

# COUNCIL OF INSTITUTIONAL INVESTORS

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Suite 500 • 888 17<sup>th</sup> Street, NW • Washington, DC 20006 • (202) 822-0800 • Fax (202) 822-0801 • [www.cii.org](http://www.cii.org)

## Via Email

October 11, 2008

The Honorable Charlie McCreevy  
European Commissioner  
Internal Market and Services  
European Commission  
B-1049 Brussels  
Belgium

Dear Commissioner McCreevy:

I am writing to you on behalf of the Council of Institutional Investors (“Council”),<sup>1</sup> an association of more than 140 public, corporate and union pension funds with combined assets of over \$3 trillion. As a leading voice for long-term, patient, and increasingly global capital,<sup>2</sup> the Council strongly believes that the accuracy of public company financial statements is critical to the integrity of capital markets.

It is with great interest that we have read your October 8, 2008, remarks before the European Parliament Plenary Session in Brussels.<sup>3</sup> Of note, those remarks include the following statement:

In addition we are urgently putting changes to our accounting rules to ensure Banks in the EU can avail of the same flexibility that is offered to banks in the US. Namely this will provide the option for individual banks if they want to move assets from their trading books to their banking books.<sup>4</sup>

We find your statement both puzzling and disturbing. Your statement is puzzling because it appears to reflect a misunderstanding of United States (“US”) generally accepted accounting principles (“GAAP”).

US GAAP generally *does not* permit a financial instrument categorized as a “trading security” to be moved or reclassified to a “held-to-maturity security” and, thereby, avoid remeasurement at fair value.<sup>5</sup> More specifically, with respect to the transfer of a trading security between categories of investments US GAAP states:

Given the nature of a trading security, transfers into or from the trading category . . . *should be rare*.<sup>6</sup>

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<sup>1</sup> For more information about the Council of Institutional Investors (“Council”), visit our website at [www.cii.org](http://www.cii.org).

<sup>2</sup> A recent survey of general members of the Council found that approximately 20% of the total assets held in members’ funds as of December 31, 2007, was composed of “global/international” equity and fixed income investments.

<sup>3</sup> Charlie McCreevy, European Commissioner for Internal Market and Services—Lamfalussy Follow Up: Future Structure of Supervision, European Parliament Plenary Session Brussels (Oct. 8, 2008), <http://www.exchange-handbook.co.uk/index.cfm?section=news&action=detail&id=77935>.

<sup>4</sup> *Id.* at 1.

<sup>5</sup> See Accounting for Certain Investments in Debt and Equity Securities, Statement of Financial Accounting Standards No. 115, ¶¶ 7-16 (Fin. Accounting Standards Bd. 1993), [http://www.fasb.org/pdf/aop\\_FAS115.pdf](http://www.fasb.org/pdf/aop_FAS115.pdf).

<sup>6</sup> *Id.* ¶ 15 (emphasis added).

In those rare circumstances, reclassifications from trading to the held-to-maturity category could occur “*only* if the reporting enterprise has the positive intent and ability to hold those securities to maturity.”<sup>7</sup>

In the unlikely event that a security could qualify to be transferred from trading to the held-to-maturity category under US GAAP, such a transfer could not be used for the purpose of avoiding the recognition of losses in the financial statements.<sup>8</sup> Moreover, US GAAP requires that individual securities classified as held-to-maturity “shall be written down to fair value . . . and the amount of the write-down shall be included in earnings” if a decline in fair value below the amortized cost of the security is “other than temporary.”<sup>9</sup>

Your statement is also disturbing because permitting individual banks the option of ignoring the existing fair value accounting requirements for financial instruments: (1) harms the credibility and independence of the private sector accounting standard setting process that developed the accounting standards for financial instruments following an extensive public due process in which all interested parties, including banks, participated;<sup>10</sup> and (2) is inconsistent with the views of investors—the key consumers of financial reports—who generally support fair value accounting for financial instruments.<sup>11</sup>

For your information and review, we have attached to this letter two items that the Council recently issued on the topic of fair value accounting for financial instruments. First, a July 2008 white paper entitled “Fair Value Accounting: Understanding the Issues Raised by the Credit Crunch.”<sup>12</sup> The white paper was prepared for the Council by Stephen G. Ryan, Professor of Accounting and Peat Marwick Faculty Fellow, Stern School of Business, New York University. The white paper concludes:

The . . . relevant question is whether fair value accounting provides more useful information to investors than alternative accounting approaches. The answer to that question is “yes.”<sup>13</sup>

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<sup>7</sup> *Id.* ¶ 7 (emphasis added).

<sup>8</sup> *See id.* ¶ 15 (“For a security transferred from the trading category, the unrealized holding gain or loss at the date of the transfer will have already been recognized in earnings and shall not be reversed”).

<sup>9</sup> *Id.* ¶ 16.

<sup>10</sup> The general members of the Council recently approved an update to the Council’s existing policies supporting “the view that the responsibility to promulgate accounting and auditing standards should reside with independent private sector organizations.” Policies on Other Governance Issues, Independence of Accounting and Auditing Standard Setters 1 (updated Oct. 7, 2008),

<http://www.cii.org/UserFiles/file/council%20policies/CII%20Policies%20on%20Accounting%20and%20Auditing%2010-7-08.pdf>.

<sup>11</sup> *See, e.g.*, Letter from Rebecca McEnally, Member, Investors Technical Advisory Committee, to Mr. Robert Herz, Chairman, Financial Accounting Standards Board & Sir David Tweedie, Chairman, International Accounting Standards Board 1 (May 23, 2008), [http://www.fasb.org/investors\\_technical\\_advisory\\_committee/itac\\_05-23-08.pdf](http://www.fasb.org/investors_technical_advisory_committee/itac_05-23-08.pdf) (“The ITAC believes that clear, complete, objective, and timely information, measured as accurately as market conditions and information permit, that is, fair value measurement, is of fundamental importance to financial statement users and the functioning of markets at all times”).

<sup>12</sup> Stephen G. Ryan, *Fair Value Accounting: Understanding the Issues Raised by the Credit Crunch* (July 2008), [http://www.cii.org/UserFiles/file/resource%20center/correspondence/2008/CII%20Fair%20Value%20Paper%20\(final\)%2020071108.pdf](http://www.cii.org/UserFiles/file/resource%20center/correspondence/2008/CII%20Fair%20Value%20Paper%20(final)%2020071108.pdf) (Attachment 1).

<sup>13</sup> *Id.* at 1.

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In addition, we have attached an October 1, 2008, joint statement by the Council, the Center for Audit Quality, and the CFA Institute opposing the suspension of mark-to-market accounting.<sup>14</sup> That statement concludes:

In the interest of investor confidence and the health of our capital markets and overall economy, we urge the SEC to resist calls from those with a questionable commitment to transparency and to reject any proposal that would suspend fair value accounting.<sup>15</sup>

In closing, we would respectfully request that, in the interests of investors and the global capital market system, you consider realigning your views about fair value accounting for financial instruments with the views of the consumers of financial reports. We would also respectfully request that you publicly reject the unsound and self-serving views about fair value accounting espoused by the banking lobby—whose clients' poor business practices and decision-making were perhaps the most significant contributors to the ongoing global financial crisis.

Thank you for the opportunity to share with you the views of investors on this important matter. Please do not hesitate to contact me at (202) 261-7081 or [jeff@cii.org](mailto:jeff@cii.org) if you have any questions or comments about this letter or the related Attachments.

Sincerely,



Jeff Mahoney  
General Counsel  
Council of Institutional Investors

Attachments

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<sup>14</sup> News Release, Joint Statement of the Center for Audit Quality, the Council of Institutional Investors and the CFA Institute Opposing Suspension of Mark-to-Market Accounting (Oct. 1, 2008), <http://www.cii.org/UserFiles/file/CAQ%20CII%20CFA%20statement%20on%20FV.pdf> (Attachment 2).

<sup>15</sup> *Id.*