Council of Institutional Investors®
The voice of corporate governance

Via E-Mail

April 27, 2023

Ms. Hillary H. Salo
Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116,
Norwalk, CT 06856-5116

Re: Agenda Request to Consider Eliminating the Held-to-Maturity Classification of Debt Securities and Improving Financial Instrument Disclosures about Liquidity Risk and Interest Rate Risk

Dear Ms. Salo:

We appreciate the opportunity to submit an agenda request to the Financial Accounting Standards Board (FASB or Board) to consider the elimination of the held-to-maturity [HTM] classification of debt securities and to improve financial instrument disclosures about liquidity risk and interest rate risk.

The Council of Institutional Investors (CII) is a nonprofit, nonpartisan association of United States (U.S.) public, corporate and union employee benefit funds, other employee benefit plans, state and local entities charged with investing public assets, and foundations and endowments with combined assets under management of approximately $4 trillion. Our member funds include major long-term shareowners with a duty to protect the retirement savings of millions of workers and their families, including public pension funds with more than 15 million participants – true "Main Street" investors through their pension funds. Our associate members include non-U.S. asset owners with about $4 trillion in assets, and a range of asset managers with more than $40 trillion in assets under management.[1]

As the leading voice for corporate governance, CII places great importance on financial statements and related disclosures as "a critical source of information to institutional investors making investment decisions."[2] And CII believes that the quality, comparability and reliability of the information contained in those financial statements, "in turn, depends directly on the quality of the financial reporting standards that: [] enterprises use to recognize, measure and report their economic activities and events . . . ."[3] Importantly, CII also believes that the responsibility to

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[1] For more information about the Council of Institutional Investors ("CII"), including its board and members, please visit CII's website at http://www.cii.org.
[2] CII Policies, Policies on Other Issues, Independence of Accounting and Auditing Standard Setters (Updated Mar. 1, 2017), https://www.cii.org/policies_other_issues.
[3] *Id.*

promulgate accounting standards "should reside with independent organizations" that, among other attributes, are accountable to investors.[4]

Generally consistent with our aforementioned membership-approved policies and related public positions, we respectfully request that the FASB add two projects to its technical agenda to consider (1) eliminating the held-to-maturity classification for debt securities under Accounting Standards Codification (ASC) Topic 320 Investments,[5] and (2) requiring disclosures about liquidity risk and interest rate risk under ASC Topic 825 Financial Instruments.[6]

Background to Request

As you are aware, on December 31, 2022, the parent of Silicon Valley Bank, SVB Financial Group (SVB), had most of its assets invested in fixed income securities, including U.S. government bonds.[7] SVB chose to classify $91 billion of those assets as held-to-maturity and measure and report those assets at amortized cost on the face of its balance sheet with a parenthetical disclosing that those assets had a fair value of just $76 billion.[8] In accordance with ASC Topic 320,[9] footnotes to SVB's financial statements also revealed that the assets classified as held-to-maturity had a $15 billion unrealized loss.[10] The $15 billion unrealized loss in value was created, in large part, by the Federal Reserve's seven interest rate hikes in 2022,[11] and the loss would have wiped out most of SVB's total equity of $16 billion at year-end had it in fact been recognized.[12]

Notably, SVB's audited financial statement footnotes did not explicitly disclose any information about SVB's liquidity risk and provided only limited information about its interest rate risk.[13]

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[4] *Id.*

[5] *See* Classification of Debt Securities, 320-10-25-1, FASB Acct. Standards Codification (last visited Apr. 23, 2023), https://asc.fasb.org/1943274/2147481736 ("At acquisition, an entity shall classify debt securities into one of the following three categories: . . . Held-to-maturity securities [and] [i]nvestments in debt securities shall be classified as held-to-maturity only if the reporting entity has the positive intent and ability to hold those securities to maturity.").

[6] *See* Financial Instruments Disclosure, 825-10-50-1, FASB Acct. Standards Codification. (last visited Apr. 27, 2023), https://asc.fasb.org/1943274/2147482907 ("This Subsection addresses incremental disclosures about all of the following: a of financial instruments b Concentrations of credit risk of all financial instruments c Market risk of all financial instruments.").

[7] *See* SVB FINANCIAL GROUP, Annual Report (FORM 10-K) 43 (Feb. 24, 2023), https://d18rn0p25nwr6d.cloudfront.net/CIK-0000719739/f36fc4d7-9459-41d7-9e3d-2c468971b386.pdf.

[8] *See id.* at 95.

[9] *See* Securities Classified as Held to Maturity, 320-10-50-5A, FASB Acct. Standards Codification (last visited Apr. 27, 2023), https://asc.fasb.org/1943274/2147481800/320-10-50-5A ("A public business entity shall disclose the following information for securities classified as held to maturity, by major security type, as of each date for which a statement of financial position is presented: Aggregate fair value, Gross unrecognized holding gains, Gross unrecognized holding losses.").

[10] *See* SVB FINANCIAL GROUP, Annual Report (FORM 10-K) at 125 (Total HTM Securities Unrealized Losses: (15,160)); Jean Eaglesham, Auditors Didn't Flag Risks Building Up in Banks, Wall St. J., Apr. 10, 2023, https://www.wsj.com/articles/auditors-didnt-flag-risks-building-up-in-banks-6506585c ("That $15 billion loss was big enough to wipe out most of the bank's total equity of $16 billion at year-end.").

[11] *See, e.g.,* Taylor Pepper, Federal Funds Rate History 1990 to 2023, Forbes, updated Mar. 22, 2023, https://www.forbes.com/advisor/investing/fed-funds-rate-history/.

[12] *See* SVB FINANCIAL GROUP, Annual Report (FORM 10-K) at 95 (reporting "total equity" of "16,295").

[13] *See id.* at 113, 144-45, 147-48.

Those disclosures included some qualitative and quantitative information about its use of derivative financial instruments for hedging purposes as required by ASC Topic 815 Derivatives & Hedging.[14]

On February, 1, 2023, and again on March 2 the Federal Reserve raised interest rates by 25 basis points.[15] Customers of SVB, some dealing with their own cash shortfalls, began withdrawing their deposits.[16] The amount of withdrawals left SVB with insufficient cash reserves. As a result, on March 8, SVB management announced that it: (1) sold approximately $21 billion or substantially all of its available-for-sale securities at a realized loss of $1.8 billion, and (2) sought to raise over $2 billion in new capital through offerings of common stock and mandatory redeemable preferred stock.[17]

The efforts to raise capital likely led even more SVB customers to lose confidence in the bank's liquidity and a rush to withdraw their deposits. As a result, on March 10 the California Department of Financial Protection and Innovation took possession of SVB and appointed the Federal Deposit Insurance Corporation as receiver.[18]

In our view, financial accounting and reporting was clearly not the cause of SVB's collapse, but its failure raises legitimate questions about the appropriateness of certain provisions of FASB standards, including (1) the propriety of classifying held-to-maturity debt securities under ASC Topic 320; and (2) the lack of required footnote disclosures about the liquidity risk and interest rate risk of financial instruments under ASC Topic 825.[19]

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[14] *See* Derivative & Hedging, 815-10-50-1, FASB Acct. Standards Codification (last visited Apr. 27, 2023), https://asc.fasb.org/1943274/2147480434/815-10-50-1 ("An entity with (or nonderivative instruments that are designated and qualify as hedging instruments pursuant to paragraphs 815-20-25-58 and 815-20-25-66) shall disclose information to enable users of the financial statements to understand all of the following: a How and why an entity uses derivative instruments (or such nonderivative instruments) b How derivative instruments (or such nonderivative instruments) and related hedged items are accounted for under Topic 815 c How derivative instruments (or such nonderivative instruments) and related hedged items affect all of the following: 1 An entity's financial position 2 An entity's financial performance 3 An entity's cash flows.").

[15] *See, e.g.,* Taylor Pepper, Federal Funds Rate History 1990 to 2023, Forbes.

[16] *See, e.g.,* Vidhura S. Tennekoon, The Conversation, Analysis: Why Silicon Valley Bank and Signature Bank failed so fast, PBSNewsHour (Mar. 14, 2023), https://www.pbs.org/newshour/author/vidhura-s-tennekoon-the-conversation ("earlier this year as its customers, dealing with their own cash shortfalls, began withdrawing their deposits — while even higher interest rates were expected").

[17] Press Release, SVB, SVB Financial Group Announces Proposed Offerings of Common Stock and Mandatory Convertible Preferred Stock (Mar. 8, 2023), https://ir.svb.com/news-and-research/news/news-details/2023/SVB-Financial-Group-Announces-Proposed-Offerings-of-Common-Stock-and-Mandatory-Convertible-Preferred-Stock/default.aspx#:~:text=SVB%20sold%20approximately%20%2421%20billion%20of%20securities%2C%20which,%241.8%20billion%20in%20the%20first%20quarter%20of%202023.

[18] Press Release, FDIC Creates a Deposit Insurance National Bank of Santa Clara to Protect Insured Depositors of Silicon Valley Bank, Santa Clara, California, FDIC (Mar. 10, 2023), https://www.fdic.gov/news/press-releases/2023/pr23016.html.

[19] *See, e.g.,* Fair Values and Interest Rate Risk – Silicon Valley Bank, Footnote Analyst (Mar. 15, 2023), https://www.footnotesanalyst.com/fair-values-and-interest-rate-risk/ ("The recent collapse of Silicon Valley Bank raises interesting questions about interest rate risk disclosures and the measurement of financial instruments in bank financial statements. What assets and liabilities should be reported at fair value rather than amortised cost, and should more fair value changes be included in profit and loss?").

Classification as held-to-maturity

CII has long believed that fair value accounting for financial instruments, accompanied by robust disclosures, provides investors with more informative reporting than other alternative accounting approaches, including amortized cost accounting that accompanies the held-to-maturity classification for debt securities.[20] We believe amortized cost measurement fails to provide information about key risks such as liquidity, interest-rate sensitivity, asset liability duration mismatches. By contrast, fair value measurement encompasses market views about each of these. Thus, amortized cost measurement may mask the real economics of the underlying financial instruments and the entity as a whole.[21] As a result, we generally support the recent recommendation of Sandy Peters, Senior Head of financial reporting policy for the CFA Institute, that the FASB should consider the "eliminat[ation] [of] the HTM classification to reflect all financial instruments properly at fair value in the financial statements."[22] The basis for Peters' recommendation includes following:

> [T]he financial statement carrying value of those financial instruments held-to-maturity is reflected at amortized cost, or what management paid for the asset sometime in the past plus amortization of the discount or premium from the face value. The fair value is only disclosed on the face of the financial statement and in the footnotes. Any unrealized loss is "hidden in plain sight."
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> . . . [M]anagement intent and business model do not change the value of financial instruments. The HTM classification only makes it harder for investors and depositors to see.
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> . . . .
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> . . . [U]nrealized losses [at SVB] were there for investors and depositors to understand. It just required some digging. . . . [But the CFA Institute believes that] "highly relevant information" belongs in the measurement of financial instruments in the financial statements not simply in the disclosures.[23]

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[20] *See, e.g.,* Letter from Jeff Mahoney, General Counsel, CII to Florence E. Harmon, Acting Secretary, Securities and Exchange Commission 4 (Oct. 29, 2008), https://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 . . . providing investors clear and accurate information . . . .").

[21] *See, e.g.,* Letter from Jeff Mahoney, Co-Chair, ITAC et al. to Sir David Tweedie, Chairman, International Accounting Standards Board 4 (Sept. 22, 2009), https://www.fasb.org/Page/ShowPdf?path=2009+09+22+IAS+39+Financial+Instruments.pdf&title=ITAC%20Comment%20Letter%20-%20September%2022,%202009 ("Amortized cost, given its smoothed mature and underlying assumption of a long-term holding period, provides limited decision-useful information, and would best be delegated to the notes to the financial statements [and] we believe that fair value is the only meaningful measurement basis for financial instruments . . . .").

[22] Sandy Peters, Market Integrity Insights, Views on Improving the Integrity of the Global Capital Markets, SVB Collapse: FASB Should Eliminate "Hide-'Til-Maturity" Accounting, CFA Institute (Mar. 2023), https://blogs.cfainstitute.org/marketintegrity/2023/03/13/the-svb-collapse-fasb-should-eliminate-hide-til-maturity-accounting/.

[23] *Id*.

Similarly, famed investor and of Berkshire Hathaway CEO Warren Buffett appeared to question the appropriateness of the HTM classification in a recent CNBC interview.[24] Mr. Buffett indicated that several banks engaged in misleading accounting to artificially inflate their profits.[25] He provided the example of banks valuing their long-dated bonds at their par value instead of their market value, which hid the fact their value had fallen on paper.[26]

Concerns about the classification of debt securities as HTM are not limited to investors. Some bank executives, such as Timothy Spence, chief executive of Cincinnati-based Fifth Third Bancorp have also questioned the classification.[27] In commenting on SVB in a television interview on CNBC, Mr. Spence said:

> [T]he accounting designation[] . . . held-to-maturity treatment need[s] to be addressed. "There's no question that what triggered the outflows at Silicon Valley Bank last week was the surprise on the unrealized losses on their securities portfolio because such a significant share of it was embedded in held-to-maturity securities" . . . .[28]

And Stephen Ryan, accounting professor at New York University and author of CII's 2008 report entitled "Fair Value Accounting: Understanding the Issues Raised by the Credit Crunch,"[29] said:

> "Had Silicon Valley Bank . . . been using fair value for their long-term market securities, they would have had to cope with the rises in interest rates as they occurred rather than putting it off until a stress point."
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> . . . .
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> SVB executives would have known interest rate rises were likely to dent the value of its bonds. "They would have been much less likely to acquire long-duration securities in the first place and not to hedge them" if the bank was going to have to recognise mark-to-market losses . . . .[30]

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[24] *See* Theron Mohamed, Warren Buffett Slams Banks for Hiding Their Losses - and Reveals He Sold Some Bank Stocks After Spotting Red Flags, Bus. Insider, Apr. 12, 2023, *available at* https://finance.yahoo.com/news/warren-buffett-slams-banks-hiding-201639860.html?fr=yhssrp_catchall.

[25] *Id*. ("The famed investor and Berkshire Hathaway CEO told CNBC on Wednesday that several banks engaged in misleading accounting to artificially inflate their profits.").

[26] *Id.* ("He gave the example of banks valuing their long-dated bonds at their par value instead of their market value, which hid the fact their value had fallen on paper.").

[27] *See* Mark Maurer, Banks, Investors Revive Push for Changes to Securities Accounting After SVB Collapse, Wall St. J., Mar. 20, 2023, https://www.wsj.com/articles/banks-investors-revive-push-for-changes-to-securities-accounting-after-svb-collapse-99caa9ce ("Timothy Spence, chief executive of Cincinnati-based Fifth Third Bancorp, said in a recent television interview the accounting designations in the differences in the available-for-sale or held-to-maturity treatment need to be addressed.").

[28] *Id.*

[29] Stephen G. Ryan, Fair Value Accounting: Understanding the Issues Raised by the Credit Crunch (July 2008), https://www.cii.org/files/publications/white_papers/07_11_08_fair_value_accounting.pdf.

[30] Stephen Foley, Silicon Valley Bank Losses Embolden Calls for US Accounting Rule, Fin. Times, Mar. 21, 2023, https://www.ft.com/content/10cfba27-a63c-4263-b958-61753b32f151.

These recent views about the appropriateness of the HTM classification are not new. In 1991 the U.S. General Accounting Office issued a report entitled "Failed Banks, Accounting and Auditing Reforms Urgently Needed" (GAO Report).[31] Among other reforms, the GAO Report directed the following recommendation and related analysis to the FASB:

> [W]e believe that market value accounting should be adopted *now* for debt investment securities. . . .
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> Accounting for debt investment securities under present GAAP is based on management's ability and intent to hold or sell the investments. If the intent is to hold, the investments are typically carried at their historical cost basis. This accounting treatment relies for the most part on management's intent, which may not be consistent with historical experience in the investment portfolio.
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> While management's intent is the primary basis for the accounting treatment, the accounting guidance also requires an assessment of whether the financial institution has the ability (ability to hold) to carry out management's intent. *Our concern is that management's intent and the assessment of ability to hold are very subjective and often cannot be verified until an investment is disposed of or an institution fails.* Further, because market values are readily available for most investment securities . . . it seems unnecessary and unreasonable to rely on such subjective measures. In the absence of an intent and ability to hold, investment securities are generally carried at the lower of historical cost or market value.
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> In the TAPA report for the Dallas subsidiary bank of First RepublicBank . . . a $72 million loss on debt securities with a book value of $1.9 billion was estimated based on the quoted market values of the securities. The securities held were primarily U.S. Treasury securities, with no credit risk. The losses estimated were due to interest rate fluctuations, with rising interest rates reducing the market value of the securities held (at historical cost) in the investment portfolio. During a period of rising interest rates, the loss on marking to market bank investment securities could be significant.
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> We believe that recognition of such economic losses on a current basis, rather than through recognition over an extended period as the investments yield below market interest rates, is appropriate. We note that there may be asset/liability management strategies that could be impeded by the application of market value accounting concepts on a piecemeal basis. Similarly, we recognize that piecemeal application may raise policy issues regarding the types of assets banks are encouraged to hold. *Nevertheless, the present accounting rules are so flawed that we favor market value accounting for investment securities*.[32]

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[31] U.S. GAO, Failed Banks, Accounting and Auditing Reform Urgently Needed (Apr. 1991), https://www.gao.gov/assets/afmd-91-43.pdf.
[32] *Id*. at 29-30 (emphasis added).

Disclosures about the liquidity risk and interest rate risk of financial instruments

As indicated, CII has long believed that fair value accounting for financial instruments, *accompanied by robust disclosures*, provides investors with more informative reporting than other alternative accounting approaches. We acknowledge that no measurement attribute, including fair value, conveys to investors and other users of financial statements complete information about a financial instrument's inherent risks and the broader risks to which an entity, including a bank is exposed. And there is little dispute that in the case of SVB and many public and private companies those risks include liquidity risk and interest rate risk.

CII generally agrees with the following analysis provided in the dissenting views of then FASB members Thomas Linsmeier and Marc Siegel in response to the Board's 2016 standard on Recognition and Measurement of Financial Assets and Financial Liabilities:[33]

> Messrs. Linsmeier and Siegel believe that the decision to retain existing classification and measurement guidance represents a significant lost opportunity to provide users with the information necessary to understand the potential risks in financial instruments that have caused significant issues in past economic crises. This concern is exacerbated further by the failure in this Update to require additional disclosures that provide users with a better understanding of the . . . interest-rate risk, and liquidity risk of financial instruments, which they believe have led to significant market uncertainty in past financial crises. Therefore, they believe that both fair value information and disclosures about these risks are critical inputs for users. . . . Interest rate risk is a form of duration risk that is especially important to understanding the economics of depository financial institutions, in part, because it affects a key metric of financial performance (that is, net interest income). Messrs. Linsmeier and Siegel believe that understanding interest-rate risk will become crucial to users as interest rates change in the future. They also believe that failing to provide additional information that permits comparison of interest-rate risk across depository financial institutions will introduce significant information asymmetries for users that could affect market efficiency. Furthermore, the amendments fail to require additional disclosures about the timing of realizations from available financial assets and the timing of payments needed to settle existing financial liabilities, hindering users' understanding of liquidity needs at the balance sheet date. They believe that a lack of reliable information about potential liquidity issues has hindered users' abilities to identify entities in stress in past financial crises.

CII also acknowledges that the U.S. Securities and Exchange Commission's rules for management's discussion and analysis (MD&A), among other requirements, currently mandates

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[33] Recognition and Measurement of Financial Assets and Financial Liabilities, Financial Instruments—Overall (Subtopic 825-10) No. 2016-01, FASB 180-81 (Jan. 2016), https://fasb.org/Page/ShowPdf?path=ASU+2016-01.pdf&title=UPDATE+2016-01%E2%80%94FINANCIAL+INSTRUMENTS%E2%80%94OVERALL+%28SUBTOPIC+825-10%29%3A+RECOGNITION+AND+MEASUREMENT+OF+FINANCIAL+ASSETS+AND+FINANCIAL+LIABILITIES&acceptedDisclaimer=true&Submit=.

disclosures about an entity's liquidity risk.[34] We, however, believe that audited, standardized, and consistent disclosures about liquidity and interest rate risk of financial instruments that are responsive to the information needs of investors can be complementary to those found today in the MD&A of banks and other public companies. And as a starting point, we believe the FASB should reconsider the proposed disclosures contained in the Board's 2012 Exposure Draft on Disclosures about Liquidity Risk and Interest Rate Risk (2012 ED).

Liquidity risk

Generally consistent with the requirements in the 2012 ED, we believe the Board should consider the following proposed footnote disclosures for the liquidity risk of financial instruments:

- Tabular disclosure of the carrying amounts of classes of financial assets and financial liabilities segregated by their expected maturities, including off-balance-sheet financial commitments and obligations;[35]
- Disclosure in a table of available liquid funds, which include any unencumbered cash and highly liquid assets and any available borrowings such as loan commitments, unpledged securities, and lines of credit with a reconciliation to the financial statements;
- Disclosure of information about time deposit liabilities, including a table disclosing the cost of funding from the issuance of time deposits and acquisition of brokered deposits during the previous four fiscal quarters;
    - Such disclosure should include information about the amount of uninsured deposits and the concentration of deposits;
- Disclosure of the significant changes related to the timing and amounts of financial assets and financial liabilities in the tabular disclosures about liquidity risk and available liquid funds from the last reporting period to the current reporting period, including the

[34] *See* Management's Discussion and Analysis of Financial Condition and Results of Operations, 17 C.F.R. § 229.303(b)(1) (2021), *available at* https://www.law.cornell.edu/cfr/text/17/229.303 (Describing the requirements to disclosure information about "*Liquidity and capital resources.*").

[35] We note that this proposed disclosure is particularly important, in part, because in 2021 the Securities and Exchange Commission eliminated the required Management's Discussion and Analysis tabular disclosures about contractual obligations—an amendment CII and others strongly opposed. *See* Management's Discussion and Analysis, Selected Financial Data, and Supplementary Financial Information, Securities Act Release No. 10,890; Exchange Act Release No. 90,459; Investment Company Act Release No. 34,100, 86 Fed. Reg. 2028, 2081 (Jan. 11, 2021), https://www.federalregister.gov/documents/2021/01/11/2020-26090/managements-discussion-and-analysis-selected-financial-data-and-supplementary-financial-information ("Our Amendments . . . Eliminate Item 303(a)(5), Tabular disclosure of contractual obligations . . . ."); Letter from Sandra J. Peters ,CPA, CFA, Senior Head, Global Financial Reporting Policy & Jeff Mahoney Esq., General Counsel, CII to Vanessa A. Countryman, Secretary, Securities and Exchange Commission 7 (Apr. 28, 2020), https://www.cii.org/files/issues_and_advocacy/correspondence/2020/CFA%20and%20CII%20Response%20to%20SEC%20Proposal%20on%20MDA.pdf ("***We absolutely do not support the proposal to eliminate the requirement in Item 303(a)(5) to provide a contractual obligations table*** [and] [t]he information contained in this table is not duplicative and it is critical to assessing the cadence or funding of liabilities.").

reasons for the changes and actions taken, if any, during the current period to manage the exposure related to those changes; and
- Additional quantitative or narrative disclosure to the extent necessary so that investors and users of financial statements can understand an entity's exposure to liquidity risk.

Interest rate risk

In addition, and generally consistent with the requirements in the 2012 ED, we believe the Board should consider the following proposed footnote disclosures for the interest rate risk of financial instruments:

- Disclosure of the carrying amounts of classes of financial assets and financial liabilities segregated according to time intervals based on the contractual repricing of the financial instruments;
    - Such a disclosure also would include the weighted-average contractual yield by class of financial instrument and time interval as well as the duration for each class of financial instrument, if applicable;
- Disclosure of an interest rate sensitivity table of the effects on net income and shareholders' equity of specified hypothetical, instantaneous shifts of interest rate curves as of the measurement date;
- Disclosure of significant changes related to the timing and amounts of financial assets and financial liabilities in the tabular disclosures about interest rate risk from the last reporting period to the current reporting period, including the reasons for the changes and the actions taken, if any, during the current period to manage the exposure related to those changes; and
- Additional quantitative or narrative disclosure to the extent necessary so that investors and users of financial statements can understand an entity's exposure to interest rate risk.

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Thank you for consideration of CII's proposed agenda requests. If we can answer any questions or provide additional information regarding this letter, please do not hesitate to contact me.

Sincerely,

Jeff Mahoney

Jeffrey P. Mahoney
General Counsel