THE FINANCIAL SERVICES ROUNDTABLE

Impacting Policy. Impacting People.

1001 PENNSYLVANIA AVE., NW
SUITE 500 SOUTH
WASHINGTON, DC 20004
TEL 202-289-4322
FAX 202-628-2507

E-Mail info@fsround.org
www.fsround.org

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VIA EMAIL at rule-comments@sec.gov

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

RE: SEC's Study on Mark-to-Market Accounting (File No. 4-573).

Dear Ms. Harmon:

The Financial Services Roundtable[1] ("Roundtable") appreciates the opportunity to provide comments to the Securities and Exchange Commission ("SEC") as it studies the effects of mark-to-market accounting (also known as fair value accounting or FAS 157), on the current market, as required by the *Emergency Economic Stabilization Act of 2008*.[2]

Fair value accounting is an important tool to assessing the true value of an asset, while ensuring transparency to investors. We do not question that fair value accounting has considerable merit in stable, active markets. However, fair value accounting for a long-term, non-tradable asset in an inactive market, provides minimal transparency and does not reflect economic value.

Unfortunately, recent actions by the SEC and the Financial Accounting Standards Board ("FASB") on the application of FAS 157 in an inactive market have not provided the clear direction that is needed.

Roundtable Recommendations

To alleviate the problems associated with the valuing of assets when there is no market, the Roundtable recommends: 1) the creation of a new sub-category under the fair value hierarchy that will aid in the valuing of long term, non-trading assets in an inactive market; and 2) clearer guidance from the SEC, FASB, and the Public Company Accounting Oversight Board ("PCAOB") on the use of judgment when determining a value under FAS 157. In addition, the

[1] The Financial Services Roundtable represents 100 of the largest integrated financial services companies providing banking, insurance, and investment products and services to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO. Roundtable member companies provide fuel for America's economic engine, accounting directly for $66.1 trillion in managed assets, $1.1 trillion in revenue, and 2.5 million jobs.
[2] *Emergency Economic Stabilization Act*, Public Law 110-343, §133 (2008).

Roundtable suggests the FASB consider adopting the other than temporary impairment ("OTTI") rules that are consistent with those of the International Financial Reporting Standards ("IFRS"). As an example, IFRS, for available for sale securities, does not require the assertion of intent and ability to hold to avoid an interest-related impairment. Given the number of securities in unrealized loss positions due to the widening of corporate spreads in the market, the burden of intent and ability to hold represents a significant disadvantage to U.S. Generally Accepted Accounting Principles ("U.S. GAAP") filers compared to their IFRS counterparts.

In response to the specific questions posed by the SEC for this study, the Roundtable further describes the effects fair value accounting have had in the current market.

The Effects of Fair Value Accounting on a Financial Institutions Balance Sheet

Under FAS 157, financial statements that include values based on liquidation values rather than "fair value", can cause large paper losses due to the uncertain market pricing. This, in turn, can then cause investors and shareholders to lose confidence in a company and its financial statements. Thus, fair value accounting can potentially inject further uncertainty in an already weakened market.

At the heart of the problem is the fact that the current application of FAS 157 requires an entity to value all of its assets or liabilities at the current "market price," even when there is no market. As a result, the balance sheets and earnings of these entities become distorted and based on short term market fluctuations, rather than on the true value of assets, particularly those that are held for long term, non-trading purposes.

Market prices in a dysfunctional market can provide meaningful information and perhaps should be included in the balance sheet of entities that cannot demonstrate a going concern or entities that are traders. But for long term investors, these values distort the equity of the company. Market prices or liquidation values may have a place as a disclosure in the footnotes of the financial statements, but do not belong on the balance sheet. The balance sheet should represent the company's expectations to collect the underlying cash flows of the asset.

The Impacts of Fair Value Accounting on Bank Failures in 2008

As markets and assets froze during the bank failures of 2008, the current application of FAS 157 required an entity to value all of its assets or liabilities at the current "market price," even though there was no market. Consequently, institutions had to base the value of a long term, non-trading asset on the short term market fluctuations, causing distortions to the balance sheets and earnings of these entities. This, in turn, significantly affected the safety and soundness of financial institutions and caused even greater harm to their positions as investors, creditors and customers observed the decline in U.S. GAAP equity.

The Roundtable has also identified concerns with pro-cyclicality stemming from the industry's attempt to fair value assets in a poor economic market. Accounting requirements to write-down securities to observable prices encouraged some companies to sell sooner than they otherwise would; further depressing prices in an illiquid market. Problematic pro-cyclical effects have created further problems in the areas of purchase accounting, adjustment of loan loss reserves, and auction rate securities.

The Impact of Such Standards on the Quality of Financial Information Available to Investors

The current application of FAS 157 often leads to less relevant and unreliable financial information about the financial condition of the company. This type of fair value accounting causes large paper losses due to the uncertain market pricing, which can then cause investors and shareholders to lose confidence in a company and its financial statements. This problem stems from the fact that the financial information available to investors is improperly valued; thereby creating financial information of low quality that is disseminated among investors. It would be an improvement to use economic valuation models to determine the value of assets on the balance sheet and to provide investors the liquidation value of the portfolio in a footnote. This serves to provide investors with two data points, management's best estimate of economic value of the asset and the market price of the asset. This is superior to only providing the market price. While the SEC has suggested that companies can include additional information in their MD&A on economic values, most companies choose not to do so as it has the potential to undermine the basic financial statements. However, providing economic value in the basic financials would then allow companies to disclose liquidation values without compromising best estimate information in the financials.

The Process Used by the FASB in Developing Accounting Standards

The FASB, in issuing FAS 157, did not adequately determine if exit value was the proper standard for all provisions in U.S. GAAP that required fair value accounting. Prior to FAS 157, fair value was applied in varying degrees to each standard that required it. FAS 157 had a noble goal of standardizing the definition of fair value, but in doing so the FASB failed to properly consider if that definition still provided the appropriate measurement basis in all instances in U.S. GAAP. In the case of investments trading in inactive markets, it does not appear to be the most appropriate basis.

We have further concern with the direction of the FASB in its continued development of fair value standards. The *ad hoc* adoption of fair value on a standard-by-standard basis provides for a mixed attribute model in accounting for similar, or in some cases the same, asset or liability. Moreover, the current basic financial statements do not provide a framework for investors to properly understand the impact of fair value and to separate the effect of realized *versus* unrealized impacts on earnings. This has resulted in significant distortion in the financial results. This is particularly true with financial institutions.

FASB is now preparing to adopt fair value for non-financial instruments and to expand its use for certain liabilities. We are concerned with this direction without an appropriate review to understand the conceptual benefits of fair value accounting and the appropriate median to report it to financial statement users in an understandable way.

Therefore, the Roundtable supports suspension of all new fair value requirements until the FASB determines the appropriateness of fair value as a measurement basis. In addition, completion of the financial statement presentation project should be a precedent to any new fair value requirements in U.S. GAAP.

The Advisability and Feasibility of Modifications to Fair Value Accounting Standards

What constitutes "fair value" has been debated for many years. At the time the standard was developed, the drafters of FAS 157 may have anticipated the complexity of determining the "fair value" of an asset or liability by creating a three tier approach to determine the value. This seems like a logical solution in a strong market. However, its current application in an illiquid market has raised considerable problems. It is imperative to act quickly to alleviate the pressure caused by the current fair value standards. An interpretation by the FASB, as was done with FAS 157-3, will not provide substantial authority to depart from the exit value premise of FAS 157. As such, a modification to FAS 157 will be required to effectuate change in practice.

Alternative Accounting Standards to those Provided in Statement Number 157

If the market is functioning properly, the Roundtable recommends that the current FAS 157 accounting guidance apply. [3]

In the context of inactive markets, the Roundtable recommends that the SEC evaluate FAS 157 and recognize that fair value accounting cannot be applied consistently in all market conditions. The Roundtable contends that a company's financial statements should be based on a concept of what certain financial assets are worth, not on the latest fire sale price in an illiquid market. This essentially counters the underlying intent of FAS 157 to provide more transparency.

Creation of Sub-Category within Fair Value Hierarchy

One possible solution under existing accounting standards is the creation of a sub-category within the fair value hierarchy for illiquid or dysfunctional market conditions. In these situations, financial instruments that meet certain criteria would continue to follow the appropriate balance sheet and income statement classifications with enhanced disclosures. However, a refined valuation methodology would be based upon the financial instrument's

[3] "Properly functioning market" should be defined as a market in which there are multiple parties that would buy and sell a security, loan or other financial instrument and, as such, multiple trades occur.

expected future cash flows discounted at the instrument's original effective interest rate and would permit a departure from the exit value concept.

Instruments eligible for such proposed measurement would need to meet clearly defined criteria, especially with respect to the determinations that dislocated or inactive markets exist and an entity has the ability and intent to hold to maturity or recovery. As a result, those entities that have no intention or financial motivation of exiting a position would not be obligated to recognize a write-down based on infrequent or no transactions occurring in a highly dislocated market. Additionally, for assets in this sub-category, registrants should be able to rely on internally developed cash-flow based models to account for credit risk and interest rates, rather than relying on exit prices. Such a change would minimize unintended consequences with respect to the safety and soundness of companies and more accurately reflect an entity's intent to hold for the longer term or to maturity.

The Roundtable also recommends qualitative disclosure for this recommended sub-category. Such disclosure would include the amount of securities in the sub-category, why the market is dislocated or inactive, and a discussion of the effect of selling such securities in this market, including selling the security at a market price significantly below the carrying value of the security.

This proposed approach serves several purposes. It provides investors with valuations that consider both the market's short term pricing vagaries and the fundamental risk to the firm in holding these financial instruments for a longer period of time. At the same time, this approach also will create confidence in the market by improving liquidity and eliminating diversity among companies applying fair value. Additionally, this proposed solution will continue to support the underlying intent of FAS 157 to provide transparency in a company's accounting valuation process and consequently, emphasize the importance of disclosures in a company's financial statements.

Clearer Guidance from SEC, FASB, and PCAOB

Recent actions by the SEC and PCAOB to clarify the use of fair value accounting in an inactive market appeared, at first, to alleviate the problems associated with this accounting standard. Specifically, the SEC clarification permitted management to use internal assumptions or judgment in assessing the value of an asset in an inactive market. In particular, the SEC seemed to allow companies to move to the Level 3 tier of price assessment within the fair value hierarchy if significant modifications were necessary to determine a price in an inactive market. Our members have reported that the subsequent FASB guidance did not, unfortunately, correspond to the SEC's clarification or permit the use of judgment when valuing assets in an inactive market. Rather, the FASB guidance seems to simply clarify the existing guidance on FAS 157. As such, for legal liability purposes, auditors continue to require companies to assess the value of an asset at Level 2 prices, even though there is no market, when, in actuality, companies should be permitted to mark-to-model these assets.

The Roundtable recommends clearer guidance on the use of FAS 157 in an inactive market. The use of judgment is necessary to provide an accurate assessment of an asset's value in an inactive market. The SEC and FASB should develop clearer guidance that elaborates on the use of judgment in FAS 157 in an inactive market. Such guidance will provide management with the flexibility it needs to determine the value of an asset, while providing auditors with the necessary direction needed to permit such flexibility. Additionally, the PCAOB should issue guidance to auditors that further clarifies that companies can utilize their judgment for price assessment in the inactive market. This guidance for auditors, key players in the financial reporting structure, will fill the gap and alleviate ambiguity and confusion caused by recent SEC and FASB actions.

Conclusion

The Roundtable endorses the concept and use of fair value when there is a readily identifiable value established in the market. However, despite recent efforts by the SEC and FASB, uncertainty continues to exist on the use of fair value accounting in an inactive market. As such, the Roundtable recommends either the creation of a new sub-category in the fair value hierarchy or clearer guidance by the SEC, FASB, or PCAOB on fair value accounting in an inactive market.

Thank you again for the opportunity to share our views with you on this subject. If you have any questions, please feel free to contact me or Melissa Netram at 202-289-4322.

Sincerely,

Richard M. Whiting

Richard Whiting
Executive Director and General Counsel