**Introductory Remarks for SEC Roundtable on Mark-to-Market Accounting**

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Thank you, Mr. Chairman, for the opportunity to participate in today's roundtable discussion on mark-to-market accounting.

Today's roundtable has been organized by the Commission to address Section 133 of TARP. Section 133 requires the Commission to conduct a study of market-to-market (fair value accounting) as set out in SFAS 157, focusing on financial institutions, and to report back to Congress its findings within 90 days. In particular, the study should consider the following:

(1) the effects of such accounting standards on a financial institution's balance sheet;
(2) the impacts of such accounting on bank failures in 2008;
(3) the impact of such standards on the quality of financial information available to investors;
(4) the process used by the Financial Accounting Standards Board in developing accounting standards;
(5) the advisability and feasibility of modifications to such standards; and
(6) alternative accounting standards to those provided in such Statement Number 157.

I briefly consider each of the points, but in a different order and by grouping them together.

## <u>An Independent Standard Setting Process</u>

Points 3 through 6 all relate to the standard setting process for financial reporting. The FASB and its international counterpart, the IASB, are private standard setting bodies that set accounting standards with an open, deliberative process. Standards are set with substantial input from interested constituents, including preparers, auditing firms, and financial statement users. The FASB and IASB consider a variety of factors when setting their standards, with a focus on providing relevant and reliable information to investors and other financial statement users. Such information is critical to well functioning capital markets and allocation of capital. I submit that the process used by each body is an effective model that serves all constituents well. I agree fully with the Financial Accounting Foundation, which sent a letter to President Bush in his role as host of the Global 20 summit urging leaders of the G-20 countries not to permit government interference in standard setting, i.e., to leave standard setting in the private sector. Thus, although some may conclude that changes in SFAS 157 or any other standard may be advisable or feasible, I do not believe it is advisable for any changes to come about because of government intervention in the standard setting process.

**The Effects of SFAS 157 on Financial Institutions Balance Sheets and Impact on 2008 Bank Failures**

SFAS 157 did not cause banks to writedown their assets in 2008. Writedowns have been required under existing standards for many years. Rather, SFAS 157 provides more specific guidance for determining the specific value to use as a target for required writedowns when assets become impaired. Writedowns obviously cause financial institution balance sheets to become smaller, necessitating, in some cases, the sale of assets to meet regulatory capital requirements. This can result in a variety of undesirable pro-cyclical effects, including a further deterioration of bank asset prices. The role SFAS 157 played in contributing to these proc-cyclical effects is, in my view, highly overstated. At most, the contribution is incremental—bank assets became impaired, and writedowns had to occur. As the FASB and SEC Office of the Chief Accountant made clear in the September 30 release, SFAS 157 has provisions to address how to measure fair value in the absence of well functioning liquid markets. Thus, writedowns are not—and have not been—required based on prices in illiquid markets characterized by distressed sales (e.g., those associated with sales necessitated by the need to meet regulatory capital requirements). Another important point to remember is to avoid conflating the obligation of the FASB and IASB to set standards that require publicly traded entities to provide investors with transparent information they need to make informed investment decisions, and the obligation of bank supervisors and regulators to maintain the stability of financial intermediation around the world. It is the job of bank supervisors to establish regulatory practices that address the effects of pro-cyclicality, not the FASB or the IASB.

**Quality of Information Provided to Investors**

The remaining point that remains to be addressed is the quality of information provided to investors. There is a plethora of academic research in both the US and international settings regarding the quality or relevance of fair value information to investors. A summary of these findings is contained in a survey paper I wrote for the Institute of Chartered Accountants in England and Wales in *Accounting and Business Research* (2007). The key conclusion of that paper is that investors do generally find fair value information to be of sufficiently high quality as to be incrementally informative to historical cost information. Several of the studies, including those that I have coauthored, specifically address the issue of informativeness of fair value information to investors valuing bank stocks and arrive at similar conclusions that fair value information is useful to investors.