



Technical Director  
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**File Reference: Proposed FSP FAS 157-e**

Dear Sir,

Thank you for the opportunity to comment on the proposed FASB Staff Position "*Determining Whether a Market Is Not Active and a Transaction Is Not Distressed*".

The governance structure of the IVSC includes two independent technical Boards – the **International Valuation Standards Board** and the **International Valuation Professional Board**. Responses to consultations issued by related standard setters and others are submitted on behalf of the IVSC by the International Valuation Professional Board.

Our response is in two parts. We provide answers to the five questions posed in the exposure draft before making additional comments.

**Responses to the questions**

**1. Is the proposed effective date of interim and annual periods ending after March 15, 2009, operational?**

No. The proposed FSP will be operationally difficult to implement in the short term for all but large sophisticated financial institutions. Accordingly, we believe the effective date would need to be extended. In addition, the proposed FSP reduces transparency and has significant conceptual inconsistencies, such as providing an exception from the exit price notion in Statement 157 which investors require.

**2. Will this proposed FSP meet the project's objective to improve financial reporting by addressing fair value measurement application issues identified by constituents related to determining whether a market is not active and a transaction is not distressed? Do you believe the amendments to Statement 157 in this proposed FSP are necessary, or do you believe the current requirements in Statement 157 should be retained?**

No. We do not believe the project's objective will be met. Please see below.

**3. Do you believe the proposed two-step model for determining whether a market is not active and a transaction is not distressed is understandable and operational? If not, please suggest alternative ways of identifying inactive markets and distressed transactions.**

No. Please see below.

**4. Are the factors listed in paragraph 11 of the FSP that indicate that a market is not active appropriate? Please provide any other factors that indicate that a market is not active.**

Yes, they are a reasonable list of factors.

**5. What costs do you expect to incur if the Board were to issue this proposed FSP in its current form as a final FSP? How could the Board further reduce the costs of applying the requirements of the FSP without reducing the benefits?**

N/A

#### **Additional Comments**

The IVSC believes the proposed FSP should not be issued in its current form. There is a lack of clarity regarding the issue the FASB is really trying to address and the objective of the proposed FSP. If the FASB Board decides to go forward with the proposed FSP, we believe significant revisions are required.

The scope of this proposed FSP is unclear. Is it intended to apply to all financial assets as indicated? Should it be limited to loans or securities backed by loans?

The proposed FSP also seems to be becoming “how to” guidance as opposed to clarifying what principles in Statement 157 should be employed in formerly active markets that suddenly become inactive markets. A concern is that unsophisticated users of this information will attempt to perform valuations which they are unqualified to do.

As indicated, this proposed FSP applies to financial assets where the determination of fair value falls within the scope of Statement 157. The IVSC believes it is very important to restrict the discussion to financial assets. It would create a problem if the proposed FSP became a de-facto standard for all assets.

In the context of financial assets, the proposed FSP does not appear to be contrary to the conclusions of the IASB Expert Advisory Panel in its report published October 2008 “Measuring and Disclosing the fair value of financial instruments in markets that are no longer active”. That report also mentions appropriate time to sell and multiple buyers (paragraph 23 of the Expert Advisory Panel’s report) as indicators of a forced transaction. The proposed FSP does however reverse the argumentation. Where the Expert Advisory Panel report concluded that a transaction in an in-active market is not forced unless certain criteria are met (see paragraph 24 a-c), the proposed FSP presumes that – as soon as a market is in-active – the transactions are forced unless the entity can prove otherwise.

The proposed FSP and the Expert Advisory Panel report arrive at the conclusion that a forced transaction is not a good indicator of fair value and should be either adjusted or disregarded in the interest of other valuation methods. The IVSC concurs. The Expert Advisory Panel report (paragraphs 21-25) also makes the important point that an entity should not conclude automatically that any transaction price is determinative of fair value. The IVSC also concurs.

We note the proposed FSP does not prohibit use of a "distressed transaction" in the valuation of the financial asset; it only prohibits the use of the "distressed transaction" without significant adjustment. Valuation knowledge and experience is necessary at this point. This is when preparers must exercise a significant degree of judgment and where valuation professionals need to be involved.

The proposed FSP would permit a reporting entity to effectively ignore current market conditions by assuming an "orderly transaction" scenario (however defined), but if such a value could only be realised by delaying the sale (for what may be a significant time) until the market becomes less distressed or more liquid, then this is also at odds with the concept of measuring exit value at a point in time (the reporting date). If the value reported does not represent the price that could be achieved in the market prevailing at the reporting date, then it could be argued it provides investors with misleading information. Was the market just before the commencement of the current situation "normal" and were transactions completed in that market representative of a longer term view of value?

If the preceding paragraph is correct, terminology other than "fair value", such as "fundamental value", may need to be used to describe the measurements of financial assets in inactive markets where quoted prices are not used. Valuations in this situation are based primarily on management estimates using models with little use of observable inputs.

Although the proposed FSP clearly states that it relates to the valuation of financial assets, we have a concern that the principles may not be sufficiently "ring fenced". Statement 157 is intended to apply to all assets that are required to be fair valued under US GAAP. If this proposed FSP was ever seen as setting a precedent for identifying forced sales in other sectors, it could undermine the whole objective of measuring other assets and liabilities at fair value, as for many asset classes the preconditions identified for an inactive market exist more often than not. The limited scope of this guidance should be made clear in the title.

The IVSC believes it is a major weakness of Statement 157 that there is no requirement for the entity to disclose how and by whom fair value estimates are made. In many of the International Financial Reporting Standards that permit or require fair value, there is a requirement to disclose this sort of information. The Expert Advisory Panel report (paragraphs 130 -133) also recognises this point and gives an example of a disclosure by HSBC.

In the proposed FSP, paragraph 11(d) on page 4 there seems to be a circular statement. Fair value is the output one is trying to determine, not an input. Maybe it should read "Indices that previously were highly correlated with fair values of the asset are demonstrably uncorrelated with recent prices".

In paragraphs 13, 14 and 15 should the references to a "quoted price" be to a "transaction price"? An actual transaction price may be deemed to be the result of a "forced" sale, but a quoted price is evidence only of a seller's ambition or expectation, not what a buyer would pay.

The Expert Advisory Panel report has much relevant information on this topic. Has this been considered in drafting this FSP? Could the proposed FSP's objectives be better met by simply codifying the Panel's report?

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We trust these comments are useful to you. If you wish to discuss any of them, please do not hesitate to contact the IVSC Executive Director – [ivsc@ivsc.org](mailto:ivsc@ivsc.org)

Sincerely,

**International Valuation Professional Board**