



**David Schraa**  
*Director, Regulatory Affairs*

September 7, 2010

Sir David Tweedie,  
Chairman  
International Accounting Standards Board  
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Mr. Robert H. Herz,  
Chairman  
Ms. Leslie Seidman,  
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**Re: ED/2010/7 Measurement Uncertainty Analysis Disclosure for Fair Value Measurements**  
**File reference No. 1830-100 Fair Value Measurement and Disclosures (Topic 820)**

Dear Sir David, Mr. Herz and Ms. Seidman:

The Institute of International Finance Senior Accounting Group appreciates the opportunity to comment on the boards' respective proposals on fair value measurement guidance. We believe that convergence in international accounting standards is a top priority and hence fully support the boards' joint efforts to achieve full convergence in this area.

However, as noted in our comment letter on the FASB's proposed Accounting Standard Update (ASU) on accounting for financial instruments, we are concerned about the apparent divergence in 'when' fair value measurement is required. Convergence on 'how' to fair value is important, but convergence on 'when' to fair value is equally important. Divergence in the latter is likely to undermine the boards' efforts in the former, and, more broadly, the overall G20/FSB call for converged, high-quality standards.

This comment letter includes our views on both the IASB's Exposure Draft (ED) on *Measurement Uncertainty Analysis Disclosure for Fair Value Measurements* and the FASB's Proposed Accounting Standards Update (ASU) on *Fair Value Measurement and Disclosures (Topic 820)*.

*Measurement Uncertainty Analysis Disclosure*

While the impetus for uncertainty disclosure is understood in the post-crisis environment, the present proposals appear likely to cause a high degree of diversification in explaining the uncertainties and need reconsideration.

We agree that the current Level 3 measurement sensitivity disclosure prescribed by IFRS 7 is theoretically less than useful if computed without consideration of the potential inter-relationships among the unobservable variables. However, we do not believe that layering on the proposed requirement to disclose the effect of correlation between unobservable inputs (if such correlation would be relevant when estimating the effect on a fair value measurement of a change in more than one unobservable input) would add decision-useful value for a number of reasons. For large financial institutions, unobservable Level 3 inputs are often multi-dimensional, incorporating model selection, input selection and input correlation. In valuing a complex Level 3 instrument, an entity inherently makes judgments in each dimension based on input data of varying degrees of quality – the selection of the most appropriate inputs is unlikely to follow a simple rule for identifying a fixed point within a finite distribution. Currently, there are no robust, industry standard metrics (comparable, for instance, to VaR, in the context of market risk) that could provide a basis on which a standardized articulation of the interrelationship among dimensions can be formed. As a result, even entities with highly sophisticated valuation functions are unlikely to arrive at the same view of a given item. This is not inappropriate, given the “model risk” that would arise if all entities were required to come to the same conclusions in such a process.

Further, were a standardized approach currently available on an instrument-by-instrument basis, there would still be correlation and diversification factors amongst the instruments themselves that either increase or decrease the overall impact of estimation error on the Level 3 portfolio. Thus, an aggregation of the possible estimation errors on individual instruments would yield a flawed representation of risk.

In addition, uncertainty exists within all levels of the hierarchy; the focus on Level 3 alone would lead to incomplete and misleading results as financial risk management generally follows a holistic, rather than stratified approach. Thus the proposal fails to address a critical issue by focusing only on Level 3 instruments and not allowing for disclosure of significant offsets where unobservable parameters are hedged with instruments in Level 2 of the fair value hierarchy containing similar, offsetting parameters. As a consequence, the disclosure would overstate the net sensitivity to unobservable parameters.

Noting the boards’ desire to provide useful information to users, there is no basis to require such disclosures for Level 3 instruments only, given that uncertainty exists on all levels. However, in order to make any uncertainty analysis disclosure meaningful, a large amount of qualitative supplemental information and data would be required. Consequently, such disclosures across all levels of the fair value hierarchy might easily become overwhelming for general users of financial statements and therefore be of limited value.

The confluence of these factors would certainly result in disclosures that are subject to high levels of subjectivity, lack comparability across similar reporting entities, and

artificially purport to measure risk in a manner which is not actually employed in generally accepted risk management practices. Overall, it is doubtful that such highly subjective and non-comparable disclosures would enhance the information value of financial statements or be of any practical use to users.<sup>1</sup>

Given the limited value of the information proposed and the disproportionate burden on preparers to compile and collate data for the single purpose of disclosure, we recommend that the FASB remove this requirement from the ASU (and the IASB correspondingly withdraw the disclosure currently mandated pursuant to para. 27(e) of IFRS 7).

We further suggest the boards continue their dialogue with the financial sector, representative users of financial statements, the Big Four accounting firms and international valuation committees in order to develop more useful and relevant guidance for disclosure in line with sound risk-management practices. The outcome of this consultation, taking into account the issues mentioned above, should be a consistent, fully converged approach on this issue.

#### *Blockage factors*

There is significant confusion regarding the application of the proposed guidance on blockage factors. The language in the proposed standard and basis for conclusions appear contradictory. Firstly it is unclear precisely what constitutes a “block discount”. It is also unclear whether block discounts are only prohibited when fair value is measured using a quoted price as an input (Level 1) in all circumstances, or whether it is also intended to apply to instruments that are not actively traded but have an input that is based on a quoted price or any quoted input. In addition it is unclear whether the proposed guidance on block discounts is only intended to be applicable to non-derivative equity or debt instruments that are not actively traded, or whether it is intended to apply to OTC derivatives (Level 2 or 3).

We are aware that some accounting firms have interpreted the guidance to prohibit block discounts on any instrument, and could interpret a block discount quite widely to include concentration and correlation adjustments and other such items that are appropriately included in fair value measurement today. A blanket prohibition on all such items in all circumstances is clearly not appropriate and would be completely at odds with the actual conduct of business, and the market participant view. Thus, the boards should clarify that adjustments are only permissible where a market participant would make them in determining fair value, thus clarifying that appropriate items such as concentration and correlation adjustments would be appropriate based on the size of an OTC contract if a market participant would consider such an adjustment given the unit of account.

Some members continue to have broader concerns about blockage factor adjustments. As recommended in our previous response to the IASB’s exposure draft on fair value measurement, we continue to see value in the boards’ jointly considering the conceptual merits of unit of accounting issues as there are still areas where the unit of

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<sup>1</sup> We welcome the IASB’s and FASB’s efforts in seeking the views of users to assess the usefulness of such disclosure. Members report that they have received few or no requests from investors or analysts for the type of information in the proposal.

account for fair value measurement is unclear. Therefore, we would emphasize that the comments set out above apply equally to the proposed guidance in the Exposure Draft and existing guidance set out in IFRS. We believe that IFRS and US GAAP should be converged in this area, and based on the most appropriate guidance.

*Fair value disclosure for financial instruments measured at amortised cost*

It would be useful for both boards to reconsider fair value disclosures for financial instruments not measured at fair value in light of the broader project(s) on classification and measurement of financial instruments.

For reasons explained in comments on the broader FASB project, all members agree that fair-value information for items measured at amortized cost should be required only in note disclosures and not in the primary statements.<sup>2</sup>

Further, if required at all, disclosure of the fair value amount would be sufficient and further stratification within a three-level hierarchy would not provide additional information value, given the primary measurement attribute of these instruments is amortized cost.<sup>3</sup>

However, some members do not believe that fair value disclosure of financial instruments not measured at fair value should be required at all.<sup>4</sup> They note that the usefulness of such disclosures may vary in different markets depending on the types of financial instruments and market characteristics; therefore, it is not appropriate to impose a general requirement of only limited potential interest. Moreover, the cost-benefit tradeoff of imposing such disclosures is disproportionate given limited or lacking actual utility. For financial instruments measured at amortised cost, a disclosure such as the proposed measurement uncertainty disclosure is one where there is a cost-benefit trade-off.

*Credit Valuation Adjustments on net portfolio exposures*

Finally, we are concerned that the condition relating to counterparty credit risk, as prescribed in para. 35-18L of the ASU, (para. 53 of the IASB staff draft on fair value measurement) may result in entities' overstating credit adjustments where mitigating arrangements other than legal rights of offset, are used to manage counterparty exposure.

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<sup>2</sup> Disclosure of fair value information in the notes as opposed to the primary statements for items measured at amortized cost is more effective as it appropriately reflects the fact that such information is of interest only for purposes of comparison and analysis where it relates to non-trading and non-derivative financial instruments, and should not be taken as an operative valuation for most purposes. It also affords more space for the explanation of the information, particularly when fair values are derived from non-observable inputs and subjective valuation methodologies.

<sup>3</sup> We note that the IASB considered the requirement to disclose by level of the fair value hierarchy financial instruments not measured at fair value in its Exposure Draft, *Improving Disclosures about Financial Instruments*, published in October 2008. In March 2009, in finalizing the proposals after reviewing comments received, the IASB decided not to require such a disclosure. IFRS 7.BC39G set out the Board's rationale.

<sup>4</sup> These members believe the disclosed information would be of little relevance as such instruments are not measured at fair value in the primary statements and do not affect an entity's performance. Moreover, many or most debt instruments measured at amortized cost are not quoted on the market and their fair values would need to be derived from non-observable inputs and subjective valuation methodologies under Level 3. This makes such disclosures even more unlikely to provide meaningful information.

For instance, collateral, security, legal-isolation arrangements, statutory rights of offset, etc. may all have the effect of accomplishing the same objective as a master netting agreement from a credit risk-management perspective. Gross up of underlying risk for purposes of credit valuation may conflict with risk management practice and yield a distorted view of actual risks in the business.

We would therefore encourage the boards to articulate this requirement in the form of a principle rather than a rule; e.g., to replace the words “when there is a legally enforceable right to set off one or more financial assets and financial liabilities with the counterparty in the event of default” with “when there is a legally enforceable right to set off one or more financial assets and financial liabilities with the counterparty in the event of default, or when other legally enforceable risk-mitigation techniques are available to the entity that are managed consistently with its credit-risk management practices”.

The IIF Senior Accounting Group appreciates the opportunity to comment on the boards’ proposals to fair value measurement guidance and disclosures. Should you have any questions about this letter or views expressed, please contact the undersigned ([dschraa@iif.com](mailto:dschraa@iif.com) +1 202 857 3312) or Carol Wong ([cwong@iif.com](mailto:cwong@iif.com) +1 202 857 3633).

Very truly yours,

A handwritten signature in black ink, appearing to read "David Schraa", with a long horizontal flourish extending to the right.