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November 13, 2008

Mr. Jim Kroeker
Deputy Chief Accountant
U.S. Securities and Exchange Commission
100 F Street NE
Washington, DC 20549

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

Dear Mr. Kroeker:

The American Bankers Association (ABA)¹ supports providing users of financial statements with relevant, reliable, and useful information. As our industry is built on trust, transparent financial information is critical to our foundation. We want to make it clear that we support the use of mark to market in certain circumstances, where it is a reliable and relevant model; however, in other circumstances – painfully demonstrated in today’s environment – it can be terribly misleading to investors and other users of financial statements. We also want to clarify that we do not support an immediate suspension of all forms of fair value, because it would result in confusion for both preparers and investors.² Instead, we believe that (1) improvements must be made to existing rules prior to December 31, 2008, year-end reporting, (2) any further moves to require fair value for all financial instruments should be abandoned.

The problems that exist in today’s financial markets can be traced to many different factors. One key factor that is recognized as having exacerbated these problems is fair value accounting. It simply has not worked properly. Our descriptions of the problems and our recommended solutions are described below.

¹ ABA brings together banks of all sizes and charters into one association. ABA works to enhance the competitiveness of the nation's banking industry and strengthen America's economy and communities. Its members – the majority of which are banks with less than \$125 million in assets – represent over 95 percent of the industry's \$12.7 trillion in assets and employ over 2 million men and women.

² ABA's primary concern with an immediate suspension of all fair value is the lack of accounting guidance that would be available along with such a suspension. For example, fair value is used in many different accounting standards (SFAS 115, SFAS 107, SFAS 133, the Derivatives Implementation Group decisions, the “other than temporary impairment rules, etc.). For preparers, who are responsible for reporting in accordance with GAAP, this would result in confusion. We strongly believe that a longer term project to take a fresh look at the various places in the accounting literature that require fair value should be undertaken.

IMPROVEMENTS TO EXISTING RULES

SFAS 157

As we indicated in our letters to the Financial Accounting Standards Board (FASB), the federal banking agencies, and the Securities and Exchange Commission (SEC),³ we believe that Statement of Financial Accounting Standards No. 157, *Fair Value Measurement* (SFAS 157), and certain other related accounting literature are flawed because they do not provide a framework to guide preparers of financial statements and auditors in applying their fundamental concepts when markets become illiquid. As financial markets thin out or even seize up, as trades become fewer and more volatile, and in general as trading values become increasingly unreliable, it is daily more apparent that for many assets, especially under current conditions, there is not a true “fair value”. Although SFAS 157 defines fair value for accounting purposes, it does not adequately describe how to estimate fair value in an environment with far fewer than normal buyers and only distressed (or liquidating) sellers. Typical sellers are not selling and typical buyers are not buying in meaningful volumes. Many holders of assets are restrained from selling, because they know the economic values of their assets are greater than the distressed sale values they are seeing in the marketplace. Both buyers *and* sellers are “market participants”, yet they are not participating, and there are either no trades or insufficient trades in order to estimate fair value under SFAS 157 and other literature.

During the exposure period for the FASB’s FSP 157-3, we believe the FASB had the opportunity to work within the current standard to clarify the definition of fair value. However, as ABA expressed in its letter to Chairman Cox on October 13,⁴ the standard fell short of providing the guidance that was needed. This inability to recognize how to amend the standard within its current framework leads us to believe that the framework itself must be amended. Mark to market based on exit price in an illiquid market results in an unrealistic downward bias, which reduces transparency and can have serious public policy implications.⁵

SFAS 157 should be amended to relieve the downward bias it creates in illiquid markets. It is fairly clear that the use of fair value is still not understood in the marketplace, and there is much confusion over what is the “real” market price. An exit price is not necessarily the fair value of a financial instrument, as it is currently being implemented. A more logical route would be to follow the former definition of fair value (which was generally viewed as a willing buyer and willing seller in an

³ See ABA letter to FASB dated August 7, 2008; ABA letter to the four federal banking agencies dated May 12, 2008; ABA letter to SEC dated September 11, 2008; ABA letter to SEC dated September 23, 2008.

⁴ See ABA letter to SEC dated October 13, 2008.

⁵ See ABA letter to FASB dated October 9, 2008; ABA letter to FASB dated August 7, 2008; ABA letter to Federal Reserve dated May 12, 2008.

arm's length transaction that is not a forced sale), which seemed to be well understood. It would also represent a more likely estimate of fair value.⁶

OTTI

Other than temporary impairment (OTTI) has been controversial for many years, especially subsequent to the implementation in 1994 of Statement of Financial Accounting Standards No. 115, *Accounting for Certain Investments in Debt and Equity Securities* (SFAS 115). Recording OTTI that is based on credit impairment is non-controversial in the banking industry – financial institutions fully understand and support the need to record such impairment. However, there has been and continues to be much controversy over recording losses that are based on the market's perception of value (fair value), which often results in recognizing losses that exceed credit losses or recording losses for instruments that have experienced no credit problems and are fully performing in accordance with their terms. The erosion of earnings and capital due to a market's perception of losses or due to a lack of liquidity that drives values lower is misleading to investors and other users of financial statements.

The ABA was pleased to read the letter from the SEC to the FASB, dated October 14, 2008, which included a request that the FASB “expeditiously address issues that have arisen in the application of the OTTI model in Statement 115”,⁷ and we have strongly encouraged the FASB to resolve the OTTI issues prior to December 31, 2008, as described in our letter to the FASB on November 13, 2008.⁸

Fair value accounting influences the recognition of OTTI. In today's illiquid market the results can be severe: (1) capital is artificially eroded despite solid fundamental credit performance, (2) the lending capability of a bank is reduced as much as \$13 for every \$1 of needless OTTI, and (3) the accounting formula is driving economic outcomes – including reduced availability of consumer and small business credit, with a negative impact on the health of individual institutions – and does not reflect economic reality.

Inasmuch as the current OTTI model is based on fair value estimates – from an often hypothetical market participant's perspective – with impairment recognized when the decline in fair value is considered other than temporary, it results in distortions, unnecessary complexity, and reduced transparency – and it suppresses economic activity. For example, the ABA met on September 25, 2008, with the SEC and other interested parties to discuss our concerns about how OTTI concepts were

⁶ Also see ABA letter to FASB dated November 12, 2008, which called for a deferral of the effective date (delayed application) of SFAS 157 for non-financial assets and non-financial liabilities. The current effective date (delayed application) is fiscal years beginning after November 15, 2008, and interim periods within those fiscal years.

⁷ See SEC letter to FASB dated October 14, 2008.

⁸ See ABA letter to FASB dated November 13, 2008.

being applied, primarily for instruments that are fully performing.⁹ Over the years there have been proposals and practices by accounting firms that utilized “bright lines” based on the severity and duration of declines in fair value. Those bright lines – or even not so bright lines – often result in permanent write-downs of fully performing assets or assets that subsequently recover value, but whose subsequent increases in value can only be recognized over the remaining life of the financial instrument, which can be many years. Additionally, the OTTI write-downs for non-credit related matters (without writing instruments up when liquidity improves) subsequently results in an artificially high yield ratio as the assets – debased in fair value estimates – continue to perform as originally contracted. In such a case, neither the write-down nor the resulting yield/income to maturity or sale is reflective of actual company “performance” or the result of operational decisions made by management. This results in volatility, particularly in today’s markets, that is inaccurate for these instruments, is misleading to the users of financial statements, reduces transparency and comparability against peers, and introduces unwarranted uncertainty in the performance measurement of individual financial institutions. The resulting misleading information is contributing to the uncertainty in the markets and the freezing of investment.

There is and has been much confusion over what OTTI is and what it means. For example, is OTTI permanent? If not, is it closer to permanent than a pure fair value concept? If closer to permanent, then why are the short durations for recovery (such as 12 months) used by some of the accounting firms? If closer to pure fair value, should OTTI really result in impairment losses that cannot be reversed? What is the impact of an uncertain market on OTTI (that is, the lack of typical buyers and sellers, the definition of “exit price” in illiquid markets, the application of Emerging Issues Task Force Issue 99-20)? Should “bright lines” or other guidelines be used for severity, duration, or recovery? How should “market participants” be defined? How does one identify the assumptions a market participant would use when there are reduced numbers and types of market participants for an asset class? How is an illiquid transaction or market defined?

The intersection of two accounting concepts has introduced a negative bias into accounting for available for sale (AFS) securities. Those concepts are: (1) valuation of assets based on “exit price,” regardless of market conditions (SFAS 157); and (2) evaluation of assets for OTTI based on cash flow and other assumptions that a hypothetical “market participant” would use (Emerging Issues Task Force Issue 99-20). While these concepts may have been intended to enhance objectivity by forcing third party data to be considered, they have had the unintended consequence of creating accounting results that are often not based on reasonable assumptions and that are so negative that the results are truly not objective. Further, these concepts have driven companies and their auditors to spend huge amounts of time and money attempting to find or extrapolate third party support or market-based data for assumptions, when in fact such third party sources do not exist. Thus, the best estimate of fair value lacks the appropriate level of reliability that is needed for sound financial reporting purposes.

⁹ See ABA letter to the SEC dated September 11, 2008.

Preparers of financial statements and their auditors have continuously faced the following problems with the existing OTTI rules:

1. Determining whether or not an impairment loss must be recorded. Some auditors' views (along with the rules-based approach of the FASB's Emerging Issues Task Force Issue 99-20) suggest that a significant decline in fair value must be OTTI, even if there is no credit loss. In such a case, performing assets that have no credit losses are written down as impaired, with the result being a sort of "lower of cost or market" (LOCOM) approach reported in earnings.
2. Determining the amount of impairment to record. The loss recorded on impaired securities is the difference between book value and fair value. Thus, instruments that have any amount of credit loss – even small amounts – must be written down to fair value, sometimes necessitating larger write-downs than the credit loss entails.
3. Requiring that AFS securities not be sold. During the analysis of whether OTTI exists, it is sometimes determined that OTTI does not exist and that the reporting entity has the intent and ability to hold the instrument until a recovery of value. Unfortunately, this also has the contorted result of prohibiting sales of securities from AFS even though sound portfolio management strategies might suggest otherwise at a date preceding the estimated recovery.

After encountering these problems and recording instruments in accordance with the above, the resulting financial statements are misleading.

To help cure this situation, we recommend that the FASB adopt an OTTI model that is similar to that of the International Accounting Standards Board (IASB), but with some changes.^{10 11} The approach would be that for Held to Maturity (HTM) and AFS OTTI recognition in earnings:

¹⁰ Because the IASB's standard (IAS 39, *Financial Instruments: Recognition and Measurement*) is based largely on U.S. GAAP, there are also shortcomings with that model that need to be overcome.

¹¹ Our understanding of the IAS 39 approach is that it focuses on loss events that provide objective evidence of impairment, and, if impaired:

- Held to maturity securities – the amount of impairment is determined by comparing the carrying amount of the instrument with the present value of future cash flows (excluding future credit losses that have not been incurred), discounted at the financial asset's original effective interest rate), essentially the credit impairment. If impairment loss subsequently decreases, the amount can be reversed through earnings.
- Equity securities carried at cost (unquoted equities or derivatives linked to unquoted equities) – the amount of impairment is determined by comparing the carrying amount and the present value of future cash flows discounted at the current market rate of return for a similar financial asset. If impairment loss subsequently decreases, the amount cannot be reversed.

- OTTI would exist if loss events provide objective evidence of credit impairment.¹²
- The amount of impairment would be determined by comparing the carrying amount of the instrument with the present value of estimated future cash flows (excluding future credit losses that have not been incurred), discounted at the financial asset's original effective interest rate.
- If impairment loss subsequently decreases, that amount would be reversed through earnings.

Under our recommended approach, HTM and AFS would continue to be reported as described in the current accounting literature (SFAS 115), with HTM reported at amortized cost and AFS at fair value (with changes in fair value reported in other comprehensive income) and with the existing robust disclosures. Under this model, just as in a fair value model, the need for rigorous, objective analysis must also involve reasoned judgment.¹³

We note that this approach may be difficult to apply for some smaller institutions and may be difficult to apply for all banks for all instruments by December 31, 2008 (due to the need for systems changes, etc.). However, it is very important that the new model be available. Thus, entities should be given the option of following the current U.S. accounting rules for OTTI or the new model for OTTI and should have the option of applying the new model to individual instruments. We believe there are precedents for this (Statement of Financial Accounting Standards No. 159, *Fair Value Option*), and it would result in improved information for users of financial statements.

Basing OTTI on credit risk would result in more logical financial statements. For example, under SFAS 115, a financial institution must identify instruments that are "available for sale". However, under current practice relating to OTTI, the financial institution is also required to ascertain that it has the intent and ability to hold the

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- Available for sale – the amount of impairment is the cumulative loss that has been recognized in other comprehensive income, and is reclassified from equity to earnings. The amount that is reclassified is the difference between amortized cost and fair value, less any impairment loss previously recognized in earnings. If impairment loss subsequently decreases: (1) for equity securities, the amount cannot be reversed through earnings, (2) for debt securities, the amount can be reversed through earnings.

¹² We anticipate that for most classes of securities that most banks are permitted to own there should not be a need for extensive documentation to support the lack of recognition of OTTI.

¹³ The purpose of this section is to address OTTI and not whether other parts of SFAS 115 may need to be amended. Thus, this letter assumes that SFAS 115 continues to be the basis for investment securities.

instrument until recovery if OTTI is not recorded. Thus, the same instrument that is labeled as “available for sale” is also labeled with the “intent to hold”, which are contradictory. This is extremely illogical to financial institution preparers and cannot possibly be logical to investors and other users of financial statements. This new model for OTTI would help remedy that situation.

The U.S. GAAP model for OTTI simply has not worked well and has not served investors well. We strongly encourage the SEC to ensure that a proposal is issued quickly that would utilize credit risk rather than fair value to determine OTTI. Fair value fluctuations – as demonstrated in today’s market – generally do not provide either a true fair value or economic value.

SFAS 141(R)

We are also concerned about additional accounting projects in the pipeline that, if finalized, could ignite new disruptions in the market place.¹⁴ In our October 13, 2008, letter to the Commission, we recommended that any new fair value standards projects be suspended pending Congressional review of the fair value study mandated by the Emergency Economic Stabilization Act of 2008 (EESA).

In our November 12, 2008, letter to the FASB,¹⁵ we expressed continued concern about fair value projects that are highly controversial with respect to whether or not they improve the accounting literature. We recommended that the FASB take into consideration the importance of the study being conducted by the Commission by delaying the effective date for fair value guidance that has been issued but has not yet been implemented. Our most immediate concern is fair value for business combinations, which is required by Statement of Financial Accounting Standards No. 141(R), *Business Combinations* (SFAS 141(R)). The current effective date is for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008.

During the SEC Roundtable on mark to market on October 29, 2008, two banking industry participants noted that the combination of SFAS 157 and SFAS 141(R) have prevented acquisitions of financial institutions from occurring during 2008. Other ABA members have had this same experience. Prior to SFAS 141(R) and SFAS 157, assets and liabilities were required to be marked to market under the purchase accounting rules. However, SFAS 141(R) requires new fair value for loans, and SFAS 157 defines fair value in such a way that it tends to result in lower fair values.

The current approach in accounting for business combinations (purchase accounting) has assumed that when a company is acquired, the acquisition is based on the fair values of individual assets and liabilities. This fair value primarily included fair value adjustments for interest rate effects and minor credit adjustments.

¹⁴ See ABA letter to SEC dated September 23, 2008.

¹⁵ See ABA letter to FASB dated November 12, 2008, which requested a deferral of the effective date for both SFAS 141(R) and non-financial assets and liabilities in SFAS 157.

Under the new standards (SFAS 141(R) and SFAS 157), acquired loans must be recorded at a different fair value. That fair value is defined under the new definition in SFAS 157, *which is based on exit price*, and includes discounts for liquidity and credit risk that exceed the previous definition of fair value and the accrued losses currently recognized under GAAP for loans. Although the acquirer may not expect to realize these estimates of market losses on the loans, it must write the loans down, which reduces capital at acquisition. Over time, that loss will be accreted back into income. However, the liquidity and credit spread discount on the fair value of the loans can be so severe that such effects as higher goodwill levels, potentially higher capital needs, etc., make acquisitions undesirable under conditions of market stress. The result in 2008 has been the nearly total disappearance of mergers as a means of resolving troubled financial institutions at the very time when this important tool would be of significant value to regulators and to the financial system as a whole. That is to say, that a crucial tool in reducing systemic risk has been taken off the table by the effect of these fair value rules.

An additional complication with the use of fair value in SFAS 141(R) is the increased complexity in accounting for loans. Loans typically represent a significant portion of the assets of financial institutions. Historically, the allowance for loan and lease losses (ALLL) related to the acquired entity's loans and leases has been carried over from the acquired institution's books to the acquirer's books. Thus, the loans are displayed on the balance sheet at the loan balance along with the corresponding ALLL contra-account. This makes it clear to readers of financial statements the amount of credit losses accrued against the loans. However, under 141(R) the acquired loans are required to be recorded at fair value at acquisition, and the ALLL is only recorded if losses are incurred subsequent to acquisition. This results in a mixture for the newly combined entity of some loans being reported at the fair value as of the acquisition date with no ALLL, some reported at the fair value as of the acquisition date with ALLL, and other loans being reported at current balances with ALLL. The use of fair value in SFAS 141(R) also results in inconsistency in the treatment of loans on an institution's books, systems problems for tracking the various accounting methods for loans, and difficulty in measuring or understanding credit risk both for regulators and management. Understanding credit risk is paramount, especially in the current environment. This accounting will make financial institutions' financial statements more difficult to understand for investors and other users of financial statements.

The effective date of SFAS 141(R) should be delayed indefinitely and should be re-established only after a thorough analysis of the significant issues involving fair value accounting, including such questions as to whether the proposed standards are clearly to the benefit of users of financial statements, whether fair value is procyclical, whether the impact of the proposals on the marketplace has been adequately taken into account and provided for, and whether entities of all sizes have the ability to prepare their own financial statements without undue cost burdens. At the time when the restoration of stability in the financial services industry may be greatly promoted—and financial failures avoided—through appropriate consolidations, implementing a new standard that is based on such a controversial model seems counterproductive.

FURTHER MOVES TOWARD FAIR VALUE

There has been a long history of controversy over whether mark to market accounting should be used by financial institutions. Some examples are:

- In July, 1938, the Comptroller of the Currency provided a revision of its bank examination procedures¹⁶ to move from the use of market value to intrinsic value.

Under the new designations, the principle is clearly recognized that in making loans, whether for working capital or fixed capital purposes, the banks should be encouraged to place the emphasis upon intrinsic value rather than upon liquidity or quick maturity.

Similarly, the reviews examination procedure recognizes the principle that bank investments should be considered in the light of inherent soundness rather than on a basis of day to day market fluctuations. It is based on the view that the soundness of the banking system depends in the last analysis upon the soundness of the country's business and industrial enterprises, and should not be measured by the precarious yardstick of current market quotations which often reflect speculative and not true appraisals of intrinsic worth.

- On March 19, 1990, the federal banking regulators submitted a report to Congress on market value accounting by banks for the sovereign debt of highly indebted countries. In this report (*Study of the Merits of Market Value Accounting for Certain International Debt Exposures*), they concluded that moving from existing generally accepted accounting principles (GAAP) to market value was not an improvement in reporting and it "would likely result in volatility in banks' reported financial position and earnings. This could make judgments by the banking agencies, as well as investors and depositors, much more difficult."¹⁷ Also, "...market value accounting could have a significant adverse effect on the safety and soundness of the banking system."
- In June 1990, the ABA provided to the FASB a white paper entitled, *Market Value Accounting*.¹⁸ Its summary of conclusions still holds true today:

¹⁶ Revision in Bank Examination Procedure and in the Investment Securities Regulation of the Comptroller of the Currency, Pages 563-564, July, 1938, Federal Reserve Bulletin.

¹⁷ *Study of the Merits of Market Value Accounting for Certain International Debt Exposures*, March 19, 1990, Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Report to Congress.

¹⁸ *Market Value Accounting*, June, 1990, pages 1-2, American Bankers Association.

- Users of financial statements are many and varied. Market value financial statements are designed to meet the needs of a very limited group of users – those interested in an estimate of liquidation value – while ignoring the needs of all other users.
- The existing historical cost accounting model is practical and understandable. Historical cost information, supported by appropriate reliable market value disclosures, adequately meets the needs of all users.
- The market value accounting model is based primarily on constantly changing interest rates, together with subjective secondary market information, and involves significant estimation processes. This will cause market value financial statements to be very subjective, volatile, and unreliable. Small changes in interest rates will have a dramatic impact on reported earnings and capital, causing those key elements of information to be volatile and potentially misleading.
- The cost/benefit of market value accounting to the banking industry would be negative. Banks would incur significantly higher costs for an end product that, at best, has little value and, at worst, could be misleading. The tremendous difficulty in implementing a reporting system that would not be totally misleading should not be underestimated.
- The historical perspective on market value accounting is relevant. Over the last five decades, there have been numerous discussions about various aspects of market value accounting. The consistent result of these discussions and related studies, including the FASB's Conceptual Framework Project, has been the retention of the present reporting basis. Additionally, studies conducted by the banking industry, and more recently by banking regulators, have reached these same conclusions specifically with respect to bank financial statements and certain specific assets in those financial statements. That work and the related conclusions are still applicable today.
- The effect of market value accounting on the deposit insurance system would not be beneficial. Adoption of market value accounting for bank financial statements would have no positive impact on the deposit insurance system, and could very possibly have a negative impact. This is because the subjectivity, volatility, and unreliable nature of market value financial statements could severely impede regulatory monitoring of capital adequacy by masking significant, permanent problems. Also, the uncertainty of the earnings results would constrain the ability of banks to raise capital, weakening the banking system and thereby creating more risk to the insurance funds.

During 1999, the Joint Working Group of Standards Setters (JWGSS), an international group that included the FASB, and the Joint Working Group of Banking Associations (JWGBA), which was an international group of banking

associations including the ABA, exchanged views. In an October 1999 paper¹⁹, the JWGBA concluded that:

- A full fair value system does not provide a sound basis for predicting banking book net cash flows and lacks relevance.
- Banking book income is earned on an ongoing basis over time and not from taking advantage of short term fluctuations in prices; the accruals accounting method provides a dynamic and faithful representation of both this earning process and the manner in which a bank's management operates. It, therefore, provides a more relevant and reliable representation of this earning process. A notional fair value snapshot taken at a historic balance sheet date fails to achieve this.
- Fair values for a banking operation are significantly more subjective than values derived under the mixed measurement accounting model and this would reduce both the reliability and comparability of financial statements.
- Financial statements prepared using the mixed measurement method of accounting are well understood by users who have developed sound and extensive financial management processes that rely on this information as a basis for economic decision-making. A move to a full fair value measurement basis would represent a radical change to those analytical processes. This should not be undertaken as the case for such a radical change has not been made with sufficient conceptual justification.
- Within any given accounting measurement model, it is not possible to encapsulate in a single measure everything that an investor needs to know. Both fair value and historical cost accounting need to be supplemented by appropriate risk-based and other disclosures in order to provide investors with a complete picture.

More recently, the FASB and IASB issued a controversial document for exposure and comment, *Reducing Complexity in Reporting Financial Instruments*.

- In its October 17, 2008 comment letter on the IASB/FASB document, the following comments were made by the four U.S. federal banking agencies:²⁰
 - ...we continue to have concerns about the wider use of fair value accounting for financial instruments.
 - ...we continue to strongly oppose an expansion of the required use of fair value accounting in the primary financial statements beyond where it is currently required or permitted, particularly for non-traded, illiquid financial instruments whose fair value cannot be reliably measured.
 - We believe that measurement should reflect the way in which instruments are used to generate earnings and cash flows, regardless of whether active markets for the instruments in question typically exist. For example, we agree that fair value accounting through earnings is appropriate for trading activities where cash flows are generated by active

¹⁹ See JWGBA paper dated October 1999.

²⁰ See letter from four federal banking agencies to FASB dated October 17, 2008.

buying and selling. However, most financial institutions in the United States do not manage their business on a fair value basis.

- Broader use of fair value accounting would increase the complexity of application of financial instrument accounting standards for these financial institutions – especially medium-sized and smaller institutions, which represent the overwhelming majority of preparers by number – which in general do not use fair values to manage their exposures.
- Notwithstanding the recent issuances by the FASB and the Securities and Exchange Commission concerning fair value, the market turbulence during the past year has emphasized a number of lessons, including:
 - There are important unresolved conceptual and practical issues surrounding the definition and meaning of "fair value" when markets are illiquid.
 - In illiquid markets, measurement of fair values can be very difficult, involve considerable subjective judgment, and require a high level of technical sophistication.
 - Disclosures concerning measurement methods and measurement uncertainty are in need of further improvement.

We strongly encourage the FASB to work on these issues as they relate to existing fair value measurement and disclosure requirements.

- *The current market turmoil has increased instances where the range of uncertainty regarding certain fair value estimates is material in relation to the overall balance sheets of financial institutions. (Emphasis added.)*

The International Banking Federation (IBFed),²¹ on which the ABA actively participates and is a founding member, wrote two comment letters to the IASB/FASB on the joint project mentioned above. In the first comment letter,²² the IBFed concluded that:

- Fair value measurement provides an appropriate accounting base for financial instruments held for trading purposes or if the business model is based on fair value. However, applying fair value measurement to financial instruments held to maturity within the banking book would overstate the extent to which instruments are held for trading or managed on a fair value basis within the business and the extent to which deep and liquid markets exist. These are highly significant factors in determining the relevance of fair value in financial reporting.
- A mixed measurement model provides investors with better information for evaluating financial institutions. It requires fair value measurement

²¹ The International Banking Federation (IBFed) is the organization of the banking trade associations of the leading financial nations. The members of the IBFed include the American Bankers Association, the Australian Bankers Association, the Canadian Bankers Association, the China Banking Association, the European Banking Federation, the Indian Banks Association, and the Japanese Bankers Association. The objectives of IBFed include increasing the effectiveness of the financial services industry's response to multilateral and national government issues affecting their common interests.

²² See IBFed paper dated April 2008.

for assets and liabilities managed on a fair value basis and recognizes that not all financial instruments – let alone non-financial assets and liabilities – are managed on a fair value basis or are even capable of reliable fair value measurement. If an entity’s business model is not on a fair value basis, amortized cost is the more appropriate way to estimate future cash flows. Fair value information is already disclosed in footnotes, which are an integral part of financial statements, and is a more suitable format for providing the information to investors.

- Reality is more complex than can be communicated in a fair value model. Relevant performance reporting will never be achieved if the framework for financial reporting sticks rigidly to either a historical cost model or a fair value model. A mixed measurement model represents a principles-based approach to measurement by acknowledging that an entity’s business model may determine that more than one measurement basis is relevant. Instead of the IASB determining that one approach offers a superior model to that of others, the aim should be for accounting standards to accommodate the various business models and circumstances in which financial instruments are used. As widely recognized at the IASB Roundtables on measurement, a mixed model is more likely to result in useful reporting.

In its second comment letter to the IASB,²³ the IBFed stated the following: “We do not support, and do not accept, that the long term solution is fair value for all financial instruments.” The IBFed further noted that the August 2008 Final Report of the Advisory Committee on Improvements to Financial Reporting to the SEC expresses reservations about expanding the use of fair value in financial reporting. IBFed states that the Advisory Committee Report:

- observes that a full fair value approach may be simpler and more meaningful for some investors, but adds that “a full fair value approach would diminish the reliability of some reported amounts (while increasing the effort required to prepare them) because they cannot be based on observable prices.”
- notes that some fair values would need to be estimated on the basis of model inputs that are also unobservable and that such estimates would be highly subjective.
- expresses concern about the variance in quality, skill, and reports of valuation specialists and the fact that there is no comprehensive mechanism for ensuring the ongoing quality, training and oversight of valuation specialists for the purpose of financial reporting.
- adds that this leads some to conclude that “a wholesale transition to fair value would reduce the reliability of financial reports to an unacceptable degree”.

According to the FASB’s Statement of Financial Accounting Concepts No. 1, *Objectives of Financial Reporting by Business Enterprises*:

²³ See IBFed letter to IASB dated September 19, 2008.

Financial reporting should provide information to help present and potential investors and creditors and other users in assessing the amounts, timing, and uncertainty of prospective cash receipts from dividends or interest and the proceeds from the sale, redemption, or maturity of securities or loans. Since investors' and creditors' cash flows are related to enterprise cash flows, financial reporting should provide information to help investors, creditors, and others assess the amounts, timing, and uncertainty of prospective net cash inflows to the related enterprise.

Financial accounting is not designed to measure directly the value of a business enterprise, but the information it provides may be helpful to those who wish to estimate its value.

The ancillary costs of implementing fair value are also significant. For example, personnel must be trained, accounting systems need to be re-written, software providers need to be educated, etc. Additionally, the ABA's June 1990 white paper included the following: "An additional major cost to the banking industry would be the uncertainty and confusion that is expected among financial statement users – including bank management." This is now being experienced, not only among users and management but also by auditing firms.

CONCLUSIONS

ABA supports the use of fair value for instruments that are traded or if an entity's business model is based on fair value. In many other comment letters not quoted in this letter (including those relating to SFAS 115, SFAS 133, etc.), the ABA has continuously opposed the FASB's efforts to move to fair value for financial instruments if the entity's business model is not based on fair value. We urge that any further moves toward the fair value model be abandoned in favor of a more useful model. Whether or not fair value is used for financial instruments, the resulting model will continue to be a mixed model. The current practical mixed model is more appropriate than the more complex mixed model that would be used with fair value for all financial instruments.

We recommend the following:

1. Current problems relating to fair value must be addressed for December 31, 2008, financial reporting, including: improving the definition of fair value in SFAS 157, improving the accounting rules for OTTI, and delaying the implementation date for SFAS 141(R) as well as the remaining items (those with a delayed effective date) in SFAS 157.
2. Mark to market (fair value) should not be the model for all financial instruments, and the current efforts to do so should be abandoned.

We appreciate the effort that the SEC is undertaking and would be glad to provide additional information. Please feel free to contact me.

Sincerely,

A handwritten signature in cursive script that reads "Donna J. Fisher". The signature is written in black ink and is positioned to the right of the word "Sincerely,".

Donna Fisher

Enclosures