

September 7, 2010

Mr. Russell Golden  
Technical Director  
Financial Accounting Standards Board  
401 Merritt 7  
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Via email: [director@fasb.org](mailto:director@fasb.org)

File Reference: No. 1830-100 *Amendments for Common Fair Value Measurements and Disclosure Requirements in U.S. GAAP and IFRSs*

Dear Mr. Golden:

The American Bankers Association (ABA) appreciates the opportunity to comment on the exposure draft: *Amendments for Common Fair Value Measurements and Disclosure Requirements in U.S. GAAP and IFRSs* (ED). 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 \$13.3 trillion in assets and employ over 2 million men and women.

### **Measurement Uncertainty Analysis**

The ABA is very concerned about the requirement to provide a measurement uncertainty analysis for fair value measurements categorized as Level 3 – fair value estimates that use unobservable inputs. We communicated our concerns to you in 2009 when FASB proposed similar disclosures. We have attached that comment letter to this. While the language in the ED has been slightly changed, our concerns are the same.

Our primary concern is particularly urgent now because of the proposal to require fair value accounting for all financial assets and liabilities. If the Exposure Draft *Accounting for Financial Instruments and Revisions to the Accounting for Derivatives and Hedging* (Financial Instruments ED) is put into effect as drafted, over half of the assets of the typical commercial bank (over 60% of the assets at most community banks) will be subject to this disclosure. The majority of these assets are commercial loans for which there is not, and never has been, an active secondary market. The “exit price” for these assets will, by nature, contain significant and wide bid/ask spreads relating to each aspect of the price – credit, interest rate, and liquidity. But considering there has never been an active market for many of these loans, other “reasonable” assumptions will include a wide spectrum of possibilities, as bankers speculate how such a market might operate. Just as there will be a lack of fair value comparability among banks, there will be wide ranges of reasonable inputs used, resulting in exponentially increasing comparability problems. Users of financial statements will be left confused as to why, even in normal economic times,

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most banks could be “reasonably” considered well capitalized or under-capitalized, based on the wider range of possible market values.

The data required in this ED translates into significant costs for the reporting banks: major internal and external fees incurred for producing the information, and major fees to be paid to audit this information. This information, which is not normally used by commercial banks to manage the credit risk of their non-trading portfolios, will provide marginal benefit to financial statement users and will often obscure the financial position of an entity. Due to the wide ranges that will likely result, this information will likely be rendered meaningless.

Judgments and estimates are integral to the development of financial statements. Including a sensitivity analysis related to the fair value of financial instruments is inconsistent with estimates made for other purposes, including, among other things, pension liabilities. But in the end, it is management’s responsibility to record its best estimate. Therefore, we believe that a sensitivity analysis further opens the door to litigation – not only that the recorded amounts are inaccurate, but also that the “reasonably possible” range was misleading.

We understand that measurement uncertainty disclosure is already a part of IFRS. However, under IFRS 9, *Financial Instruments*, the uncertainty analysis would not be required for assets held for long-term investment (since they are not recorded at fair value in the face of the financial statements). So, the basis for their inclusion is under significantly different circumstances. With all this in mind, we urge the Board to drop this portion of the proposal.

#### Highest and Best Use Valuation Premise

The ED proposes that the concepts of highest and best use and valuation premise in a fair value measurement are relevant only when measuring the fair value of nonfinancial assets and are not relevant when measuring the fair value of financial assets or of liabilities. We disagree with this proposal and note two of several circumstances in which the “in use” valuation premise should be maintained for financial assets:

- Certain residential mortgage loans are currently valued under the premise that they will be securitized and sold. For most conforming residential mortgage loans, securitization market pricing can often more efficiently price these kinds of instruments as pools, especially considering the uncertainty in projecting individual asset performance. This would be especially applicable to those assets that are already securitized, yet recorded on the balance sheet as individual loans.
- Certain assets acquired under an FDIC-assisted transaction are valued under the reasonable premise that the loans would be pooled and sold with the FDIC indemnification. Market participants who are interested in acquiring these assets would normally consider the FDIC indemnification in determining a fair value.

These are two instances in which the in-use valuation premise provides a practical and more realistic

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valuation. With this in mind, we recommend that the Board retain the valuation premise for financial assets.

### **Effective Date Coordination**

While there is no effective date proposed in the ED, we do note there is a scope exception proposed in the Financial Instruments ED to exclude investments in unquoted equity instruments from the measurement uncertainty disclosure. Further, the fair value option for equity method securities is proposed to be discontinued under the Financial Instruments ED. We are concerned about what we perceive to be disconnects between these two proposals and whether the ED will be fully responsive to the new fair value measures in the Financial Instruments ED; if not, another revisit and amendment to Topic 820 would be required. We recommend that the effective date of a final standard from this ED be coordinated with related proposals in the Financial Instruments ED to allow for one integrated implementation.

Thank you for your attention to these matters and for considering our views. Please feel free to contact me ([mgullette@aba.com](mailto:mgullette@aba.com); 202-663-4986) if you would like to discuss our views.

Sincerely,



Michael L. Gullette

Enclosure



*World-Class Solutions,  
Leadership & Advocacy  
Since 1875*

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File Reference: No. 1710-100 *Fair Value Measurements and Disclosures (Topic 820) – Improving Disclosures about Fair Value Measurements*

Dear Mr. Golden:

The American Bankers Association (ABA) appreciates the opportunity to comment on the exposure draft: *Fair Value Measurement and Disclosures (Topic 820) – Improving Disclosures about Fair Value Measurements* (ED). 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 \$13.3 trillion in assets and employ over 2 million men and women.

The ABA is concerned about the direction that the FASB is taking with regard to the continued expansion of mark to market (fair value) accounting and related requirements. Each new morsel of required data often translates into significant incremental work for the reporting banks and significant external fees incurred for producing the information. At some point, there needs to be an acknowledgement that providing the information that certain investors may desire is not cost-beneficial.

We have the following primary concerns about the ED:

- The ED should not apply to companies that are not SEC registrants. Community bank shareholders, for example, have not been requesting additional fair value information, and the burdens and costs for community banks outweigh any incremental benefit.
- For SEC registrants, the sensitivity disclosures required in the ED should not be required, as they will be costly to derive and to audit, and will often be confusing to many investors.

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- Any additional requirements to provide fair value disclosures should be subjected to a documented field test and a cost/benefit analysis that publicly details the cost estimates and expected benefits.

Below is additional information regarding our concerns.

### **The Disclosures Will Often Provide Meaningless Information.**

For Level 3 fair value measurements, the ED proposes disclosing the key significant input and a sensitivity disclosure that shows how the measurements would increase or decrease based on “reasonably possible alternative inputs.” Inputs for relatively “simple” products like private-label residential mortgage-backed securities, as noted in the example, may include prepayment rates, probability of default, loss severity, and yield. However, there are many other inputs, which are often interdependent, to be considered. For example, prepayment rates often reflect interest rate and home price assumptions, as well as assumptions on credit classification. Geographic location of the underlying assets can affect both prepayment and default rates. Fair values are also often reflective of the relative level of subordination in the structures. More complicated assets and structures invite other considerations.

With this in mind, details of weighted averages of key significant inputs can often have little meaning, as certain changes in the inputs may have a material effect on some assets within a sub-class and little, if any, on others. While one may argue that more disaggregation could be required, it is likely that an unmanageable level of disaggregation would be necessary to attain sufficient correlation among those assets.

This discussion, so far, has focused on homogenous underlying assets. Within a context of non-homogenous assets, which may be common in a commercial mortgage backed-security or a specific collateralized debt obligation, the relevance of these averages naturally diminishes further. Therefore, no matter the underlying assets, we question how a user will substantively interpret the amounts disclosed.

### **The “Reasonably Possible Alternative Inputs” Will Often Result in a Meaningless Range.**

While we understand certain investors’ desire to know how sensitive fair value models are, “reasonably possible” can represent an extremely broad range of results. Further, based on existing fair value guidance, it is not management’s assessment of “reasonably possible”, it is what management believes is the market’s perception of “reasonably possible.” The quick, deep drop in housing prices and increase in national unemployment rate over the past twelve months will necessarily be included in the realm of “reasonably possible” in the future – even though it was an anomaly based on historical experience. This is just one example of the difficulty with requiring a “reasonably possible” range. Providing these disclosures implies an acceptable level of certainty that does not exist.

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Though the ED notes that the increase and decrease are not the best and worst case scenarios, based on many current economic forecasts, it is nonetheless reasonable to expect ranges so wide that users will eventually (if not immediately) find this disclosure – if not all Level 3 measurements – irrelevant. In the meantime, we believe that debates with auditors to agree on what is “reasonably possible” will eat up significant time during an already hectic quarterly closing process.

### **The Sensitivity Disclosures will be Costly.**

Level 3 fair value measurements already are costly to companies to prepare. The addition of “reasonably possible” alternatives will introduce significant complexity for companies as they try to develop procedures to ensure that the input assumptions are derived in a controlled and documented environment. This will be a significant challenge for any size company, as large banks will need to deploy valuable resources to achieve this and smaller banking institutions will likely need to hire external consulting firms. Current costs to obtain external modeled values range from \$2,000 to \$5,000 per position for relatively uncomplicated securities. Determining a “reasonably possible” range not only will take extra external consulting time, but will require time, as noted above, for management and its auditors to agree upon this range. Depending upon the economic environment, the ranges could also change between reporting periods. This concern is also compounded by the possibility, as expressed by various large accounting firms to our members, that many collateral-dependent mortgage loans will be included in this disclosure because the net investment in the loan is recorded at the collateral’s fair value. Such a requirement will necessitate a broad effort to educate and to procure real estate appraisal companies to provide such estimates.

There are over 7,000 banks and thrifts in the United States, with almost 80% of them not registered with the SEC. These banking institutions, like the vast majority of public banking institutions, are managed based on a traditional banking model and their shareholders are not requesting information about the short term fair value of their non-trading assets. For these banking institutions, the costs of providing this information would far outweigh any incremental benefit. The same is true for all size categories of banks as well – whether or not they are SEC registrants.

### **Recommendations**

In summary, we believe the ED should not apply to companies that are not SEC registrants – including banks – primarily due to excessive costs compared to possible benefits. With regard to the sensitivity analysis, many SEC registrants have worked with investors on an ongoing basis to provide information on a variety of issues that are responsive to investors’ changing needs. Some banks have provided additional sensitivity information in their Management’s Discussion and Analysis (MD&A) with their Form 10-K filings. This information has included specific input assumptions used across a broad range of inputs, as well as the specific effects on fair values

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caused by certain input changes. We believe these disclosures are more responsive to investor needs and are more reliable than the sensitivity analysis in the ED. MD&A also provides the ability for preparers to adapt to future changes in investor preferences for information. Requiring such disclosures in the financial statement footnotes will likely result in quickly obsolete, and ultimately, irrelevant data.

Because of this, we recommend that the sensitivity disclosures be omitted from any final standard. Further, we recommend that the ED be subject to a field test prior to requiring companies to provide information that is costly to obtain. Field testing should be openly documented as to the estimated costs and perceived benefits.

Thank you for your attention to these matters and for considering our views. Please feel free to contact me ([mgullette@aba.com](mailto:mgullette@aba.com); 202-663-4986) if you would like to discuss our views.

Sincerely,

A handwritten signature in cursive script, appearing to read "Michael L. Gullette".

Michael L. Gullette