

May 13, 2009

The Honorable Chairman Barney Frank
Chairman, Committee on Financial Services
United States House of Representatives
2252 Rayburn House Office Building
Washington, DC 20515

Ranking Member Spencer Bachus
Ranking Member, Committee on Financial Services
United States House of Representatives
2246 Rayburn House Office Building
Washington, DC 20515

RE: Progress on Mark to Market Accounting

Dear Chairman Frank and Ranking Member Bachus:

The financial services organizations listed below thank you for your leadership in addressing the issue of mark to market accounting. We appreciate your efforts and those of Mr. Kanjorski, Mr. Garrett, and members of the House Financial Services Committee for responding to some extremely important accounting concerns expeditiously and in a very impressive bi-partisan manner. The FASB's recent accounting guidance was an important interim step. We acknowledge and support the due process procedures that FASB follows, but we also believe that these are extraordinary times that require an expeditious process with more meaningful change.

We acknowledge the concerns expressed by Committee members that Congress should not write accounting standards and, instead, should rely on an independent accounting standard setter to do so. This independent process is important to us. The Committee permitted the FASB to reach its own conclusions about how to approach the mark to market (MTM) problems, and your efforts created a sense of urgency for improvements that were sorely needed. We thank you for that, as we believe that the changes that were made by the FASB to the accounting for "other than temporary impairment" (OTTI) represent a major improvement in financial reporting for OTTI.

Although FASB acted expeditiously as the Committee requested, the changes only scratched the surface. For example, OTTI continues to result in higher losses for U.S. companies versus companies that follow international accounting standards and may unintentionally increase the number of bonds that become subject to an OTTI charge. Additionally, while the other changes made by the FASB on MTM provide more specific guidance, which is useful for more consistent application of the rules, they do not focus on the heart of the problem: mark to market does not provide the most relevant measurement basis for many types of transactions.

In response to a question about MTM during a recent conference, former Fed Chairman Paul Volcker made the following observations:

“I do think in the current disturbed situation...pushing mark to market accounting to an extreme is a mistake. It can lead to a cascading decline in valuations. It certainly led to inconsistencies among institutions. But beyond that I think there is a more fundamental problem: Is mark to market accounting really consistent with the traditional banking system, and...insurance companies and pension funds as well? All regulated institutions that perform a vital economic function of transferring maturity and credit differences into a practical, money-making operation, they are intermediaries. You can't intermediate if you can't take any maturity differentials or if you can't take any credit risk.” (Financial Markets Research Center, Vanderbilt University, April 18, 2009)

Mr. Volcker’s points are important to consider as we examine the current MTM accounting. We are not suggesting that existing accounting standards be suspended. Instead, we hope to *improve* them.

Today’s environment and the volatility of exit prices for many financial instruments in uncertain economic times have demonstrated how unreliable fair values can be. This lack of reliability has severe adverse implications when determining total reported capital and it undermines the public’s confidence. In short, FASB’s emphasis on MTM not only results in misleading information in a distressed market, but it can also result in misleading information in a typical market.

In our view, accounting rules should follow the business model. If the cash flows to be received are based on an expectation the asset will be sold, then MTM is appropriate. If the cash flows to be received are not based on buying and selling in the market, then it is not appropriate. Accounting should provide information about an entity’s financial condition and should not cause management to make decisions based solely on accounting outcomes.

Although our associations have a number of concerns about MTM, the most important improvement that we believe still needs to be made is the definition of “fair value.” The definition of fair value, which was reaffirmed by FASB in its recent Staff Position, continues to mislead users of financial statements. In practice, the application of the FASB’s rule defining fair value as “exit price” gives no consideration to what price a seller is willing to accept, and therefore, results in a downward bias in reported values. It is precisely this immense difference between the economic value of the underlying assets in the security (the expected cash flows) and the prices brokers are offering that has frozen the markets. In other words, when there is no market, “market value” does not provide relevant, decision-useful information about an asset. Fair value should be defined as a “willing buyer and willing seller” in an arm’s length transaction that is not a forced sale.

On a longer term basis, FASB has publicly stated its view that MTM accounting should be required for all financial instruments, including loans. Simply put, the result of such a requirement would be that many financial institutions would need to curtail their lending activities due to the risk of volatility (from recording immediate MTM gains and losses). Such a risk is expected to drive up the cost of loans to consumers for the increased financial reporting risk assumed. We believe that the current efforts to require that all financial instruments be marked to market should be abandoned.

Again, we sincerely appreciate the bipartisan efforts we have witnessed on these issues. As you can see, progress was made and in a timely manner. However, significant work is needed not just to produce more useful financial statements, but to provide a basis for financial institutions to focus, without distraction, on what they are meant to do: supply credit that helps individuals and their businesses to grow in their communities.

Sincerely,

American Bankers Association
American Council of Life Insurance
American Insurance Association
Council of Federal Home Loan Banks
The Financial Services Roundtable