



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*

Dear Chairman Golden:

Thank you for the opportunity to comment on FASB's Proposed Accounting Standards Update, *Fair Value Measurement (Topic 820): Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurement*. As an independent securities valuation specialist with over twenty years' experience in financial reporting, securities valuation, and the use and application of fair value measurement, Harvest Investments, Ltd. welcomes the Board's attention to improving transparency in fair value reporting. In what follows, our main focus will be the proposed changes to Level 3 disclosures, which we generally support even as we have concerns about the path by which the Board arrived at them. In sum, we recommend that the Board address questions of the relation between Level 2 and Level 3 assets in the fair value hierarchy not by following the logic of a transformed notion of materiality, but with the idea of appropriately highlighting items whose fair values may not be as accurate as the values used for readily-traded assets.

The proposed changes to Topic 820 hinge on FASB's proposed changes to Topic 235 regarding materiality. Consequently, we would like to offer some brief remarks on the proposed changes to Topic 235 before proceeding to the current proposal for Topic 820. In general, we concur with the grounds for opposing the changes in the definition of materiality outlined by the SEC's Investor Advisory Group (IAG).<sup>1</sup> That is to say, while we support moves to increase transparency in financial reporting, the proposed changes represent a basic and confusing re-definition of materiality that will in all likelihood produce the opposite of its desired effect. We also follow the SEC's IAG in the recommendation that the proposed changes be withdrawn and reconsidered in their entirety. The central problem with the materiality change is that it appears to be motivated by the assumption that "information overload" in financial statements is something other than a myth, so that reducing disclosures would thereby become in itself a way to increase transparency. But the problems with reporting are in fact quite different: they arise from a failure to highlight items that may

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<sup>1</sup> The letter is available here:

[http://www.fasb.org/cs/BlobServer?blobkey=id&blobnocache=true&blobwhere=1175832725950&blobheader=application%2Fpdf&blobheadername2=Content-Length&blobheadername1=Content-Disposition&blobheadervalue2=661875&blobheadervalue1=filename%3DDISFR-M.ED.0078.SEC\\_INVESTOR\\_ADVISORY\\_COMMITTEE.pdf&blobcol=urldata&blobtable=MungoBlobs](http://www.fasb.org/cs/BlobServer?blobkey=id&blobnocache=true&blobwhere=1175832725950&blobheader=application%2Fpdf&blobheadername2=Content-Length&blobheadername1=Content-Disposition&blobheadervalue2=661875&blobheadervalue1=filename%3DDISFR-M.ED.0078.SEC_INVESTOR_ADVISORY_COMMITTEE.pdf&blobcol=urldata&blobtable=MungoBlobs)

involve insufficiently precise information, insufficient granularity in leveling, and insufficient transparency and understanding of pricing inputs used for harder-to-value items.

We think the relation between the logic of the proposed changes to Topic 820 and the proposed changes to the definition of materiality goes beyond the Board's characterization of it. The Board notes that the language of the latter has been included in the former and implies that the consequences of a failure to adopt the changes to Topic 235 would only require that language be removed from the current proposal. Rather, it seems to us that a decision not to implement the Topic 235 changes undercuts the rationale for the proposed amendments to Topic 820. Both express the same equation of reduced disclosures with increased transparency.

Our position on the proposed changes to Topic 820 themselves is in part shaped by the above: critical in places where it seems FASB is adhering too closely the logic of its redefinition of materiality, but supportive of the proposed changes to disclosures for Level 3 assets in particular. We recommend that the Board address questions of the relation between Level 2 and Level 3 assets in the fair value hierarchy by clarifying the categorization of Level 3, and not by following the logic of a transformed notion of materiality.

First, we note the Board's proposed elimination of providing a rationale for transfers into and out of level 2. Market liquidity problems have been a repeated motif across the installments of the IMF's 2015 Global Financial Stability Report.<sup>2</sup> The SEC's recent proposed changes to liquidity management for mutual funds, undertaken in co-operation with the FSOC, underscore the seriousness of the concerns expressed in the IMF research. Additionally, the financial press has been buzzing about market liquidity risk for many months. As the Board noted in the rationale provided in paragraph BC14 (p. 31), there have been problems with shifting levels designations. Financial reports are snapshots by virtue of their temporal framing, snapshots that produce specific states from within a continuum of movement in asset prices; these states make it possible to conflate transient market situations with more lasting ones. From our perspective, however, this situation calls for more differentiated or granular information capable of signaling to users the distinctions between shorter and longer-term liquidity issues, or asset from market illiquidity. Similarly, the ambiguity of Level 1 and Level 2 designations requires a more fine-grained approach to leveling, given that most Level 1 and 2 fixed income securities are not priced with the highest level inputs available in the market, which is to say that while trading is the highest-level input, it is not often used in determining Level 1 values.

That said, we are even more concerned with ambiguities between Levels 2 and 3 in the fair value hierarchy. Obviously, the problems that follow from the nature of financial reporting itself that the Board points to obtain here as well. For example, the "snapshot effect" may result in an asset being classed as Level 2 because a similar asset might happen to trade at the time of reporting, information about which had not been available previously and would not be available the following year. There is an inherent, systemic preference for assigning assets to Level 2, which implies that the fair value is fairly certain, instead of communicating to investors the uncertainty that accompanies Level 3. While Harvest supports additional understanding of and attention to such items, the disclosures shouldn't be so burdensome that they create further pressure to keep a questionable asset at Level 2 even if the methodology and inputs used for the fair valuation are not appropriately supported by closely-related market information.

The broader question, then, concerns the extent to which FASB is interested in the correct use of Level 3. We think that disclosure of inputs would make it easier for auditors to flag Level 3 more consistently and appropriately. Such input ranges per ASU 11-04 are already a standard feature in our insurance contracts,

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<sup>2</sup> For example, see chapter 2 of the October 2015 Global Financial Stability Report, pp. 50-62 in particular. Available here: <https://www.imf.org/External/Pubs/FT/GFSR/2015/02/index.htm>

such as synthetic GICs and the like. As the Board notes in BC40 (p. 37), the new proposed requirements for unobservables go beyond what is supplied by most third-party pricing services. We regard this as a very positive development, since our experience has shown that excessive reliance on pricing services that do not provide transparency in their pricing methodologies for hard-to-value Level 2 and 3 assets continues to be a major problem for the coherent implementation of fair value and risk assessment.

In summary, while we are concerned about the overall changes to the notion of materiality and the equation of reduced disclosures with increased transparency, we are supportive of the general approach that the Board has taken with respect to transparency about the risks and uncertainties associated with fair value reporting of non-traded assets. Disclosures that would provide investors with information about the observable market supports for the inputs that FASB would require are nevertheless warranted: this would entail a shift away from the logic of the proposed change to Topic 235, focusing instead on ensuring that valuations at higher risk of potential inaccuracy are clearly underscored and understood.

We thank the Board for the opportunity to comment on this proposal concerning changes in fair-value reporting, and for its time in reviewing our arguments and concerns. If the Board would be interested in discussing any of our arguments in more detail, we are at its disposal: please contact Susan DuRoss at 312-823-7051.

With best regards,

Harvest Investments, Ltd.