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President and Chief Executive Officer

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Mr. Conrad Hewitt
Chief Accountant
US Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

RE: SEC Study of Mark-to-Market Accounting, File No. 4-573

Dear Mr. Hewitt:

The BAI CFO Roundtable is pleased to have the opportunity to comment on the study of "mark-to-market accounting" being undertaken, at the request of Congress, by the Securities and Exchange Commission ("SEC" or "Commission"). The BAI CFO Roundtable is an informal group of Chief Financial Officers from many of the largest U.S. banks. The Roundtable has been in existence for 15 years and meets periodically to discuss a variety of important issues. BAI is a non-lobbying organization that provides objective information in the form of research and education to executives in financial services companies.

This letter is being sent on behalf of the BAI CFO Roundtable to communicate that the Roundtable supports the SEC's involvement in the study on the use of fair value measurements in financial reporting and it supports the findings and recommendations submitted by "The Center for Audit Quality (CAQ)" to the SEC.

Summary Recommendation

The Roundtable supports the use of fair market value (FMV) accounting as it serves to provide increased transparency, but the FMV valuation techniques require a number of improvements. In particular, the impairment accounting treatment of securities that are held for the long term requires excessive write-downs to fair value through the income statement. While we do not believe the determination of FMV of the securities requires change, the impairment in the income statement should be only the amount of the credit loss, not market value loss. It is hoped that the FASB would implement this change for year-end 2008.

For debt securities held for a longer term, requiring an impairment charge only when a credit impairment has occurred or the company has decided to sell the security in the near term will reduce the complexity of US GAAP, achieve more consistency with loan impairment accounting and represent a meaningful step toward conforming US GAAP with IFRS. Since this represents a minor modification to FSP FAS 115-1, there is no reason it should not be able to be implemented timely; particularly given the multiple, public roundtables that have been hosted by both the SEC and the FASB/IASB and the numerous comment letters that have been submitted.

In particular the BAI CFO Roundtable supports the following key recommendations in the CAG study.

"... there are several initiatives regarding accounting and reporting for loans and debt securities, presented in greater detail below, that could be considered without compromising the core principles of fair value measurement.

A. Align the accounting guidance for loan impairments with the accounting guidance for impairments of debt securities

Under GAAP, the requirements for measurement and recognition of impairment losses are different for loans than for investments in debt securities—even though the underlying cash flows for both asset types might be exactly the same. Although the measurement and recognition of impairment for an asset in loan form is based on incurred credit losses at the measurement date, if that same loan were securitized, impairment would be measured and recognized based on the fair value of the security at the measurement date in relation to its current carrying value. This imbalance means that a change in form from a loan to a debt security, without any corresponding fundamental economic change, compels an entirely different accounting treatment.

A potential response would be to revise the loss recognition model for other-than-temporarily impaired debt securities by recognizing currently in income only those impairments representing probable losses of contractual cash flows (or expected cash flows, in cases where a debt security does not have contractual cash flows—e.g., interest-only strips). This portion of the impairment would be deemed to be attributable to credit. The non-credit loss portion of the impairment (i.e., the difference between the amortized cost, as adjusted for impairment, and current fair value) would be recognized in other comprehensive income until the security is sold or matures. In addition to providing better alignment between impairment accounting for loans and debt securities, this change should help address the concern that fair value accounting unduly affects the regulatory capital adequacy of commercial and investment banks.

In applying this approach, a decision would be required to determine whether to base the measurement of impairment losses on loan assets only on incurred credit losses as of the measurement date, or alternatively, expected credit losses to be incurred over the life of the loan. The "life-of-loan" approach to measuring and recognizing credit losses has been debated for some time. A reconsideration of incurred versus expected loss models could be undertaken as part of broader review of FAS 5, with a view toward simplification of and consistency for all financial instruments.

B. Modify and conform the impairment models under EITF 99-20 and FAS 115

The standard for recognizing other-than-temporary impairment ("OTTI") on investments in debt securities is different under FAS 115 than under EITF 99-20. FAS 115 looks to the "probability of collecting all amounts due according to the contractual terms," while EITF 99-20 is based on evaluating whether there are "any adverse changes in the estimated cash flows that a market participant would use in determining the current fair value." As was the case for loan impairments and debt securities, these standards require different treatment of instruments that in many cases (but not all cases) have the same underlying economics, based only on the question of whether they are securitized or not. The CAQ suggests that consideration be given to bringing these models into conformity as much as possible, while giving recognition to the fact that some securitized beneficial interests, such as residual interests, do not have contractual cash flows and possess a high degree of variability in cash flows because of factors such as credit losses, prepayments, and changes in interest rates. To the extent that those beneficial interests are not accounted for at fair value through profit and loss (e.g., under FAS 155), an impairment model similar to EITF 99-20 could be developed to cover those types of assets. Alternatively, the scope of EITF 99-20 could be reconsidered.

In addition, consistent with the comments above about reporting changes in fair value, the CAQ suggests that consideration may be given to whether FAS 115 (and SAB 59) could be further revised such that OTTI would be recognized at the time a credit loss becomes probable—i.e., when it becomes probable that an investor will not receive the contractual cash flows on its investment. Also, the CAQ suggests that consideration be given to eliminating the "ability and intent to hold to recovery" test under FAS 115 and SAB 59, which was never intended to address credit risk, and replacing it with a requirement to recognize an impairment loss (to fair value) in income when it becomes probable an investor will sell an otherwise impaired security. Accordingly, OTTI would be recognized only (1) when there is a credit loss impairment (and then only for probable losses of contractual or expected cash flows); or (2) when it becomes probable that an investor will sell an otherwise impaired security.

Finally, the CAQ supports the SEC's request that FASB address the appropriate impairment model for hybrid securities, such as perpetual preferred stocks, and encourages FASB to complete that project as soon as practicable.

C. Modify the approach for reporting periodic changes in fair value

Under current GAAP, changes in fair value from period to period are generally reported either in income or in accumulated other comprehensive income, depending upon the nature of the item. Standards-setters could consider modifying this model in the following ways:

Consider separating, for accounting and reporting purposes, the periodic changes in fair value into two components: (i) probable credit losses (incurred or expected, per the discussion above) in income; and (ii) all other changes in fair value (including, for example, liquidity discounts) in other comprehensive income until it becomes probable that the asset will be sold or the asset matures.

Consider changes in the format of the income statement to allow for (i) more visibility to the income effects of items reported at fair value and (ii) the inclusion of other comprehensive income on the face of the statement.

These actions could help enhance transparency and usefulness by providing a more consistent framework for recognizing impairment losses, and by reporting all changes in fair value-measured items in a single financial statement.

D. Further enhance and improve transparency through disclosures

The concerns expressed about the application of FAS 157 in distressed or illiquid markets could be addressed, at least in part, through clear and transparent disclosures. These disclosures could include information about the conditions present in a particular market and the assumptions and methods applied in the fair value measurement process. Entities that apply fair value accounting to financial assets and liabilities could also consider providing disclosures in Management's Discussion and Analysis about the "hold-to-maturity" (or a similarly defined term) values of those assets and liabilities. Such disclosures would help address the concerns of some that fair value accounting forces institutions to use overly pessimistic market prices to value their assets. Investors and other financial statements users could look to these disclosures to make an informed judgment about the financial position and estimated future cash flows of the entity."

Conclusion

In conclusion, fair value measurement principles under FAS 157 should be retained; there is room to consider changes to current accounting requirements that might enhance the relevance of financial reporting without undermining the benefits of fair value measurement.

Many of the concerns expressed by those in favor of departing from FAS 157 can be addressed through disclosures about the conditions present in a particular market and the assumptions and methods applied in the fair value measurement process.

We strongly urge the SEC to adopt the recommendations of The Center for Audit Quality as the BAI CFO Roundtable supports this effort and recommends timely response to the need for modification of the impairment recognition process by the standard setters.

Sincerely,

Deborah L. Bianucci

DLB:jw

cc: Christopher Cox, Chairman
Florence E. Harmon, Acting Secretary
Jim Kroeker, Deputy Chief Accountant