



BASEL COMMITTEE ON BANKING SUPERVISION

BANK FOR INTERNATIONAL SETTLEMENTS

Chairman

Via email: iasb@iasb.org

Sir David Tweedie
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

20 April 2009

Response to a request for views on recent FASB amendments on (1) fair value measurement and (2) impairment requirements for certain investments in debt and equity securities

Dear Sir David

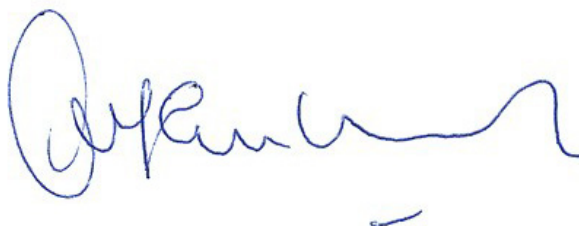
The Basel Committee on Banking Supervision welcomes the opportunity to provide views on the questions raised by the recent US Financial Accounting Standards Board (FASB) amendments to existing fair value measurement and other-than-temporary impairment models. It is our understanding that the International Accounting Standards Board (IASB) is interested in views on the topics but that this request is not part of IASB due process and that any action taken by the IASB will be subject to the IASB's due process.

We would like to reiterate our support for the convergence between international and US accounting standards as there are clear advantages in such initiatives. In particular we would also like to stress that these new FASB amendments illustrate the urgent need to implement a fast-track procedure to deal with urgent matters in an efficient manner.

The FASB's final document on impairment is broadly in line with what the Committee has previously recommended for available-for-sale debt securities; we also believe that the final published FSP on fair value is now broadly in line with IAS 39. You will find below our analysis of, and our position on, the final FASB Staff Positions and we trust that you will find our comments useful and constructive.

These responses have been prepared by the Committee's Accounting Task Force, chaired by Sylvie Mathérat. If you have any questions regarding our comments, please feel free to contact Mrs Mathérat (+33 1 4292 6579), Ian Michael of the UK FSA (+44 20 70 66 70 98) or Xavier-Yves Zanota of the Basel Committee Secretariat (+41 61 280 8613).

Yours sincerely

A handwritten signature in blue ink, appearing to read 'Nout Wellink', with a small horizontal line underneath.

Nout Wellink



Detailed comments on the FSPs

(I) **FASB Staff Position (FSP) on 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 (FSP FAS 157-4)**

We have analysed the FSP against the background of the definition of fair value in Statement of Financial Accounting Standards No. 157 *Fair Value Measurements* (FAS 157). In our view, making more explicit a hierarchy in which active markets dominate inactive ones is likely to be helpful. That approach is already found in IAS 39, and, to our knowledge, it has not caused significant difficulties. However, we are concerned with some of the indicators of an “inactive” market.

(a) **Markets where there has been a significant decrease in the volume and level of activity**

The Committee is of the view that setting out potential factors that should be evaluated to determine whether there has been a significant decrease in the volume and level of activity for an asset or liability is likely to be helpful to preparers and users of financial statements. Of the eight – non-exhaustive – factors set out in paragraph 12 of the FSP, we broadly agree that factors (a), (b), (c), (e), (f), and (g) are likely to be suggestive of a significant decrease in market activity. However, we question whether factors (d) and (h) are robust indicators of whether a market activity has significantly decreased for the reasons set out below.

- *Indicator (d)*: the correlation between the fair value of an asset or liability and an index can change for numerous reasons which have little to do with the activity in the market for the asset or liability; the reasons would depend on the composition of the index in question;
- *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.

Nevertheless, we agree with the provision in paragraph 12 of the final FSP that requires a preparer 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 an asset or liability. Preparers are also required (paragraph 13) to evaluate whether or not a significant decrease in activity means that transactions or quoted prices are not determinative of fair value (and thus whether or not significant adjustments to observed prices are needed in order to establish fair value). Such an evaluation requires the preparer to exercise judgment, which is consistent with the views expressed by the Committee in its April 2009 “Supervisory guidance for assessing banks’ financial instrument fair value practices”.

Furthermore we suggest drawing attention to the benefit of formalising (e.g. documenting) this judgmental approach, in order to provide an audit trail for verifying this otherwise rather subjective process. References to audit trail in both FAS 157 and IAS 39 could facilitate the work of the IAASB in evaluating the current ISA on auditing fair value estimates.

(b) Disclosures

The final FSP increases the extent of preparer judgment in establishing fair values. Against that background, we would have expected requirements for enhanced disclosures in the document.¹ The effect of the FSP will lead to a greater use of valuation techniques which would probably lead to more fair values being classified as Level 3, where FAS 157 already requires more extensive disclosures. However, a high percentage of fair values based on valuation techniques typically are assigned to Level 2, based on the assertion that the inputs are substantially observable. The Committee urges the standard setters to ensure that disclosures are modified appropriately, in line with changes to accounting requirements.

In conclusion, the analysis above relating to markets where there has been a significant decrease in the volume and level of activity suggests that the final FSP clarifies the important role of judgment in evaluating available information when estimating the fair value of assets and liabilities when markets are not active. As a result, the final FSP is consistent with the guidance in the report of the IASB Expert Advisory Panel,² which emphasises the use of significant judgment when estimating fair value. However, it is worth mentioning that, for the time being, that report is only an educational paper. Considering the new FSP guidance, formal approval of this paper by the IASB could give the report greater standing.

(II) FSP on Recognition and Presentation of Other-Than-Temporary Impairments (FSP FAS 115-2 and FAS 124-2)

The Committee's position on this question remains the one expressed in its response to the IASB's Discussion Paper on *Reducing Complexity in Reporting Financial Instruments*, of September 2008. In this document we indicated that for AFS debt securities, we believe that it would be appropriate to distinguish impairment due to credit events from other factors leading to a reduction in the value of such assets. Hence, in our view, for AFS debt securities, the thrust of the FSP should be incorporated into IAS 39 in a timely manner. In that context, we would like to emphasise our support for two specific aspects of the FSP: (1) there should be clear presentation of total impairment, and the split between "credit" impairment and the remainder; and, (2) entities should be required to disclose the methodology and key inputs used to measure the portion of the total impairment that relates to credit losses. With regard to the latter, we welcome the extensive disclosure requirements contained within the final FSP. We do not think that the introduction of such changes into International Financial Reporting Standards (IFRS) should wait for the more fundamental review of IAS 39 which is taking place, as the review is likely to take some time to complete.

1 We recognise that the FASB has a separate near-term project to improve disclosures about fair value measurements. We understand that this project may consider additional disclosures, such as (a) the sensitivity of fair value measurements to changes in assumptions and (b) transfers between the three levels of the fair value hierarchy.

2 Report of the IASB Expert Advisory Panel Measuring and disclosing the fair value of financial instruments in markets that are no longer active, October 2008.

The key issue regarding AFS equity securities, which are not within the scope of the final FSP, is whether the prohibition on reversals of impairment losses recognised in profit or loss remains appropriate. We are of the view that it is not convincing to assert that preparers are in a position to determine when an AFS equity security has become impaired, but are not able to identify circumstances in which impairment has partly or fully reversed.

The case of securities structured in equity form, but generally possessing significant “debt-like” characteristics should be further investigated. We believe applying an impairment model similar to a debt security may be appropriate in these circumstances, consistent with a recent US Securities and Exchange Commission letter to the FASB.³ We are not advocating the presentation treatment applied to certain other-than-temporarily impaired debt securities by the final FSP.

In our view, the IFRS impairment model for held-to-maturity investments (which is different from US GAAP) should remain unaltered.

In conclusion, the Committee is of the view that the thrust of the FSP approach to impairment of AFS debt securities should be incorporated expeditiously into IAS 39, with appropriately robust disclosure requirements – along the lines described in the first paragraph above in this section (II) – being included in IAS 1 and IFRS 7.

³ <http://www.sec.gov/info/accountants/staffletters/fasb101408.pdf>