

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH

20 April 2009

Dear Sirs,

Request for views

We are responding on behalf of PricewaterhouseCoopers to your request for views on the proposed FSPs issued by the FASB in March 2009.

Following consultation with members of the PricewaterhouseCoopers network of firms, this response summarises the views of member firms who commented on this document. "PricewaterhouseCoopers" refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

We welcome the IASB's efforts in seeking input from constituents in light of the Boards' commitment to work jointly to address issues arising from the financial crisis. We continue to support the goal of a single set of high quality accounting standards that are accepted and applied across the world's capital markets.

As the FASB finalised the FSPs during the period that the request for views document was out for comment, our responses refer to the final FASB positions rather than the original proposals. Our response to FASB on the proposed FSPs is attached as an Appendix to this letter for information.

In light of the recent G20 recommendations we would support the publication of additional guidance on the determination of fair value in illiquid markets. As the Board will shortly be issuing an exposure draft on fair value measurements, we recommend that the principles underlying FSP 157-4 and the IASB's Expert Advisory Panel (EAP) report should be incorporated as application guidance in that exposure draft. There are some subtle differences between the guidance in the FSP and the EAP report but we do not believe that these will result in significant differences in practice. Nevertheless we would welcome clarification of this in the context of the forthcoming exposure draft.

We support the principle in FSP 115-2 that only credit losses should be recognised in profit or loss for impaired AFS debt investments and all other changes in fair value recognised in other comprehensive income. That principle is consistent with our comments in our response letter to the *Discussion Paper on Reducing Complexity*. However we note that there are a number of significant differences between IFRS and US GAAP in the area of impairment, some of which are reinforced by the FSP. This is exacerbated by the different criteria for classification and reclassification under the two sets of standards. Therefore, we do not believe it is practicable to address impairment in isolation.

Our preference is for the Board, with the FASB, to consider the accounting for all aspects of impairment of financial assets in the context of their broader project on financial instruments. This project should address all issues concerning the classification and measurement of financial instruments to reduce unnecessary complexity and eliminate any differences between IFRS and



US GAAP. We therefore welcome the recent announcement that the Board intends to publish an exposure draft on this topic in the next six months.

If you have any questions in relation to this letter please do not hesitate to contact Richard Keys, PwC Global Chief Accountant (+44 20 7212 4555), or Pauline Wallace (+44 20 7804 1293).

Yours faithfully

A handwritten signature in cursive script that reads "PricewaterhouseCoopers LLP".

PricewaterhouseCoopers LLP

April 1, 2009

Mr. Russell G. Golden
Technical Director
Financial Accounting Standards Board
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**File references: Proposed FSP FAS 157-e
Proposed FSP FAS 115-a, FAS 124-a, and EITF 99-20-b**

Dear Mr. Golden:

PricewaterhouseCoopers LLP (PwC) appreciates the opportunity to comment on proposed FASB Staff Position No. FAS 157-e, *Determining Whether a Market Is Not Active and a Transaction Is Not Distressed* (FSP FAS 157-e) and proposed FASB Staff Position No. FAS 115-a, FAS 124-a, and EITF 99-20-b, *Recognition and Presentation of Other-Than-Temporary Impairments* (FSP FAS 115-a) (together, the "proposed FSPs"). We believe the proposed FSPs, although released for comment separately, are inherently connected. Accordingly, we are offering our comments on them in a single comment letter.

We welcome and support the FASB's proposal to improve the financial statement presentation of other-than-temporary impairments of investments in debt and equity securities. We also support the FASB's objective to provide enhanced guidance relating to fair value measurements of financial assets in inactive markets. We believe that FSP FAS 115-a, if issued substantially in the form proposed, would address many of the concerns that the FASB has identified in putting forward the proposed FSPs. We struggle, however, with whether FSP FAS 157-e, if issued in the form proposed, would meet the objectives set forth by the FASB for its issuance and serve the needs of investors. If the FASB ultimately decides that it is necessary to issue both proposed FSPs, we urge the FASB to address what we believe are significant areas requiring improvement in FSP FAS 157-e, as described below. We believe that issuing FSP FAS 115-a is very important at this time, regardless of the ultimate decision on FSP FAS 157-e. We do not believe, however, that the issuance of *only* FSP FAS 157-e, even with our proposed revisions, would be adequate in the current circumstances, as some have suggested.

Proposed FSP FAS 115-a, FAS 124-a, and EITF 99-20-b

If issued as proposed, FSP FAS 115-a would change existing accounting standards in respect of (i) the "trigger" for recognizing an other-than-temporary impairment (OTTI) of debt and equity securities and (ii) the amount recognized currently in income when there are credit



losses associated with other-than-temporarily impaired debt securities. We believe this proposal would improve the quality of financial reporting in the following ways:

1. It aligns more closely the income statement impairment loss measurement and recognition models for instruments that differ in legal form but whose underlying cash flows may be essentially the same (i.e., loans and debt securities).
2. It provides more information about the causes of changes in the fair value of debt securities by identifying both credit-related and non-credit-related components of impairment losses.
3. It eliminates liquidity-related and other transitory charges from the determination of net income of entities with a "buy and hold" investment strategy. That is, it would not require recognition in the income statement of noncash losses that are not expected to be realized.
4. Further to point 3., it provides a more meaningful current income measure by avoiding large noncash charges in one period that are subsequently accreted back in future periods through increased yields.

We understand that some are concerned that this proposal would reduce transparency because entities would recognize only credit-related impairment losses in net income for other-than-temporarily impaired debt securities that are unlikely to be sold before recovery. Those concerns stem primarily from the view that some investors (i) prefer the entire amount of fair value changes to be reported through earnings, and (ii) believe that separating credit from non-credit losses is inherently imprecise and might lend itself to abusive practices in preparing financial statements.

We recognize the importance of meeting investor needs when reporting financial information. However, we respectfully do not believe that the concerns expressed above outweigh the significant benefits of this proposal. In our judgment, FSP FAS 115-a not only retains but enhances the level of transparency provided under current standards. Available-for-sale debt and equity investment securities would continue under the proposal to be carried on the balance sheet at fair value. In addition, because FSP FAS 115-a would require both credit-related and non-credit-related impairment components to be shown on the face of the income statement (with a corresponding adjustment for the amount recognized in other comprehensive income), investors and other financial statement users would have more information about the underlying drivers of impairment charges than they do today. If financial statement users wish to analyze an entity's performance for pro forma or other special purposes on the basis of including both credit-related and non-credit-related impairment losses in a measure of adjusted net income, they will have the information readily available to do so. In the meantime, for general purpose use, the financial statements will provide a measure of current income that is more representationally faithful to the underlying economics than under current standards, for the reasons mentioned above.

We also do not share the skepticism expressed by some critics about whether measurements of the credit-related portions of impairment losses are sufficiently reliable and/or provide information that is meaningful. From our experience, most entities have or can readily acquire the ability to estimate incurred credit losses on debt securities, using an approach consistent with either FAS 114 or some similar alternative methodology, as provided for under the proposal. We recognize that estimating incurred credit losses currently requires (and will continue to require) considerable judgment and that the reliability of an estimate is



dependent on the quality of that judgment. Estimates using appropriate judgment are required in many areas of accounting and we do not believe that a requirement to exercise appropriate judgment should be a basis upon which to reject the proposal.

Finally, some observers assert that the issues and concerns driving the proposed changes under FSP FAS 115-a can be satisfied by issuing FSP FAS 157-e, and that FSP FAS 115-a would therefore be unnecessary. We disagree, in part because we believe there are significant conceptual and operational problems inherent in FSP FAS 157-e as currently written (see comments below). Accordingly, we believe it is not advisable to proceed with FSP FAS 157-e, to the exclusion of FSP FAS 115-a. In addition, even if our suggested revisions are made to FSP FAS 157-e, we believe the merits of FSP FAS 115-a are substantial and that the FASB should proceed with its issuance.

While we support the objectives and basic approach of FSP FAS 115-a, there are some aspects of the proposal that we recommend the FASB clarify or revise, as follows:

Scope -- The proposal would apply to investments in both debt and equity securities, but we believe there may be confusion about the intended effect of the proposal on impaired equity securities. Given the change in the trigger (i.e., no intent to sell, and not likely to be required to sell), we believe some will interpret the proposal as providing more latitude than is perceived to exist under current standards when assessing whether an impairment of an equity investment is other than temporary. In other words, some believe that the bar has been lowered with respect to avoiding recognition of impairment losses on equity investments. We understand from informal discussions with the FASB staff that a lower bar was not the intended effect of the proposal. In order to reduce the potential for misinterpretation, we urge the FASB to clarify this point in the final FSP. We also recommend that the FASB provide guidance that stresses the need to assess the severity and duration of unrealized losses on equity securities, and guidance about whether and how the reporting entity should project recovery of the value of an equity investment that is in an unrealized loss position. Along these lines, we recommend that the FASB consider incorporating into FSP FAS 115-a the guidance currently contained in SEC Staff Accounting Bulletin No. 59, which we believe would be helpful to constituents. Alternatively, if the intention of the FASB was not to change the other-than-temporary impairment guidance for equity securities, perhaps the FASB should consider removing equity securities from the scope of FSP FAS 115-a.

Trigger -- We understand that in changing the trigger for non-recognition of other-than-temporary impairment, the FASB intended to make the guidance more operational. While we support that objective, we believe the FASB should address in this proposal some questions that arise in connection with the change in the trigger. While we are supporters of principles-based standards and do not advocate the promulgation of unnecessarily detailed rules, we believe there are some aspects of this proposed FSP that may require clarification, in order to minimize the risk of confusion or misapplication in practice. For example, is the assertion about "no intent to sell" meant to be *at a point in time* only (i.e., the measurement date)? Or alternatively, should it be regarded as being no intent to sell *for some foreseeable time period*? Also, is the change in trigger intended to change the way in which under current standards an entity would evaluate *subsequent sales* and the issue of *portfolio "tainting"*? Finally, how does the "not more likely than not" assertion change, if at all, the treatment of situations involving a *third-party asset manager* that controls the disposition of an entity's investment securities, such as in the case of nuclear decommissioning trusts?

Transition provisions – As proposed, FSP FAS 115-a would be effective for periods ending after March 15, 2009 and would be adopted prospectively. In order to improve the consistency and comparability of reported income in future periods, we believe it may be appropriate for the FASB to instead consider some form of retroactive or retrospective adoption. This approach would "true up" the amount of unrealized holding losses resident in other comprehensive income (for in-scope debt securities held as of the date of adoption) and would eliminate from future periods' income statements the accretion of non-credit-related impairment losses previously recognized in earnings. Otherwise, if the proposal is applied only prospectively, accretion of previously recognized non-credit-related impairment losses would continue to produce, as under current standards, artificially high yields on other-than-temporarily impaired debt securities held as of the date of adoption, until those securities either mature or are sold.

We recommend the FASB seek input from preparers as to whether some form of retroactive adoption is feasible, and as to whether the effective date itself can be accommodated or whether more time would be required. We expect that the answers to these questions will vary considerably from entity to entity.

Proposed FSP FAS 157-e

Market conditions in recent periods have obviously caused significant challenges for preparers, auditors, and users of financial statements with respect to price discovery and valuations of financial instruments, especially those for which relevant observable inputs are difficult, if not sometimes impossible, to obtain. We understand the pressures that these conditions have placed on preparers, standard setters, regulators, legislators, and other policy makers, and we appreciate the efforts of the FASB in continuing to respond to the unprecedented challenges that the current environment presents.

In proposing FSP FAS 157-e, the FASB is responding to input from a variety of constituents who believe that additional guidance is required to assist preparers and auditors in determining whether a market for a financial asset is not active and a transaction is not distressed. While we support the FASB's objectives in proposing this additional guidance, we have very significant concerns about the conceptual underpinnings of the proposal and its potential effects, intended or otherwise. However, should the decision be to move ahead, we urge the FASB to consider revisions to the proposal in the following respects:

Exit price -- Our most significant concern about FSP FAS 157-e is that it appears to depart from the exit price model established under FAS 157. Under that standard, the principle of exit price is fundamental to the process of fair value measurement. We believe that the example transaction contained in the proposal (i.e., the proposed amendment to paragraph A32 of FAS 157) will cause significant confusion, if its objective is to illustrate a fair value measurement that is consistent with the exit price concept. In that example, neither end of the hypothetical bid-ask spread, nor the mid-point, appears to represent an appropriate input in the measurement of an exit price.¹ Consequently, the reader of that example presumably

¹ This issue is particularly apparent in paragraph A32E, which calls for, in subparagraph (3), the use of "reasonable assumptions regarding liquidity and performance... that willing buyers and willing sellers

would have no alternative but to conclude that the value determined for the asset being evaluated is something other than fair value, as defined under FAS 157.

If the FASB's objective in this proposal is to establish a valuation concept and methodology to be applied in certain situations and under certain conditions that varies from the fair value principles under FAS 157 (exit price), we believe it would be important for the FASB to clarify such objective and to describe the determined amount as something other than "fair value." We also suggest that if there is such a departure from fair value measurement in these circumstances, any new guidance should explicitly retain the existing requirements under GAAP to disclose fair value in the footnotes to the financial statements. If the FASB's objective was not to move away from the use of fair value principles, we urge the FASB to revise the example transaction in a way that would make it consistent with the exit price concept.

Two-step process -- As with the example transaction and its departure from the principle of an exit price, we believe the proposed "two-step process" under FSP FAS 157-e has significant shortcomings, and we urge the FASB to reconsider this provision. Specifically, we believe that the requirement for an entity to presume that quoted prices in an inactive market are associated with distressed transactions, unless there is evidence to the contrary, is problematic and will have significant undesirable consequences.

In our experience, periods of disruption, illiquidity, and resulting inactivity in individual markets are not unusual; what has made the current environment unusual is the number of markets that have *simultaneously* been disrupted. Those prior situations have demonstrated that transactions executed in illiquid markets are not necessarily distressed (nor should they be presumed to be distressed). In our judgment, creating a presumption that all transactions are distressed because the related markets are inactive would produce an accounting model that is not consistent with the economics underlying these transactions.

We believe from discussions with preparers and others that there are many entities that are uncomfortable with the notion of being *required* to disregard quoted prices in inactive markets on the basis that the entity does not possess, or is unable to readily obtain, prescribed information to rebut a presumption of distress. What most concerns these entities is the prospect of assigning values to assets that they believe are unrealistically high because they are precluded from using, or must apply significant adjustments to, inputs that they believe (or even know) to be relevant in determining fair value. In many cases, these inputs are relevant and reliable, yet they must be disregarded under FSP FAS 157-e (or be significantly adjusted). This issue is especially acute for entities that must be prepared to meet shareholder redemption requests by liquidating assets on relatively short notice (e.g., mutual funds and certain other entities that manage investor assets on a pooled basis). It also could lead to anomalies such as would be the case for an investor acquiring an asset and immediately being required under the proposal to value it at a higher amount than the price paid.

would consider in pricing the asset *in an orderly transaction based on current market conditions.*" By the terms of FSP FAS 157-e itself, this information is unobtainable, since *all* related transactions from which the entity could obtain this information in this "Step 2" valuation are presumed distressed. Thus, virtually by definition, the entity must divorce its valuations from assumptions that would suggest an exit price.



We strongly urge the FASB to revise the two-step process to eliminate the "presumption" provision. In making revisions and developing a more workable model, it may be helpful to consider the guidance contained in the report issued in October 2008 by an IASB expert advisory panel about measuring the fair value of financial instruments in inactive markets.

Scope and practicability -- FSP FAS 157-e would apply only to financial assets. We understand that the FASB may have intentionally narrowed the scope of the proposal to exclude financial liabilities and all non-financial assets and liabilities, on the basis that the most significant perceived issue to be addressed by this guidance involves valuation of financial assets. However, as the FASB is aware, many financial liabilities (e.g., written credit default swaps), as well as most non-financial assets and liabilities, may be subject to market illiquidity factors very similar to those affecting certain financial assets. In addition, derivative financial instruments often move from asset to liability classification, and perhaps back again, from period to period. In order to avoid inconsistencies and unintended consequences, we recommend that the FASB reconsider these and other scope issues before finalizing this proposal.

Finally, we anticipate that many entities, including even large, sophisticated entities, will be extremely challenged to operationalize the provisions of this proposed guidance, especially within the timeframe indicated. Many market participants currently utilize established pricing services and/or broker quotes as primary inputs in valuing financial assets (and liabilities). If the effect of this proposal would be to render such inputs moot (because they are presumed to be associated with distressed transaction), entities would be required to build or acquire systems and related control mechanisms to support alternative valuation processes (i.e., shifting from a market approach to an income approach). It would be even more problematic for reporting entities that publish daily net asset values and, presumably, would be expected to somehow apply the guidance retrospectively for each daily close during the first quarter. We expect that financial statement preparers will provide the FASB with more details about these concerns, but from our experience, we believe it may be virtually impossible for many entities to effect the process and systems changes required to implement this proposal for the first calendar quarter of 2009.

We appreciate the opportunity to express our views on the proposed FSPs. These proposals represent an effort by the FASB to respond on an expedited basis to significant accounting and financial reporting issues arising in the current economic crisis. On a longer term basis, we continue to urge the FASB to pursue its joint project with the IASB to consider, on a comprehensive basis, improvements to the recognition and measurement of financial instruments.

If you have questions regarding our comments, please contact Russell Mallett at (973) 236-7115 or Ward Hamm at (973) 236-5616.

Sincerely,

PricewaterhouseCoopers LLP