

# COUNCIL OF INSTITUTIONAL INVESTORS

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## Via Email

December 24, 2008

Russell Golden  
Technical Director  
FASB  
401 Merritt 7  
PO Box 5116  
Norwalk, CT 06856-5116

Re: File Reference: Proposed FSP EITF 99-20-a

Dear Mr. Golden:

I am writing on behalf of the Council of Institutional Investors (“Council”), an association of more than 140 public, corporate and union pension funds with combined assets of over \$3 trillion.<sup>1</sup> As a leading voice for long-term, patient capital, we appreciate the opportunity to provide comments in response to the proposed Financial Accounting Standards Board (“FASB”) Staff Position (“FSP”) 99-20-a to amend Emerging Issues Task Force (“EITF”) Issue No. 99-20, “Recognition of Interest Income and Impairment on Purchased Beneficial Interests and Beneficial Interests That Continue to Be Held by a Transferor in Securitized Financial Assets” (“Proposal”).<sup>2</sup>

At our October 7, 2008 meeting, the Council’s general membership approved an update to our policy on independence of accounting and auditing standard setting (“Policy”).<sup>3</sup> The Policy continues to reflect our long-held view that the quality, comparability, and reliability of financial information contained in financial statements and related disclosures depends directly on the quality of financial reporting standards and the standard setters that develop those standards.<sup>4</sup>

The following two criteria contained in the Policy appear particularly relevant to the Proposal:

- The . . . standard setter has demonstrated a clear recognition that investors are the key customer of audited financial reports and, therefore, the primary role of . . . financial reports should be to satisfy in a timely manner investors’ information needs. . . .<sup>5</sup>

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

<sup>2</sup> *Recognition of Interest Income and Impairment on Purchased Beneficial Interests and Beneficial Interests That Continue to Be Held by a Transferor in Securitized Financial Assets*, Proposed FSP on EITF Issue 99-20 (Fin. Accounting Standards Bd. Proposed FSP 99-20-a Dec. 2008), [http://www.fasb.org/fasb\\_staff\\_positions/prop\\_fsp\\_eitf99-20-a.pdf](http://www.fasb.org/fasb_staff_positions/prop_fsp_eitf99-20-a.pdf) [hereinafter Proposal].

<sup>3</sup> The Council of Institutional Investors, *Policies on Other Governance Issues, Independence of Accounting and Auditing Standard Setters* (Updated Oct. 7, 2008),

[http://www.cii.org/UserFiles/file/council%20policies/CII%20Policies%20on%20Accounting%20and%20Auditing%2010-7-08\(1\).pdf](http://www.cii.org/UserFiles/file/council%20policies/CII%20Policies%20on%20Accounting%20and%20Auditing%2010-7-08(1).pdf) [Hereinafter Policy]. For more information about the Council’s policies, visit our website at

<http://www.cii.org/policies>.

<sup>4</sup> See Policy, *supra*, at 1.

<sup>5</sup> *Id.* Of note, this criterion is consistent with Recommendation 2.1 of the August 1, 2008, Final Report of the Advisory Committee on Improvements to Financial Reporting to the United States Securities and Exchange Commission which states, in part, “*investor perspectives should be given pre-eminence by all parties involved in standards-setting*” (footnote omitted), <http://www.sec.gov/about/offices/oca/acifr/acifr-finalreport.pdf>.

- The . . . standard setter has a thorough public due process that includes solicitation of investor input on proposals and careful consideration of investor views before issuing proposals or final standards . . . .<sup>6</sup>

Consistent with the Policy, and the view of many other investors, accountants, auditors, and other market participants, we generally believe that:

In the specific case of fair value reporting, investors require an accounting standard that reports a relevant and useful value of financial instruments regardless of the direction of the markets. Fair value accounting with robust disclosures provides more reliable, timely, and comparable information than amounts that would be reported under other alternative accounting approaches.<sup>7</sup>

Our belief about the benefits of fair value accounting for financial instruments is also supported by a July 2008 Council-commissioned white paper, “Fair Value Accounting: Understanding the Issues Raised by the Credit Crunch.”<sup>8</sup> The attached white paper, authored by Professor Stephen G. Ryan, a leading expert on fair value accounting, provides the following insightful comments on fair value accounting and the ongoing credit crisis:

[I]t is absolutely clear that the subprime crisis that gave rise to the credit crunch was primarily caused by . . . bad operating, investing, and financing decisions, managing risks poorly, and in some instances committing fraud, not by accounting. . . . Because of its timeliness and informational richness, fair value accounting and associated mandatory and voluntary disclosures should reduce uncertainty and information asymmetry faster over time than amortized cost accounting would, thereby mitigating the duration of the credit crunch.<sup>9</sup>

The Council, therefore, cannot support the Proposal for at least two fundamental reasons: (1) We do not believe the Proposal is consistent with the needs of investors; and (2) We do not believe an eleven day comment period (which includes significant ethnic, religious, and national holidays) constitutes a thorough public due process.

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<sup>6</sup> Policy, *supra*, at 1.

<sup>7</sup> Letter from Cindy Fornelli et al. to The Honorable Christopher Cox 1-2 (Nov. 14, 2008), <http://www.sec.gov/comments/4-573/4573-175.pdf>; accord Letter from Jeff Mahoney to Ms. Florence E. Harmon 4 (Oct. 29, 2008), <http://www.sec.gov/comments/4-573/4573-95.pdf> (“We believe that fair value accounting for financial instruments, complemented by robust disclosures, is superior to other accounting alternatives in (1) providing investors clear and accurate information, and (2) restoring the free flow of money and credit to the U.S. and global capital markets”).

<sup>8</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) [hereinafter Attachment].

<sup>9</sup> *Id.* at 16.

### The Proposal Does Not Meet the Needs of Investors

As indicated, the Council agrees with many other investors, accountants, auditors, and other market participants that the needs of investors and other consumers of financial reports are best satisfied by requiring that all financial instruments be accounted for at fair value accompanied by robust disclosures. We note that such an approach would eliminate the need for the Proposal because other-than-temporary impairment (“OTTI”) models would not be necessary if all financial instruments were reported at fair value.

We also share FASB Chairman Herz’s doubts about the usefulness of OTTI models to investors generally.<sup>10</sup> Chairman Herz recently commented:

I think all of this impairment stuff is voodoo . . . . I see a lot of utility for understanding what’s happening to particular instruments, market values, cash flows currently and projected. I don’t see a lot of value to some of these calculations that get done now *under any of the impairment models*. . . . *For those who believe impairment is an important element of the accounting model, I invite them to try to persuade me.*<sup>11</sup>

Notwithstanding the questionable usefulness of current impairment models, until the goal of reporting all financial instruments at fair value is achieved, we would not necessarily oppose any effort by the FASB to align disparate OTTI models for instruments with similar economics at least to the extent that that alignment is directionally consistent with the ultimate goal.<sup>12</sup> The Proposal, however, clearly fails in that regard.<sup>13</sup>

More specifically, the Proposal moves further away from fair value reporting by proposing to replace the OTTI model of EITF Issue No. 99-20 (“99-20”) based on “market participant assumptions regarding future cash flows,” with the FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities* (“FAS 115”), OTTI model permitting “management judgment of the probability that the holder will be unable to collect the amounts due.”<sup>14</sup> We generally agree with the following analysis of this proposed change authored by accounting & valuation experts Sarah Deans and Dane Mott of J.P. Morgan:

1. Moving from the 99-20 [OTTI model] . . . to the weaker FAS 115 [OTTI model] . . . actually moves the measure of these assets further away from fair value and makes their OTTI determinations more subject to gaming, in our view.

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<sup>10</sup> Tammy Whitehouse, *FASB Racing Through Impairment Revisions*, Compliance Wk. 1 (Dec. 23, 2008), <http://www.complianceweek.com/article/5196/fasb-racing-through-impairment-revisions>.

<sup>11</sup> *Id.* at 1 (emphasis added).

<sup>12</sup> See Proposal, *supra*, ¶5.

<sup>13</sup> See, e.g., Sarah Deans & Dane Mott, *Accounting Issues—Financial Instrument Proposals: Standard Setters Ditch Normal Due Process*, J.P. Morgan Global Equity Res. 6 (Dec. 19, 2008) (on file with the Council) [hereinafter Deans & Mott].

<sup>14</sup> Proposal, *supra*, ¶4.

2. Even though the 99-20 [OTTI model] . . . is inconsistent with FAS 115 [OTTI model], there are numerous inconsistencies in the OTTI models throughout GAAP. If the FASB is sharply focused on the objective of providing the most useful information possible to investors, how exactly does this change accomplish this mission especially if . . . a large contingent of investors have indicated that fair value measures are more relevant to investors? This seems to be a waste of valuable board time and resources that could be used more effectively elsewhere, in our view.<sup>15</sup>

We also note that at the November 11, 2008, meeting of the FASB's own Investors Technical Advisory Committee ("ITAC"), ITAC members voiced strong opposition to the FASB pursuing any project—like the Proposal—designed to amend the existing OTTI guidance for financial instruments.<sup>16</sup> Views expressed by various ITAC members explaining their opposition to the Proposal include the following:

ITAC does not believe any changes are necessary to the other-than-temporary impairment guidance. . . . ITAC supports measuring financial instruments at fair value, which would make impairment testing unnecessary.

ITAC does not see any reason for an other-than-temporary impairment project at this time. . . . ITAC thinks that those who are encouraging the Boards to add an other-than-temporary impairment project may be looking to minimize losses that are real, which is not in the best interests of investors. . . . [C]hanging US GAAP in [this] . . . area actually would put US GAAP companies at a disadvantage because the cost of capital would increase and investors would be fearful that companies have real losses that have not been recognized. . . . [A] project to revisit the other-than-temporary guidance should not be a high priority for the Board. . . . [A] more desirable project would be one that involves measuring all financial instruments at fair value and developing more robust disclosures about how fair value changes evolve over time. . . . [C]oncerns about other-than-temporary impairment are influenced by concerns over regulatory capital requirements. Those concerns should not result in changes to accounting standards that would decrease the transparency of information for investors and can be addressed through other means.<sup>17</sup>

We generally share ITAC's views on this issue.

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<sup>15</sup> Deans & Mott, *supra*, at 6.

<sup>16</sup> Minutes of Meeting, FASB Investors Technical Advisory Committee ¶¶ 7-9 (Nov. 1, 2008), [http://www.fasb.org/investors\\_technical\\_advisory\\_committee/itac\\_11-11-08.pdf](http://www.fasb.org/investors_technical_advisory_committee/itac_11-11-08.pdf).

<sup>17</sup> *Id.* ¶¶ 7-8.

### The Comment Period Is Inadequate

The FASB's rules of procedure require that the "FASB will expose all proposed Statements of Financial Accounting Standards for public comment for at least 60 days, unless a shorter period (not less than 30 days) is considered appropriate by the FASB."<sup>18</sup> Similarly, with respect to proposed interpretations that "clarify, explain, or elaborate on a pronouncement as an aid to its understanding," FASB's rules of procedure require exposure for public comment "for at least 30 days."<sup>19</sup> Finally, with respect to "Technical Bulletins" designed to provide guidance for applying standards that is, among other factors, "not expected to cause a major change in accounting practice for a significant number of entities," FASB's rules of procedure require exposure for public comment of "not . . . less than 15 days."<sup>20</sup>

We acknowledge that on October 1, 2008, the FASB approved the following resolutions temporarily modifying the FASB's rules of procedure to potentially shorten the required public comment periods ("Resolutions"):

RESOLVED, that effective immediately, and solely in respect to technical standard-setting activities of the FASB . . . that address and/or are responsive to the current spectrum of severe instability in the U.S. and global financial and capital markets, the FASB shall, to the extent and as determined by a majority of the FASB Members on a case-by-case basis to be necessary or advisable, have authority to accelerate FASB's normal due process practices and procedures for . . . receiving public . . . comments on, the FASB's and/or its staff's issuance of, any and all forms of FASB pronouncements . . . .

RESOLVED, that, absent a re-vote to extend the term of the limited modifications to the FASB's standards-setting processes permitted by the foregoing resolution, the foregoing resolution shall expire and be of no further force or effect on January 1, 2009.<sup>21</sup>

Although not explicitly discussed in the Proposal, it appears that the FASB is relying on the Resolutions to accelerate the Proposal's required comment period from not less than fifteen days to only eleven days. Of note, this scrooge-like comment period includes the following ethnic and religious holidays: Boxing Day, Hanukkah, Kwanzaa, Las Posadas, Christmas Eve, and Christmas Day—a national holiday.<sup>22</sup>

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<sup>18</sup> Rules of Procedure 14 (Fin Accounting Standards Bd. Amended & Restated Dec. 1, 2002) (on file with Council).

<sup>19</sup> *Id.* at 15-16.

<sup>20</sup> *Id.* at 16-17.

<sup>21</sup> *Authorization of Limited and Temporary Modifications to Standards-setting Processes* (Fin Accounting Standards Bd. Oct. 1, 2008) (on file with Council) [hereinafter Resolutions].

<sup>22</sup> KU Medical Center, *Ethnic and Religious Cultural Holidays, Celebrations, and Festivals 5*, [http://www3.kumc.edu/diversity/ethnic\\_relig/ethnic.html](http://www3.kumc.edu/diversity/ethnic_relig/ethnic.html) (last visited Dec. 23, 2008); see also Deans & Mott, *supra*, at 7 ("The fact that it is a 10-day comment period over a period when a considerable amount of stakeholders will be on a holiday and have limited opportunities to respond when, in our view, one of the key deficiencies of this project is that inadequate due diligence has been performed is of concern to us").

Notwithstanding our policy supporting a thorough public due process, we generally would not object to the FASB accelerating its due process in truly extreme and unusual circumstances in which a statement, interpretation, or other guidance was necessary to “address and/or . . . respon[d] [to] . . . severe instability in the U.S. global financial and capital markets.”<sup>23</sup> There is, however, no evidence that we are aware of contained in, or outside, the Proposal indicating that aligning the impairment models of 99-20 with Statement 115 before year end is necessary or appropriate to address or respond to “severe instability” in the capital markets.<sup>24</sup>

In contrast, we believe the more supportable and far better view is that if the Proposal is adopted by the FASB before year end, it is likely, if anything, to exacerbate instability in the capital markets by further lowering investors’ confidence in (1) the reporting by companies, and (2) the related independence of the accounting standard-setting process.<sup>25</sup> On this point, we generally agree with the following critique of the Proposal’s due process by expert accountant/analyst Jack Ciesielski:

So – should there be such a rush? No. Understandably, there are year end consequences. But the FASB looks pretty bad in rushing this project through – it’s almost as if they’re racing the IASB to find ways to screw up due process. The FASB takes years and years to complete projects – or not complete them – then rushes through something like this. It trivializes the importance of independent standard-setting.<sup>26</sup>

In summary, we strongly oppose the Proposal. We, however, appreciate the opportunity to provide our comments thereon.

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<sup>23</sup> Resolutions, *supra*.

<sup>24</sup> See, e.g., Attachment, *supra*, at 16.

<sup>25</sup> See, e.g., Bob Herz, *Lessons Learned, Relearned, and Relearned Again from the Global Financial Crisis—Accounting and Beyond*, Remarks before the AICPA National Conference on Current SEC & PCAOB Developments 18 (Dec. 8, 2008), [http://www.fasb.org/articles&reports/12-08-08\\_herz\\_speech.pdf](http://www.fasb.org/articles&reports/12-08-08_herz_speech.pdf) (“[A]ccounting and financial reporting are meant to inform investors and the capital markets and that straying from that objective or subordinating that objective to any other corporate, industry, social or economic objective other than sound and transparent reporting, can also cause financial instability due to loss of investor confidence in the reporting by companies”).

<sup>26</sup> Jack Ciesielski, *Like a Train In the Night*, AAO Weblog (Private) (Dec. 18, 2008) (on file with Council); accord Deans & Mott, *supra*, at 6 (“We fear that this project could be another example of the FASB and IASB succumbing to political pressure that overrides their long-established system of due process. We believe the regulatory capture of the accounting standard setting process is becoming a real threat based on recent political concessions made by both the IASB and FASB in recent months”).

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Please feel free to contact me at 202.261.7081 or [jeff@cii.org](mailto:jeff@cii.org) with any questions or if any additional information about the Council's views on the Proposal or related matters would be helpful to your redeliberations.

Sincerely,

A handwritten signature in black ink that reads "Jeff Mahoney". The signature is written in a cursive, flowing style.

Jeff Mahoney  
General Counsel  
Council of Institutional Investors

Attachment