Committee of European Banking Supervisors

20 April 2009

Tower 42
25 Old Broad Street
London EC2N 1HQ
United Kingdom

t + 44 (0) 20 7382 1770
f + 44 (0) 20 7382 1771

www.c-ebs.org

Dear Madam, dear Sir

Request for views on proposed FASB Amendments

The Committee of European Banking Supervisors (CEBS), comprised of high level representatives from banking supervisory authorities and central banks of the European Union, welcomes the opportunity to provide its views as requested by the IASB on i) FSP FAS 157-4, Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly and ii) FSP FAS 115-2 and FAS 124-2, Recognition and Presentation of Other-Than-Temporary Impairments.

Banking supervisory authorities and central banks have a strong interest in promoting sound and high quality accounting and disclosure standards for the banking and financial industry, as well as transparent and comparable financial statements that would strengthen market discipline.

CEBS is in particular closely monitoring all developments with respect to the financial crisis, as shown in the work that it has carried out in the last few months in this area. Some of the conclusions we reached in the context of these efforts are of relevance in the context of the final FASB Amendments and should therefore be considered again by the IASB.

One general comment that we would like to make relates to the fact that the FASB, in issuing these proposals and final amendments, moved in isolation from the IASB. In our view this is not in line with the joint announcements issued by the IASB and FASB:

i) in October 2008, emphasising the importance of working co-operatively and in an internationally coordinated manner to consider accounting issues emerging from the global financial crisis and

ii) in March 2009, stating the two boards have agreed to work jointly and expeditiously towards common standards that deal with off balance sheet activity and the accounting for financial instruments - including loan loss accounting - within the financial instruments project."

We find this regrettable and would like to take this opportunity to reiterate the importance we attribute to the convergence between global accounting standards.

The views put forward in the annex were initially prepared on the basis of the original FASB proposals issued for public comment but have subsequently been adapted to reflect the definitive FASB proposals. They have been coordinated by CEBS's Expert Group on Financial Information (EGFI) chaired by Mr. Didier Elbaum (Deputy Secretary General, Commission Bancaire) - in charge of monitoring any developments in the accounting area and of preparing related CEBS positions – and by its Subgroup on Accounting chaired by Mr. Ian Michael of the UK FSA. If you have any questions regarding our comments, please feel free to contact Mr. Elbaum (+33.1.4292.5801) or Mr. Michael (+ 44.20.7066.7098).

Yours sincerely,

Kerstin af Jochnick
Chair, Committee of European Banking Supervisors

Annex – CEBS Views on the proposed FASB Amendments

1) Proposed FASB Amendments on Fair Value Measurement

In principle CEBS welcomes additional guidance on fair value measurement and in particular on determining the level of activity in the market and on whether a transaction is, or is not, orderly.

CEBS therefore welcomes the FASB's attempts to improve and add to the list of indicators to be considered in evaluating if a market is inactive or not.

Nevertheless CEBS has doubts about two aspects of the proposal:

i) CEBS is not convinced that all the factors listed that an institution should consider for step 1 - i.e. determining whether a market is inactive - are indeed indicators about whether a market is active or not. In this regard:

- Indicator (b): it is not entirely clear what situations are aimed to be covered by 'price quotations are not based on current information'. To the extent that price quotations reflect actual transactions it is difficult to demonstrate that they are not based on current information. If they reflect theoretical prices provided by pricing services, their relevance – as a general input to fair value estimation – is subject to the judgement of preparers and not necessarily determinative of an inactive market.
- *Indicator (d)*: the correlation between the fair value of an asset, and an index, can change for numerous reasons unrelated to the activity in the market for the asset – including the composition of the index in question, and the fundamentals of the issuer of each asset compared with the other issuers in the index;
- *Indicator (h)*: it is not entirely clear precisely what circumstances are intended to be captured by 'little information is released publicly'. However, there are many extremely important and liquid markets which are conducted largely on a principal-to-principal basis with quite restricted public disclosure of prices e.g. markets in OTC derivatives such as interest rate and currency swaps ;
- *Indicators (e) and (f)* regarding significant increases in, or abnormally high, liquidity premia or bid-ask spreads - do not mean in all instances that a market is not active but, as noted in the FSP, might be considered when determining if a market has become less active. We would reiterate that these factors should not be considered in isolation when assessing the level of activity of a market.

CEBS recognises that the final FASB staff position requires a reporting entity to evaluate the significance and relevance of the factors to determine whether, based on the weight of the evidence, there has been a significant decrease in the volume and level of activity for the asset or liability. More generally CEBS would like to reiterate the importance of judgement in determining whether a market has become significantly less active (as already set out in the CEBS, CESR and CEIOPS statement of 21 October 2008 and below).

The indicators developed by the FASB should be helpful in ensuring that there is commonality in the way that this judgement is carried out. However in order to preserve a level playing field, and consistency between accounts of different entities, we would encourage the IASB and the FASB to develop jointly further guidance to ensure that this judgement is applied consistently across entities, whether reporting under IFRS or US GAAP.

ii) Similarly, CEBS was concerned that the initially proposed amendments included a rebuttable presumption that an observed price is associated with a distressed transaction unless the reporting entity has evidence that (a) there was sufficient time before the measurement date to allow for usual and customary marketing activities for the asset and (b) there were multiple bidders for the asset.

This presumption would create an automatic link between inactive markets and forced transactions and therefore lead to a decrease in the use of judgement when determining if a transaction is disorderly or not. Rather, quoting again the joint CESR, CEBS and CEIOPS statement of 21 October 2008, CEBS would like to emphasize that it considers that "determining if a particular transaction is forced or disorderly requires judgement".

Against that background CEBS welcomes the FASB's decision to remove the rebuttable presumption from the final FSP.

As inactive markets and/or distressed transactions may warrant reliance on multiple valuations techniques, it is important to emphasize the need for a circumspect application of fair value measurements that are based on valuation models rather than current market prices. The development of further guidance – as suggested under i) above - could also be helpful to address this concern, as could further enhancements to disclosure requirements.

More generally, CEBS recommends that the IASB and FASB engage, either directly or through the IASB Expert Advisory Panel, in further work aimed at determining high-level principles that ensure that there is a balance between using the best available information and the need for strict discipline in measuring fair value. The development of these principles (and if necessary related guidance) should involve of a wide range of experts including academics and other relevant stakeholders whose views could be gathered during workshops and roundtables.

In that context, consideration should given to elevating some of the standing of the educational guidance as well as to issuing clear statements such as those published by the FASB staff, in order to ensure that the guidance of the Expert Advisory Panel is consistently applied. It is felt that the fair value measurement project offers a suitable opportunity for addressing these issues.

We would also like to reiterate that, on various occasions, CEBS expressed the view that there are still a number of other aspects of fair value measurement that require further clarification.

In particular, CEBS suggested in its June 2008 report on issues regarding the valuation of complex and illiquid financial instruments (and in the related follow-up report published in March 2009) that the guidance of the IASB Expert Advisory Panel should elaborate on the use of primary market transactions for similar instruments and offer explicit guidance on the list of factors to be considered for valuation adjustments. Furthermore, it should be clarified whether valuation adjustments should be assessed on an item-by-item approach or on the basis of a portfolio.

2) Proposed FASB Amendments on Impairment Requirements for Certain Investments in Debt and Equity Securities

On the proposed FASB amendments on Impairment requirements CEBS also has a number of concerns and comments which have – for the large part - already been put forward previously.

Before discussing these concerns CEBS would nevertheless like to welcome the proposed amendment whereby for a debt security that is (other than temporarily) impaired, the amount of the impairment related to the credit losses shall be recognized in earnings (or the “performance indicator”) whereas the amount of the impairment related to other factors shall be recognized in other comprehensive income (or shall be excluded from the “performance indicator”). We encourage the IASB to introduce a similar principle into IAS 39 supported by a detailed guidance on the methodology for separating credit losses from other risks (in order to avoid diverging implementation solutions by preparers).

As you will remember CEBS has in its June 2008 Valuation report expressed concerns about the impairment treatment for AFS debt instruments. Indeed, CEBS has stressed that, when there is objective evidence that the asset is impaired, only the impairment arising from credit risk should be recognised in profit or loss, whereas the remaining part of the cumulative loss is recognised in other comprehensive income. CEBS notably holds the view that the current IAS 39 treatment could constitute a disincentive to timely recognition of impairment.

CEBS also would discourage the IASB from abandoning the current possibility of reversals of impairment losses (that is, making the resulting carrying amount the new cost basis). Rather, CEBS strongly urges the IASB – as it has done before – to extend the possibility of reversal of impairment losses to equity instruments, again to alleviate concerns of timely recognition and ‘under-impairment’ for equity instruments classified as available for sale.

Finally CEBS would like to stress in this context that there should not be any changes to the impairment rules in IFRS for financial assets classified as loans and receivables or as held to maturity that would result in the recognition of the fair value losses other than those related to credit risk.