Investors Technical Advisory Committee
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Via Email

November 13, 2008

Ms. Florence E. Harmon
Acting Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: File Number 4-573—SEC Study of Mark to Market Accounting

Dear Ms. Harmon:

I am writing on behalf of the Investors Technical Advisory Committee ("ITAC"). The purpose of the ITAC is to provide independent technical advice, from the investors' perspective, to the Financial Accounting Standards Board ("FASB") and its staff. The ITAC is comprised of individuals from the investment profession possessing strong technical accounting knowledge.

The ITAC has concluded that the issues raised by the Securities and Exchange Commission's ("SEC" or "Commission") study of mark to market accounting ("Study") are of sufficient investor concern that it would be appropriate to share our views on those issues with the Commission.[1] We are especially concerned to witness in recent weeks calls by some politicians, banking and insurance industry lobbyists, and other parties for changes, suspensions, or overrides to fair value accounting. In our view, those activities erode the notion of independent private sector accounting standard setting supported by a thorough and public due process that gives pre-eminence to the views of investors.[2]

We encourage the Commission to closely examine the potential grave consequences to investors' confidence in financial reporting if this important tenet is impaired. A summary of ITAC views on this and other issues raised by the Study follow.

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[1] This letter represents the views of the Investors Technical Advisory Committee ("ITAC") and does not necessarily represent the views of its individual members, or the organizations in which they are employed, or the views of the Financial Accounting Standards Board or its staff. For more information about the ITAC, including a list of current members and the organizations in which they are employed, see http://www.fasb.org/investors_technical_advisory_committee/itac_members.shtml.

[2] *See, e.g.*, Letter from Jeff Mahoney, Co-Chair, Investors Technical Advisory Committee, to Tamara Oyre, Assistant Corporate Secretary, IASC Foundation 2 (Sept. 26, 2008), http://www.iasb.org/NR/rdonlyres/BE64C3F2-193D-4DF1-B5EF-1365374A5131/0/62.pdf [hereinafter Mahoney 2008] ("Having a standard setter that is independent in appearance and in fact enhances the credibility of the standard setting process and lessens the ability of special interest groups to manipulate the process to favor their own short-term interests to the detriment of the interests of investors and the capital market system").

Fair Value Accounting Should Be Required For All Financial Instruments

ITAC, consistent with the views of most U.S. investors[3] and financial analysts,[4] believes that financial reporting would be substantially improved if fair value was the *required* measurement approach for *all* financial instruments reported by financial institutions as well as nonfinancial services enterprises. Since our formation, we have consistently communicated this view to the FASB,[5] the International Accounting Standards Board ("IASB"),[6] and the Commission.[7] In our most recent letter to the FASB and IASB (collectively, the "Boards") on this topic, we set forth the following four reasons why we believe the Boards should jointly issue an accounting standard *requiring* fair value as the sole measurement method for financial instruments:

> **First**, and most importantly, fair value measures reflect the most current, complete and accurate estimates of the value of financial instruments, and are based upon an up-to-date assessment of the amounts, timing, and riskiness of the future cash flows attributable to the asset or obligation. As market conditions change, the values, risk profiles and prospective cash flows of financial instruments change as well. It is essential that investors, who provide capital to companies and bear risk as a result, have a clear understanding of the effects of these changes.

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[3] *See, e.g.,* Letter from Jeff Mahoney, General Counsel, Council of Institutional Investors, to Florence E. Harmon, Acting Secretary, Securities and Exchange Commission 4 (Oct. 29, 2008), http://www.cii.org/UserFiles/file/resource%20center/correspondence/2008/10-29%20Comment%20letter%20on%20SEC%20fair%20value%20study%20(final).pdf ("We believe that fair value accounting for financial instruments, complemented by robust disclosures, is superior to other accounting alternatives in (1) providing investors clear and accurate information, and (2) restoring the free flow of money and credit to the U.S. and global capital markets").

[4] *See, e.g,* Press Release, CFA Institute, CFA Institute Centre Says Fair Value "Smoothing" Will Mask the Reality of Market Conditions and Allow Companies to Hide Risk (Apr. 17, 2008), http://www.cfainstitute.org/aboutus/press/release/08releases/20080417_01.html (("According to a survey of CFA Institute members worldwide (2,006 responses), 79 percent of respondents believe that fair value requirements improve transparency and contribute to investor understanding of financial institutions' risk and 74 percent think fair value requirements will improve market integrity")).

[5] *See, e.g.,* Letter from Michael Moran, Member, Investors Technical Advisory Committee, to Robert H. Herz, Chairman, Financial Accounting Standards Board & Sir David Tweedie, Chairman, International Accounting Standards Board 1 (Sept. 17, 2008), http://www.iasb.org/NR/rdonlyres/A76C7FF2-E5F0-4585-8322-E7C44539E025/0/CL29.pdf [hereinafter Moran] (indicating that ITAC "supports the goal of achieving full fair value measurement for financial instruments").

[6] *Id.*

[7] Letter from Jack Ciesielski, Member, Investors Technical Advisory Committee, to Mr. Conrad Hewitt, Chief Accountant, Securities and Exchange Commission 2 (Nov. 2, 2007), http://www.fasb.org/investors_technical_advisory_committee/11-02-07_fvr.pdf (indicating that fair value accounting, with timely and robust disclosures, helps "investors make better decisions").

Second, the current global financial crisis, accompanied by the meltdowns of a number of major financial institutions, organizations whose collapses have threatened the stability of financial markets and national economies worldwide, have highlighted the widespread exposure to financial instruments and the need for timely, relevant information on the value of such securities and related risks. Such information is critical not only for individual financial decision-makers to make well-founded decisions, but for the market discipline essential for creating fair and orderly markets. It goes without saying that regulators cannot act in a timely and effective manner unless they have the information required to identify and evaluate risks and developing threats to the financial system.

Third, the myriad of measurement methods and options that proliferate in financial reports today as a result of the dozens of reporting standards for different types of financial instruments obscure the effects of a company's financial arrangements on its operations and make financial statement analysis a daunting task, even for the highly experienced and savvy financial statement user. As a result, the utility of financial statements is grossly undermined for investors who rely on the information impounded in the statements in making informed investment and credit decisions.

> **Fourth,** the current mixed-attribute model is not only confusing for users but it creates structuring opportunities to achieve a particular accounting effect as noted in a 2005 U.S. SEC report (Report). The Report states on page 4:
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> > *The Staff recommends the continued exploration of the feasibility of reporting all financial instruments at fair value. Supporters of greater use of fair values on the balance sheet argue that the most useful information is that which reflects the current values of assets and obligations.* ***Fair value accounting for all financial instruments also would appear to have benefits in terms of reduced complexity (for example, by eliminating the need for hedge accounting and its attendant documentation and effectiveness testing requirements, in many instances), more understandability, and less motivation to structure transactions so as to achieve certain accounting treatments.*** [Emphasis added].
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> We concur with the views of the SEC Staff that an effective way to reduce this complexity is to accelerate the use of fair-value measurement for all financial instruments.[8]

Although ITAC recognizes that certain improvements to presentation and disclosures for fair value measurements may be warranted, we maintain our strong support of fair value accounting and our belief that it should serve as the principal measure for reporting financial instruments.[9] In this regard, we were very encouraged by efforts taken to enhance transparency related to financial instruments embodied in several recent FASB due process documents including: Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (Sept. 2006) ("Statement 157"); Statement of Financial Accounting Standards No. 161, *Disclosures about Derivative Instruments and Hedging Activities—an amendment of FASB Statement No. 133* (Mar. 2008); Discussion Paper, *Preliminary Views on Financial Statement Presentation* (issued Oct. 2008); Proposed FSP FAS 140-e and FIN 46(R)-e, *Disclosures about Transfers of Financial Assets and Interests in Variable Interest Entities* (issued Sept. 2008); and FSP FAS 133-1 and FIN 45-4—Disclosures about Credit Derivatives and Certain Guarantees: An Amendment of FASB Statement No. 133 and FASB Interpretation No. 45 (Sept. 2008). We hope that the Boards will continue to seek improvements in those areas.

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[8] Moran, *supra* note 5, at 2-3 (emphasis added).
[9] *See id*. at 3.

Fair Value Accounting Did Not Cause Bank Failures Or The Current Financial Crisis

ITAC is disappointed that some parties have publicly attempted to blame bank failures and more broadly the current financial crisis on fair value accounting. We believe such views represent a fundamental misunderstanding of fair value accounting, and financial accounting and reporting generally. Those views may also stem from an interest in shifting the blame for bank failures and the current crisis away from those who engaged in the poor business and investment decision-making that begat the crisis.[10] As indicated above, we believe that fair value accounting has played, and continues to play, a highly beneficial role during the current financial crisis by highlighting the (1) widespread exposure of many enterprises to certain financial instruments, and (2) the importance of timely, relevant information on the value of such securities and their related risks.[11]

The Views Of Investors Should Be Given Pre-Eminence In The Process Used To Develop Accounting Standards

As previously indicated, ITAC believes that accounting standards should be developed by an independent private sector body after a thorough public due process in which the views of investors are actively solicited, considered, and, most importantly, given pre-eminence.[12] Our view is that such a process did occur in connection with the development of Statement 157.[13]

[10] *See* Letter from Rebecca McEnally, Member, Investors Technical Advisory Committee, to Mr. Robert Herz, Chairman, Financial Accounting Standards Board & Sir David Tweedie, Chairman, International Accounting Standards Board 2-3 (May 23, 2008), http://www.fasb.org/investors_technical_advisory_committee/itac_05-23-08.pdf ("some have attempted to shift the blame for the current crisis from the poor business and investment decision-making, including the flawed underwriting, securitization, risk management, and disclosure practices in which they engaged, to fair value financial reporting, a 'shoot the messenger' argument").

[11] *See* Moran, supra note 5, at 2.

[12] *See, e.g.*, Mahoney 2008, *supra* note 2, at 2-3; *cf.* Final Report of the Advisory Committee on Improvements to Financial Reporting to the United States Securities and Exchange Commission 10 (Aug. 1, 2008), http://www.sec.gov/about/offices/oca/acifr/acifr-finalreport.pdf ("investor perspectives should be given pre-eminence by all parties involved in standards-setting" (footnote omitted)).

[13] *See* Letter from Jeff Mahoney, Co-Chair, Investors Technical Advisory Committee, to Mr. Robert H. Herz, Chairman, Financial Accounting Standards Board 1 (Oct. 16, 2007), http://www.fasb.org/ocl/AR-2007/51657.pdf [hereinafter Mahoney 2007].

More specifically, as we noted in our October 16, 2007, letter to FASB Chairman Herz in response to the potential deferral of the effective date of Statement 157 ("October 2007 Letter"):

> Statement 157 was subject to extensive due process, including more than three years of public meetings, two documents issued for public comment, the receipt and analysis of more than 100 comment letters, and solicitation, receipt, and analysis of input from the Board's Valuation Resource Group, the Financial Accounting Standards Advisory Council, members of the Investor Task Force, and many other interested parties. Finally, although Statement 157 generally "does not require any new fair value measurements," the Board provided more than thirteen months between the issuance of the final standard and the required effective date.[14]

Statement 157 Provides Significant Benefits To Investors

ITAC supports the requirements of Statement 157.[15] As explained in the October 2007 Letter, Statement 157 provides at least three significant benefits to investors who use financial reports to make economic decisions.[16]

> **First,** Statement 157 provides a single principles-based definition of fair value clarifying existing guidance that in some standards was more implicit than explicit. The standard's principles-based definition of fair value will improve the comparability and consistency of the fair value measurements.
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> **Second,** Statement 157 also will meaningfully improve the consistency and comparability of the fair value measurements by establishing a single fair value hierarchy that prioritizes the inputs used to measure fair value. We agree that the hierarchy created by Statement 157 "provides a useful construct for considering the relative reliability of fair value measurements."

[14] *Id.* (footnotes omitted).
[15] *See id.* at 2.
[16] *Id.*

> **Third,** and perhaps most importantly, Statement 157 requires expanded disclosures about the use of fair value to measure assets and liabilities. Those disclosures, including the quantitative disclosures of the amount of an enterprise's "Level 3" net assets and their impact on reported earnings, are already proving to be of significant interest and use to investors when evaluating the results of companies who early adopted Statement 157. We further note that beyond the information mandated in the disclosures, the application of Statement 157 has resulted in a much more robust dialogue with investors surrounding a company's valuation inputs and drivers and their effects on earnings – information which was sorely lacking in the past. The Statement 157 disclosures are likely to continue to play an important role for investors, including during the ongoing turmoil in the credit markets.[17]

Any Further Modification Of Statement 157 Should Focus On Requiring Additional Disclosures

ITAC acknowledges that, as is common with new accounting standards, there have been a number of implementation issues that have been raised about Statement 157 since its issuance. Some of those issues were addressed (1) during the development of Statement 157; (2) by the October 3, 2007, Center for Audit Quality's paper entitled "Measurements of Fair Value in Illiquid (or Less Liquid) Markets;" (3) by the September 30, 2008, SEC Office of the Chief Accountant and FASB Staff Clarifications on Fair Value Accounting; and (4) by the October 10, 2008, FASB Staff Position No. FAS 157-3, Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active.

Some of the Statement 157 implementation issues that have been raised, including some recent preparer requests to "elaborate on the use of judgment," should not be addressed by the Board or the Commission.[18] Those requests are, in substance, requests for more detailed rules-based guidance, bright-line tests, or on-off switches. Such guidance is unnecessary and inconsistent with reducing complexity and improving the overall quality of financial accounting and reporting.[19]

[17] *Id.* (emphasis added and footnotes omitted).
[18] Letter from Richard Murray, Chairman, U.S. Chamber of Commerce et al., to The Honorable Christopher Cox, Chairman, U.S. Securities and Exchange Commission 2 (Oct. 23, 2008), http://www.sec.gov/comments/4-573/4573-61.pdf.
[19] *See, e.g.*, Mahoney 2007, *supra* note 13, at 2.

In light of the issues that have been raised about the reporting implications of the significant widening of the bid-asked spreads in some markets in which some financial instruments trade, ITAC would support the modification of Statement 157 to require additional footnote disclosures.[20] As indicated in our October 9, 2008, letter to the FASB on this topic, we believe the following disclosures would be particularly helpful in assisting investors in better understanding the impact of the significant widening of spreads on the amounts reported in enterprises' balance sheets and income statements:

1. The full reconciliation of beginning and ending balances for the asset as currently provided for Level 3 measurements in Statement 157, including clear disclosure of transfers into and out of the Level 3 category, fair value changes already recorded, and catch-up adjustments or revisions to prior estimates resulting from experience that was different from that which had been assumed;

2. The range of discount rates the preparer considered in developing the Level 3 measurements and the reason for selecting the one used;

3. The specific values of any observable market input(s), such as discount rates or transaction prices, that the preparer chose to ignore or modify in developing the measurements, and the effect(s) on the valuation(s) that would have occurred if the preparer had chosen to use the observable input(s).

4. The sensitivity of the measurements to the discount rate the preparer selected;

5. The method the preparer used for forecasting the expected future cash flows used in the measurements and key assumptions critical to an understanding of the value measured, such as the effect of changing trends;

6. The current (actual) annualized yield realized on the securities based upon the current cash flows received during the period on the asset; and

[20] *See* Letter from Rebecca McEnally, Member, Investors Technical Advisory Committee, to Russell G. Golden, FASB Technical Director, Financial Accounting Standards Board 2 (Oct. 9, 2008), http://72.3.243.42/ocl/FSPFAS157D/52732.pdf.

7. **Any** market prices, including market transactions and broker quotes, that were available for the same or similar securities during the period, and the reasons why the preparer decided to reject them.

8. The extent to which the company has experienced recent transactions that demonstrate a recovery in value, and therefore that valuations in prior financial statements may have understated asset values.[21]

The ITAC appreciates this opportunity to provide its perspective to the Commission on issues raised by the Study. We respectfully request that our views be appropriately reflected in the resulting report to Congress. Should the Commission or staff wish further clarification of our views, we would be pleased to respond.

Sincerely,

Investors Technical Advisory Committee
By:

Jeff Mahoney
Co-Chair

[21] *Id*. at 2-3.