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Invested in America

February 29, 2016

Russell G. Golden
Chairman
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT, 06856-5116

Re: Proposed Accounting Standards Update: *Fair Value Measurement (Topic 820) Disclosure Framework-Changes to the Disclosure Requirements for Fair Value Measurement* (File Ref No. 2015-350)

Dear Mr. Golden:

The Global Financial Institutions Accounting Committee ("GFI" or the "Committee") of the Securities Industry and Financial Markets Association ("SIFMA")[1] appreciates the opportunity to provide comments on the Financial Accounting Standards Board's ("FASB" or the "Board") *Proposed Accounting Standards Update: Fair Value Measurement (Topic 820) Disclosures Framework-Changes to the Disclosure Requirements for Fair Value Measurement* (the "Proposed ASU"). GFI members have extensive practical experience in the application of fair value measurements and related disclosures.

We understand the FASB's objective for issuing this Proposed ASU was to test the guidance in the proposed Concepts Statement "*Conceptual Framework for Financial Reporting – Chapter 8: Notes to Financial Statements*" (the "Concepts Statement") and the proposed amendments are the result of the Board's consideration of the concepts in the proposed Concepts Statement as they relate to fair value measurement.

We broadly support the FASB's efforts to refine the fair value disclosure requirements in the context of the broader disclosure framework. As we have stated before[2], we believe disclosures around fair value measurements should enable financial statement users to understand the methods, assumptions and inputs involved in developing fair

[1] *SIFMA is the voice of the U.S. securities industry. We represent the broker-dealers, banks and asset managers whose nearly 1 million employees provide access to the capital markets, raising over $2.5 trillion for businesses and municipalities in the U.S., serving clients with over $20 trillion in assets and managing more than $67 trillion in assets for individual and institutional clients including mutual funds and retirement plans. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit http://www.sifma.org.*

[2] *SIFMA comment letter on Proposed ASU to Topic 820, "Improving Disclosures about Fair Value Measurements" (File Ref No 1710-100) dated October 12, 2009*

value measurements. We believe these qualitative and quantitative disclosures should be framed in a manner that is consistent with the way a company manages risk and responds to information requests from their investor community. Consistent with the proposed Concepts Statement, we also believe that specific quantitative disclosure requirements must allow the reporting entity to exercise discretion in meeting those requirements in conjunction with the financial statements taken as a whole. That is, whether a specific disclosure requirement is considered material should be assessed in the context of the level of activity and the level of aggregation of that specific disclosure requirement. Further, the benefit of providing any disclosures must be weighed against the operational costs.

With the above as a broad backdrop, we have summarized below our comments on the decisions reached in the Proposed ASU. Our detailed responses to selected questions raised in the Proposed ASU are attached as an appendix to this letter.

Disclosures Eliminated or Modified

We agree with the Board's decision to eliminate the requirement to disclose the valuation policies and procedures for Level 3 fair value measurements. We also support the Board's decision to eliminate disclosures around the amount and reasons for transfers between Level 1 and Level 2 of the fair value hierarchy and the related policy on the timing of such transfers. We agree these disclosures do not provide much decision-useful information for the reasons described by the Board in paragraphs BC12 through BC15 of the basis for conclusions. However, to the extent transfers to/from Level 3 remain a required disclosure, we believe providing the policy for the timing of these transfers continues to be important. We also support the Board's modification to the disclosures about investments that utilize net asset value to represent fair value.

We believe the proposed modifications to the disclosure around the measurement uncertainty/sensitivity of Level 3 measurements will not be meaningful. Although Level 3 is a relatively small subset of a large financial institution's overall financial instruments measured at fair value, it is a significantly diverse portfolio of financial instruments. We believe the diversity of the unobservable inputs used in measuring instruments in Level 3 of the fair value hierarchy combined with the necessary aggregation of diverse instruments into reportable classes, does not result in meaningful information regarding the measurement of any individual input and may be misleading to users of the financial statements.

Incremental Disclosures

We strongly disagree with the Board's decision to expand disclosures on unrealized gains and losses to positions categorized in Level 1 and Level 2 of the fair value hierarchy. For financial instruments recognized at fair value through net income, the changes in fair value are recorded in net income regardless of whether gains/losses are realized or unrealized. That is, the payment or receipt of cash does not affect net income; it does not inform on the timing of future cash flows and it does not provide any meaningful information about the volatility of fair value measurements. For these reasons, disaggregating realized and unrealized gains/losses is not a metric used to risk manage these positions and our members' systems and control infrastructures were not built to track realized/unrealized gains/losses on all financial instruments. We also note that our members' investors have not indicated that distinguishing unrealized income from realized income on financial instruments fair valued through net income, for portfolios valued based on observable inputs, would be a meaningful metric. Therefore, for the purpose of complying with this proposed disclosure, our members would need to overhaul their system infrastructure at a significant cost for a disclosure that is not meaningful.

We also disagree with the proposal to require the range and weighted average of significant Level 3 inputs. As we described above, quantitative disclosures should be required in the context of the financial statements taken as a whole with consideration of the necessary level of aggregation to produce such disclosures. While these disclosures may be meaningful at the transaction level, at the level of aggregation required to prepare the financial statements, these quantitative disclosures become meaningless. We note that as SEC registrants, our members are already providing most of these disclosures at significant operational costs.

We also wanted to comment specifically on the proposed incremental quantitative disclosure "for the time period used to develop significant unobservable inputs." First, this disclosure will be incremental to what SEC registrants are already providing. Second, our members do not track this type of information in a manner that could be readily aggregated for reporting purposes. More significantly, however, in the context of the broader review of the disclosure framework, it is unclear to us why the Board decided to move forward with this proposed disclosure requirement after acknowledging in paragraph BC46 that most users would not find this information decision-useful.

Other Disclosures Retained

As we have commented in the past, we prepare the Level 3 rollforward at a significant operational cost. We agree with the conclusion reached by some Board members in paragraph BC25 that the concepts in the proposed Concepts Statement do not indicate that the Level 3 rollforward should be required. Therefore, we suggest that the Board eliminate the requirement to prepare a Level 3 rollforward and instead require entities to disclose (1) transfers into and out of Level 3 and (2) total gains and losses for the period related to Level 3 instruments held at the end of the reporting period. However, we note that disclosing total gains and losses disaggregated by level of the hierarchy can be misleading because financial instruments are frequently economically hedged with instruments categorized in different levels of the fair value measurement hierarchy.

We thank you for the opportunity to provide our industry view. The Global Financial Institutions Accounting Committee would be pleased to discuss our response with the FASB staff. Please contact me at 212-902-7052 if you have questions or comments concerning our letter.

Regards,

Timothy Bridges
Chairman
SIFMA Global Financial Institutions Accounting Committee

cc:
Mary Kay Scucci, PhD, CPA, Managing Director, SIFMA
Susan M. Cosper, Technical Director, FASB

Attachment

Appendix

Responses to Selected Questions for Respondents:

<u>Question 1: Would the proposed amendments result in more effective, decision-useful information about fair value measurements? If not, please explain why.</u>

No. We strongly disagree that the proposed incremental disclosures result in more effective, decision-useful information about fair value measurements for the reasons described below.

<u>Unrealized gains/losses – Not Decision-Useful for Understanding Volatility of Fair Value Measurements:</u>

According to paragraph BC20 of the Proposed ASU, users have indicated that identifying changes in unrealized gains and losses is useful as it provides information about the volatility of fair value measurements. We disagree as volatility of fair value measurements is not relevant for Level 1 and Level 2 of the fair value hierarchy where inputs are observable. Further, by presenting gross unrealized gains or losses by level of the fair value hierarchy, the proposed disclosure can be misleading as it ignores the effects of economic hedges categorized in a different level than the hedged instrument.

For portfolios measured based on observable inputs, volatility in earnings is a function of portfolio turnover rather than volatility in the fair value measurement. Volatility exhibits itself in earnings both through realized changes as well as unrealized changes in fair value –if an entity buys and sells securities with high turnover within a quarter, this activity could lead to earnings volatility with minimal unrealized gains and losses. Therefore, disaggregating unrealized gains or losses does not provide any information about future earnings volatility.

Further, risk management strategies across product sets and fair value hierarchy levels significantly mitigate earnings volatility, but the proposed disclosure of unrealized gains and losses would not make this apparent, especially when disaggregated across levels of the fair value hierarchy and further disaggregated by gross assets and liabilities. For example, it is common to hedge exchange-traded listed futures with OTC forward derivatives. Futures settle on a daily basis and therefore have minimal unrealized gains or losses, whereas the cumulative gains and losses on the Level 2 OTC derivatives would be disclosed as unrealized. This risk management strategy clearly yields little to no real volatility. Another example would be a Level 1 cash position hedged with a Level 2 derivative that can be an asset or liability at any point in time. This strategy would be presented on a gross basis between Level 1 and Level 2 with meaningless movements in unrealized gains or losses as a derivative moves between an asset and liability position, even though earnings volatility is flat.

We also note that disaggregating unrealized gains or losses from realized gains or losses is particularly not decision-useful for derivative portfolios. Derivatives are generally cash collateralized. Whether cash moved in a derivative pursuant to the terms of the contract or under a separate collateral agreement will determine whether a position generates realized or unrealized cash flows but the economic risk position is the same.

Paragraph BC20 also seems to contradict paragraph BC26, which says that users have indicated that there is more certainty in Level 1 and Level 2 fair value measurements because they are based upon observable inputs. If users are comfortable with the relative certainty of fair value, then it is unclear to us why there is a need to distinguish between realized and unrealized gains and losses.

We are also concerned that users of the proposed disclosure would incorrectly conclude that unrealized gains and losses are a poorer quality of earnings. These arguments were acknowledged by the Board in paragraphs C97 – C99 of SFAS 157, *Fair Value Measurements.* We ask that the Board not move forward with this disclosure on the basis of these concerns.

We do not believe that the requirement to disclose unrealized gains and losses for Level 3 instruments should necessarily lead to the conclusion that this information is relevant for Level 1 and Level 2 instruments. The disclosure of unrealized gains and losses as required by SFAS 157, *Fair Value Measurements*, stemmed from EITF 02-03, which precluded the recognition of day one gains from instruments with unobservable inputs or techniques. As noted in paragraphs C11-17 of SFAS 157, the complications associated with applying the previous guidance lead to the decision to require disclosure of this information. This allows for transparency in earnings associated with unobservable inputs, which is not an issue for Level 1 and Level 2 instruments. However, we note that disclosing Level 3 unrealized/realized gains/losses can be misleading to investors as Level 3 financial instruments are frequently economically hedged with Level 1 and Level 2 financial instruments.

Unrealized Gains/losses – Not Decision-Useful to Investors:

The GFI committee members have received limited inquiries from investors as to the existing required disclosure for Level 3 unrealized gains and losses. Given this experience, we believe the existing disclosure of unrealized gains or losses for Level 3 instruments is of limited use to our stakeholders and, therefore, question the Board's decision to expand this disclosure to Level 1 and Level 2 recurring fair value measurements, which are, by their nature, fair valued based on observable inputs.

Unrealized Gains/losses – Not Decision-Useful for Risk Management:

Committee members do not manage transactions that are fair valued through net income based on cash movements as both unrealized and realized gains or losses equally affect net income. Level 1 and Level 2 assets and liabilities, in the context of our businesses, result from large volumes of transactions, giving rise to daily realized gains and losses as our members act in the capacity of market-makers and brokers for our members' clients. Unrealized gains or losses are largely a function of outstanding inventory at the end of a trading day that will be used to facilitate future client activity and do not provide insight into the company's performance or risk. We question how informative a disclosure of Level 1 and Level 2 unrealized gains/losses can be to external users if our management does not find it to be useful for its own evaluation of a business' performance or for guiding the future direction of a business.

Unrealized Gains/losses – Disclosure Framework Basis for Conclusion:

We also do not agree with the Board's view that disclosing the changes in unrealized gains and losses included in earnings disaggregated by level of the hierarchy provides insight into the relationship between financial statement line items that is not otherwise apparent. Simply put, the changes in fair value of assets and liabilities measured at fair value are recognized in earnings. Accounting policies on fair value measurement and the line items in which these changes in fair value are recorded are disclosed. It is unclear to us how further disaggregating the unrealized component of the change in fair value measurements by the level of hierarchy provides a mechanism to understand the changes in fair value of assets and liabilities, period over period.

The Board previously considered a similar disclosure about unrealized gains and losses in its June 2004 Exposure Draft, *Fair Value Measurements*. At that time, the basis for this proposed disclosure focused on earnings quality, as opposed to volatility; however, the cost-benefit analysis for this disclosure remains the same as it did in 2004. As described in paragraphs C97-C99 of the Basis for Conclusions of SFAS 157, the Board decided to require disclosure of unrealized gains and losses for only Level 3 fair value measurements in order to balance the cost-benefit constraints raised by preparers. We urge the Board to do the same as it re-deliberates this Proposed ASU.

Question 2: Are the proposed disclosure requirements operable and auditable? If not, which aspects pose operability or auditability issues and why?

We believe the proposed incremental disclosures will pose a significant operational burden on our members as we describe below.

As global dealers, our members may have thousands of purchases, sales, issuances, and settlements occurring on a daily basis in our trading or market making portfolios that are categorized in Level 1 and Level 2 of the fair value hierarchy. In order to provide unrealized gains and losses for these positions, our members would need to enhance systems that could track the unrealized/realized gains or losses at a transaction level. Our members' systems are not built to track unrealized/realized gains or losses on all financial instruments where the volumes of transactions are very large.

We note that the current preparation of this disclosure for Level 3 instruments requires a manually intensive process for isolating the changes in unrealized gains and losses.

Year-to-date reporting of Level 3 information presents additional challenges due to the volume of transactions each period which generate realized gains and losses that are not systematically tracked at the individual instrument or fair value hierarchy level. Expanding this disclosure to Level 1 and Level 2 instruments with significantly higher transaction volume will present additional challenges in terms of gathering this information.

The existing disclosure of unrealized gains or losses for Level 3 instruments is challenging because it often requires a subjective determination of whether cash flows are “realized,” which is particularly challenging when applied to certain financial instruments such as derivative instruments. Therefore, it was necessary to create accounting policies to determine what is “unrealized” for Level 3 populations as part of the existing disclosure requirements. These policies will need to be extended to the much larger population of Level 1 and Level 2 instruments and systematized which we expect will lead to more diversity in practice and reduce comparability across different entities. By way of example, consider whether the premium earned on an option is “realized” or whether the quarterly settlements on an interest rate swap are “realized.” Non-cash settlements such as the physical settlement of an option or convertible bond are equally complex in considering whether they should be classified as realized and are a source of significant manual intervention.

Despite the challenges described above, we note that Level 3 positions for our Committee members are a very small subset of financial instruments measured at fair value and by their nature, trade infrequently. Given the significantly higher volume of transactions and portfolio turnover for Level 1 and Level 2 positions, manual processes will not be operational. In addition, Level 1 and Level 2 cash and derivative instruments may be managed on a portfolio basis which makes generating this information further challenging as it would require a method of allocating valuation adjustments to each unit of account within the portfolio.

As a manual approach would not be feasible for the volume of transactions generated in Level 1 and Level 2, our members would require significant systems rebuilds to generate this disclosure. We expect that this rebuild would take a substantial amount of time and resources and result in significant costs to preparers. We also note that these costs would be incurred solely to meet this proposed disclosure requirement rather than to support risk management or to satisfy other management reporting objectives.

If the Board decides to move forward with the proposed disclosure, we believe the level of disaggregation required needs clarification. The example disclosure in the Implementation Guidance in 820-10-55-100A reflects the expanded disclosure of the change in unrealized gains and losses as an aggregated amount for the entity’s assets and separately for liabilities at any given period. The specific disclosure requirements enumerated in 820-10-50-2, however, states that the information shall be disclosed “for each <u>class</u> of assets and liabilities.” We ask the Board to clarify that their intent for the expanded disclosure was for unrealized gains or losses for Level 1 and Level 2 positions to be presented for total assets and total liabilities and not further disaggregated by class.

Question 3: Would any of the proposed disclosures impose significant incremental costs? If so, please describe the nature and extent of the additional costs.

Yes. We believe that the proposed added requirements to disclose unrealized gains and losses included in earnings for recurring Level 1 and Level 2 fair value measurements and to disclose the time period used to develop significant unobservable inputs will impose significant incremental costs for preparers on both an initial implementation and ongoing basis.

In paragraphs BC57 and BC58, the Board asserts that it "does not anticipate that entities will incur significant costs as a result of the amendments," that "the proposed amendments would not create new accounting requirements other than additional disclosures for which entities may leverage information that already exists," and that "the removal of existing immaterial disclosures would reduce costs for preparers." However, as we described above, entities will not be able to "leverage information that already exists," but will need to develop systems to track the required information and set policies for the use of this information in disclosures. With respect to the disclosure requirements that are being removed, the effort required to produce such disclosures currently is relatively minimal and so the removal does not represent an offsetting cost savings when weighed against the added cost of new disclosures. In addition, the policy for timing of transfers between levels and valuation policies and procedures for Level 3 fair value measurements generally do not change period-over-period and therefore the effort to review the disclosures on an ongoing basis and to update the disclosure when necessary does not come at significant cost. For these reasons, we request the Board to carefully consider the significant net increase in disclosure preparation costs that would result from these amendments and whether or not those costs are justified by what we believe is not useful information for users.

Question 5: The proposed amendments to paragraph 820-10-50-2(bbb) require that a reporting entity disclose the weighted average of significant unobservable inputs used in Level 3 fair value measurements. Are there classes of financial instruments for which this disclosure is inoperable or does not provide meaningful information? If yes, please describe those classes of financial instruments and explain why.

Yes. While we believe that at an aggregated level, the quantitative disclosures around weighted average and range provide limited decision-useful information, as SEC registrants, GFI members are currently disclosing the weighted average of significant unobservable inputs for most cash instruments. However, some of us do not provide this information for derivative instruments or structured notes that contain embedded derivatives. Depending on the input type, derivatives may be weighted by gross or net fair value or by the significant unobservable input (e.g., volatility). Further, the fluctuations in value of derivatives as they move between assets and liabilities based on the underlying risk, creates meaningless disclosure. As such, if the Board decides to move forward with a required quantitative disclosure around significant unobservable inputs, we ask the Board to allow alternative measures such as a simple average and/or median of input range for transactions for which a weighted average would not be meaningful at any level of aggregation.

Question 6: The proposed amendments to paragraph 820-10-50-2(bbb) require that a reporting entity disclose the time period used to develop significant unobservable inputs. What would be the costs associated with including this disclosure? Would this disclosure provide more effective, decision-useful information?

We do not agree that disclosing the time period used to develop significant unobservable inputs would provide effective, decision-useful information. Fair value measurements are a best estimate measured at a reporting date. In our view, this quantitative disclosure requirement would be misleading as it would appear to imply to readers of the financial statements that a fair value measurement is based on historical inputs rather than an estimate of exit price at the reporting date.

Level 3 inputs are typically determined by some combination of relative value analysis (e.g., yield comparisons, or multiple comparisons), fundamental valuation techniques (e.g., discounted cash flow analyses), or interpolation and extrapolation techniques. Although historical information (particularly historical correlations) may be employed to identify an appropriate comparative observable dataset, historical data by itself may not be good evidence of fair value. If historical information is employed, it is adjusted to calibrate to current market levels. Accordingly, the “time period used to develop each significant unobservable input” is not widely used by large financial institutions. Therefore, in our view, this disclosure is not relevant.

We note, from an operational cost perspective, this type of information is not currently tracked systematically by our members and given the nature of this type of information, would likely require manual data gathering at a transaction level to produce this disclosure. Further, it is unclear to us how this information can be aggregated to produce any meaningful, useful information.

However, if the FASB decides to move forward with this incremental disclosure, we ask the Board to clarify that the disclosure is limited to specific significant unobservable inputs where historical data was relevant to the valuation process. While only an illustration, the proposed example disclosure in paragraph 820-10-55-103 includes a time period for all significant unobservable inputs, which seems to suggest that time period is relevant for all unobservable inputs which is not the case.

Question 7: Are there any other disclosures that should be required by Topic 820 on the basis of the proposed Concepts Statement or for other reasons? Please explain why.

No. We believe the current disclosure requirements are already very detailed.

<u>Question 8: Are there any other disclosure requirements retained following the review of Topic 820 that should be removed on the basis of the proposed Concepts Statement or for other reasons? Please explain why.</u>

Yes. We recommend that the Board eliminate the Level 3 rollforward and retain certain elements of the existing disclosure, as described below. We believe this proposal would result in significant cost savings for preparers while retaining the most useful information required by users.

We agree with the Board's conclusion that the Concepts Statement would indicate that the Level 3 rollforward is not required as the information could be easily understood from the other existing financial statement presentations. We believe the operational cost of preparing this disclosure outweighs the perceived benefit to users.

We believe that disclosure of the transfers into and out of Level 3 by class of instrument provides the users of financial statements with information about changes in observability that would not otherwise be easily understood from the financial statements and other disclosure requirements. Information about transfers into and out of Level 3 allows users to assess the extent to which changes in Level 3 inventory are due to changes in observability.

Users may also require disclosure of total gains and losses for the period related to Level 3 instruments, by class of instrument, recognized in earnings and other comprehensive income (without differentiating realized from unrealized), and the line in the statement of comprehensive income in which those gains or losses are recognized. This disclosure gives users information about the effect of Level 3 fair value measurements on earnings or other comprehensive income. However, we note that this disclosure can also be misleading as Level 3 instruments are frequently economically hedged with Level 1 and Level 2 instruments.

<u>Question 9: How much time would be needed to implement the proposed amendments? Should the amount of time needed to implement the proposed amendments by nonpublic business entities be different from the amount of time needed by public business entities? Should early adoption be permitted? If yes to either question, please explain why.</u>

As described in our responses to questions 2 and 3 above, we believe the incremental disclosures of unrealized gains or losses for Level 1 and Level 2 positions will require a substantial amount of time to implement. We do not believe we could practically comply with this requirement before two years from the date of issuance. We also ask the Board to consider the other significant projects affecting financial institutions that will be effective in the upcoming years and are already straining available technological and controller resources. If the Board disagrees with our preferred request to eliminate these proposed disclosures in their entirety, we ask to defer finalizing the Proposed ASU until the broader disclosure framework is finalized and the Board reviews and considers feedback across other disclosure topics.