times treated as Available for Sale and Trading debt instruments under SFAS 115 and have been measured at fair value since 1994. Please note that SFAS 115 requires that all debt securities are subject to being measured at fair value. Paragraph 43 of SFAS 115 states "The Board believes that sufficiently reliable estimates of fair value can be made for those instruments." This was many years before the guidance in SFAS 157 was available.

In paragraph 44, the Board stated that they decided to limit the scope of SFAS 115 to "securities" rather than all financial instruments because they desired to expedite the resolution of some of the problems with the accounting and reporting practices for investments that existed at that time. As noted in BC 244, the writers of the Alternative Views appropriately take issue with this decision. The writers identify one of the problems with current GAAP for debt instruments is that accounting for economically similar instruments, such as a loan and a debt security, is

different just because of the legal form of the instrument.

I believe another part of SFAS 115 and the Alternative Views needs to be noted. SFAS 115 superseded SFAS 12, *Accounting for Certain Marketable Securities*, and did not bring forward the term “marketable.” SFAS 115 uses the phrase “that have readily determinable fair values” and defines explicitly when that exists. I believe SFAS 115 does not use the term “marketable” because the common usage of that term is more like “fit to be offered for sale or an item that can be sold by one investor to another.” [This definition basically comes from the 3rd Edition of the *American Heritage Dictionary*.] Reading BC 245, I believe the writers of the Alternative Views mean “a quoted market price is readily available” rather than “marketable or nonmarketable.”

To examine whether loans and mortgages or there economically similar debt securities are:

- A. marketable or nonmarketable (BC 244) using the common usage of the terms rather than the phrases,
- B. liquid or illiquid (BC 246),
- and
- C. have fair value estimates made with Observable inputs or Unobservable inputs (BC 247),

I reviewed both or one of the 2009 10-K and/or 10-Q for 3-31-2010 for each of the following financial institutions:

Bank of America	Peoples United
Citicorp	State Street
JP Morgan Chase & Co.	Fifth-Third
Wells Fargo	Comerica
American Express	Key Corp

Based upon this review:

- A. It is clear that debt securities, many described as being loans and mortgages, are marketable. Significant purchases and sales were reported for debt securities.

Some of the institutions had some amount of loans and mortgages not in security form held for sale and noted as sold.

Because many of the institutions reported loan and mortgage activity in the cash flow statement on a net change basis, it was not possible to determine whether there were purchases or sales in these instruments not in security form.

Many of the institutions were active or had been active in securitization transactions of debt instruments.

- B. It is clear that loans and mortgages are liquid assets since they are “assets near to cash.” The observations in A about marketability demonstrate this.

While it is true that loans and mortgages in security form may be considered more liquid than those not in security form, the effort to change their form is not hard, difficult or expensive.

Another observation, based on serving on the Board and the EITF, is the lobbying efforts of financial institutions about SFAS 140. These efforts used the ability to securitize loans and mortgages and other debt instruments as key to maintaining adequate liquidity for the financial institutions as their bottom line argument.

C. It is clear that observable inputs is the overwhelming basis for making fair value measurements of debt securities. For example Citicorp provides the percentages using each level of the fair value hierarchy for all assets carried at fair value as: Level 1–13.9%, Level 2–79.2%, Level 3–6.9% for their 2009 10-K. This picture was present for all the institutions and it is clear that Level 2 was mostly used for debt instruments.

Based on looking at what types of recurring and nonrecurring fair value estimates for debt instruments are made using Level 3, it appeared to me to be those that have significant credit issues, and thus, variable cash flows. These are the same type instruments where the extremely subjective measurements of credit impairments will be done under the E.D.

As an additional observation, I offer the fact that in applying fair value hedging guidance, institutions are apparently able to measure those parts of debt instruments (both in security and non-security form) that cause PART of the instruments overall fair value. I find this truly contradictory.

The Criteria

I find the criteria the writers propose for determining which measurement attribute to use for financial instruments troubling for the following reasons:

1. How much "*variability*" of cash flows is necessary for a fair value measurement?

Even the IASB recognizes that some debt instruments with specified principle and interest payments are subject to sufficient cash flow variability because of credit risk to require a fair value measurement. If the writers believe the proposed amortized cost exception will become an albatross for the Board, requiring interpretation and causing compliance issues in practice, I suggest identifying the degree of cash flow variability that calls for fair value or amortized cost will be an even greater problem.

2. Debt instruments with and without a "quoted price that is readily available" are many times economically similar. This criterion will exacerbate the problem they site in

BC 244 rather than reduce the problem.

How readily available does a quote need to be to meet this criterion? Does it need to be from an “active” market? Do the writers believe using amortized cost rather than fair value for most debt securities held as available for sale is an improvement in financial reporting? I use available for sale because I don't know how the business practice approach will deal with these instruments-whether they will be identified as using amortized cost or as held for sale under the business practice criterion.

3. Are “business practices” stable enough to be a criterion?

When SFAS 115 was first implemented, many financial institutions had large Held to Maturity portfolios. As time went by there was an observable move out of Held to Maturity to Available for Sale because of the need to meet changing economic and business needs. The writers should remember how many times the FASB was asked (and many times granted) a do-over for classifying debt securities.

I am surprised that the EDs use of FV-OCI is not sufficient to satisfy the need to reflect “business practices.”

Subjectivity

The writers raise concern about “subjective” data being included in financial statements in BC 245, BC 246 and BC 250. I believe the subjectivity introduced in the proposal on recognition and measurement of credit impairments (which the writers seem to agree with) will dwarf the fair value measurement subjectivity. I believe it is much less subjective, and many more observable inputs are available, to determine a debt instruments overall fair value than the impact of only one factor.

Convergence or High Quality Standards

Although I am not sure world leaders speak for financial statement users, I would love to see a high quality accounting standard for Financial Instruments that was used globally. However a less than high quality standard, even if converged with the IASB standard, should not be the goal of the FASB. I don't believe a convergence effort starting with two non-high quality approaches can end up being a high quality standard.

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