HARVEST
Transparent Investment Valuations

October 17, 2016

Susan M. Cosper, Technical Director
FASB
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Submitted via email: director@fasb.org

Re: ITC, Agenda Consultation (August 4, 2016) - File Reference No. 2016-290

Dear Director Cosper:

Harvest Investments, Ltd congratulates the Board on the completion of many of the major projects that had been on its agenda, and welcomes the opportunity to recommend topics for consideration as the Board prepares to set a new agenda. As an independent securities valuation specialist with considerable experience in financial reporting, securities valuation, and the use of fair value measurement, we have been in a good position to observe both strengths and weaknesses in present fair valuation practice. We hope that our comments will prove useful to the Board.

The completion of FASB's previous standards-setting agenda seems a logical place for a comprehensive, systemic assessment of the current status of fair value. As the Board notes in its ITC, there are a number of unresolved or confusing issues with respect to the implementation and scope of fair value measurement. In what follows, we rely on our experiences with fair value measurement in order to respond to the concerns that we take to be animating the first of the two broad questions posed in this ITC (p.4), namely, "should certain assets and liabilities be measured at fair value?" Our comment is also oriented by Question 01 (p.5) on significant financial reporting issues that are not specifically addressed in the ITC. It recommends a general assessment of fair valuation that could be undertaken alongside other FASB agenda-setting activities, and that would link those activities to the state of current practice.

We suggest initiating a survey or report that would both benchmark progress in the implementation of fair value and define ongoing problems. The resulting report would provide information about present practices of fair valuation that could help the Board's deliberations concerning the appropriate scope of fair valuation and assist with its future agenda-setting. Such a report would provide the opportunity for a general restatement and clarification of the overall objectives that shaped the transition to fair value, and also an assessment of the extent to which those objectives have or have not been met. For example, in more historically-oriented academic literature, fair value is presented as one of a number of institutionally legitimate options that were available at the onset of the financial crisis; central to arguments in favor of fair value was the idea that a system of accounting that marked derivatives to market might have prevented the traffic in those instruments from acquiring the scale it did. The survey/report we are recommending would reflect how FASB's thinking has moved since the crisis. It would permit a restatement and clarification of the objectives that shape the implementation of fair valuation, which in turn would aid in assessing the extent to which current standards have moved accounting (and, by extension, the financial sector) toward a more stable footing.

The report could also outline and explore the ways in which practice diverges from guidance. In securities valuation, we have noted significant gaps between written fair value guidance and what actually takes place. A systematic survey could help identify the cause(s) of these discrepancies, and generate serious deliberation about appropriate steps to mitigate them. If the general move to fair value is understood as a measure for reducing systemic risk, non-conformity to guidance constitutes a source of persistent systemic risk.

Harvest Investments has observed consistent problems with fair valuation across levels and asset types. We routinely detect problems in the accuracy of fair valuations within many types of securities, particularly among those that are more complex (e.g., levels 2 and 3 in the fair-value hierarchy). Agency mortgage pools, which are core investments for banks, are often mispriced. The vast majority of the meaningful variances we discover are due to inappropriate market comparisons and/or inputs as well as overreliance on single data sources. We regularly discover problems with leveling, especially with an overuse of level 2 in order to avoid the implication of uncertainty or "subjectivity" in valuation that accompanies level 3.

In our estimation, these problems result chiefly from what we call "transparency deficits," which arise from widespread reliance on (single) proprietary matrix pricing services whose methods do not allow for adequate clarity with regard to inputs. As important as such pricing services may be today because of the sheer volume of securities transactions, they do not and cannot provide the requisite transparency about inputs necessary to ensure that the standard of fair valuation is met.

An overview of the gaps between guidance and practice may reveal other issues that the Board may wish to consider. For example, it is possible that problems in current practice with respect to leveling could be addressed through the adoption of a more fine-grained approach, which could better differentiate risks and exposures and help categorize securities appropriately. We also think that there could be other factors contributing to discrepancies between guidance and practice; for example, professional training may not have kept pace with the transition to fair value.

Given that the Board is considering extending fair value, we think it is important to point out that current practice can and does fall short of conformity to existing guidance. When fair valuation is done correctly, it is a powerful indicator of both present and future risks and exposures; when it is not, bad prices can easily conceal bad securities and systemic risks.

We appreciate the opportunity to comment on this ITC, and we hope that our remarks and recommendations about fair value in practice may be useful to the Board in its deliberations, particularly with respect to the order and urgency of implementation. 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.

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