Remarks of Robert H. Herz,
Chairman, Financial Accounting Standards Board
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Many thanks for inviting me again to share some thoughts at this premier reporting conference. I have been a long-time attendee and presenter at these annual conferences, including those during the 1990s when I chaired the AICPA SEC Regulations Committee and now eight conferences as Chairman of the FASB. My congratulations to the Regs Committee and the very hard working staff of the AICPA for another very successful conference this year.

Following me, Russ Golden will discuss our current technical agenda projects and I will be participating in the Q&A session later this afternoon. So there will be plenty of opportunity to focus on technical matters. So, rather than using my allotted time now to dive right into technical issues, I would like to focus on a number of very important public policy matters relating to financial reporting and accounting standard setting.

Before I start, let me emphasize that the opinions I express today are my own and are not official positions of the FASB, which are only arrived at after careful consideration of relevant input and extensive open deliberation by the Board. Indeed, a hallmark of our process is its open and thorough nature that allows for very broad input by all interested parties through exposure of discussion documents and proposed standards for public comment, public roundtables, and extensive discussion and review of issues and potential solutions with our various advisory councils, project resource groups, other meetings with constituents, field visits, and field tests. Additionally, as recommended by the SEC's Advisory Committee on Improvements to Financial Reporting, our Trustees are developing a formal program for post-implementation review of standards. So, in summary, our process is very thorough, open, and designed to be as objective and neutral as possible.

While I will cover a lot of ground in my remarks today, I hope to leave you with the following key points:

- Independent accounting standards that are aimed at providing relevant, transparent, and unbiased financial information are of prime importance to our reporting system, our capital markets, and our economy.

- Much of the discussion about the role of accounting standards in the economic crisis seems to confuse our role of helping to provide investors and the capital markets with relevant and transparent information on the performance and financial condition of financial institutions (along with other companies) with the regulatory need to ensure the safety and soundness of financial institutions and stability of the financial system. While these tasks often overlap, they are not the same and the setting of accounting standards (i.e., GAAP) and the setting of regulatory capital and reserves should be decoupled so that one does not drive the other.

- Constituents have strongly divided views on issues relating to the accounting for financial instruments and reporting by financial institutions, particularly as regards the use of amortized cost vs. fair value measurements. I will discuss some of the key issues in these debates, including concerns about “procyclicality.” I will also offer some thoughts on why reporting both fair value information and amortized cost information might help bridge this divide by providing investors and regulators with better, more timely insights on the performance, financial condition, and underlying risks at financial institutions, without eliminating traditional measures of net income and earnings per share and while also allowing regulators to independently establish regulatory capital requirements.

- How we are systematically and thoroughly addressing these important issues in our project to improve the accounting for financial instruments.

First, let me note that though I will mainly be addressing these matters in a U.S. context, we continue to strongly support the objective of global convergence of accounting standards, providing it results in high-quality standards for U.S. investors, and, as Russ will discuss, we have made and continue to make significant progress towards that goal through our joint work with the IASB on a broad range of projects.

Certainly the IASB has faced significant challenges in dealing with parties that do not seem to agree with or accept that financial reporting should be geared towards investors and the capital markets and that accounting standards should be established in an independent, objective, thorough, and neutral fashion. For while there are certainly those in the U.S. that argue for a different focus for financial reporting and for a different approach to standard setting, the principles of independent accounting standard setting seem more accepted here than in many other parts of the world. That may well be due to the size and breadth of the U.S. capital markets and their importance to our economy and to the financial well-being of many, if not most, of our citizens. And, for over 75 years, we have had an agency of the government, the SEC, that is explicitly charged with investor protection, facilitating capital formation, and the effective operation of our securities markets; and that sound and unbiased accounting standards and proper disclosure have been recognized as critical to fulfilling those objectives. All of this evidences our longstanding national commitment to the ideals of transparency and high-quality financial reporting.

However, in the past year there have been calls from certain parties to change the objectives of financial reporting and the approach to accounting standard setting in the U.S. The focus of these calls, not surprising in a time of severe financial crisis, has been on the accounting for financial instruments and reporting by financial institutions. As the financial crisis deepened and widened, there were intense efforts by certain financial institutions and their trade groups and lobbyists not only for us to address perceived issues in applying fair value and impairment standards in inactive and distressed markets, but also for the SEC and Congress to eliminate or defer the requirements to recognize losses on impaired financial assets. The use of fair value was decried by some as causing undesirable “procyclical” effects on the financial system, accompanied by efforts by these parties to enable banking regulators or a systemic risk regulator to override and modify accounting standards and financial reporting to investors and the markets to achieve bank regulatory and financial stability objectives. I was pleased to note that the House Financial Services Committee, within the context of its recent markup of the systemic risk regulator bill, seemed to confirm the point that accounting standards should continue to be set through an independent process.

Please don’t get me wrong. I support the goal of financial stability and do not believe that accounting standards and financial reporting should be purposefully designed to create instability or procyclical effects. During the markup of the systemic regulator bill, Chairman

Frank noted that accounting principles should not be viewed to be so immutable that their impact on policy should not be considered. I agree with that, and I think the Chairman would also agree that accounting standards should not be so malleable that they fail to meet their objective of helping to properly inform investors and markets or that they should be purposefully designed to try to dampen business, market, and economic cycles. That's not their role. So, let me further explain what I see as overriding economic objectives and how both financial reporting and accounting standard setting and financial stability and the work of financial institution regulators each fit into those objectives.

To me, the overriding objectives in setting economic policy relate to achieving sustained economic growth and rising living standards. Whether it's measured in terms of rising GDP and increasing standards of living, declining unemployment levels, or low levels of inflation, I would hope that we could all agree that these are good and desirable economic objectives. Many things contribute to achieving these objectives, including sound fiscal and monetary policies, having an educated and skilled workforce, innovation and developing new technologies, secure and cost-effective sources of energy, efficient and effective capital markets, safe and sound financial institutions, and many, many other things.

Let me focus on a couple of these—effective capital markets and safe and sound financial institutions—for the financial crisis has highlighted a number of relationships of public policy importance between accounting standards and financial reporting to investors and the capital markets, on the one hand, and regulatory reporting by banks and regulatory policy by bank regulators, on the other hand.

Both impact financial institutions and both are vital to the effective operation of the financial system and the economy. But there seems to be some confusion in the media and elsewhere about the relationship between the accounting standards we set and regulation of financial institutions. For example, in regard to regulatory capital, we do not determine the capital levels banks are required to maintain. The bank regulators do. However, under laws enacted by Congress in the wake of the S&L crisis, the determination of regulatory capital by the bank regulators starts with the GAAP numbers. But the bank regulators have some discretion to adjust the GAAP figures, and they also have other tools to address capital adequacy, liquidity issues, and concentrations of risk at regulated institutions. For example, it has been the longstanding policy of the bank regulators to exclude unrealized gains and losses included in other comprehensive income from the computation of regulatory capital.

So, the regulators have a natural interest in the accounting standards we set. Likewise, investors have an interest both in our standards and in the impacts of regulatory requirements and actions on the institutions in which they invest. In that regard, I commend the Fed and the other U.S. bank regulators on the transparency they provided on the results of the "stress tests" of major bank holding companies. I think it was generally very well received by investors and the markets, and I would encourage this type of transparency on an ongoing basis.

Certainly, whether as depositors, as investors, as business people, or as citizens of this great country, we all share a deep interest in the strength and stability of the financial system and the economy. But the public policy missions and focus of accounting standard setting and prudential regulation in helping achieve these objectives are specifically designed to be different. Our focus as accounting standard setters is on the communication of relevant, reliable, transparent, timely, and unbiased financial information on corporate performance and financial condition to investors and the capital markets. That information is aimed at facilitating informed investment decisions and is essential to sound capital markets and effective allocation of capital across the economy. The transparency provided by external financial reports contributes to financial stability by reducing the level of uncertainty in the system. Conversely, a lack of transparency and honest reporting can be a powerful destabilizing force on the capital markets and the economy. A lack of transparency can hide the extent of risks facing financial institutions from both investors and regulators.

The mandate of the Federal Reserve and other banking regulators relates to ensuring the safety and soundness of banks and the overall stability of the financial system. Regulators must take many factors into consideration when setting capital reserve requirements and taking other actions to preserve the stability of the banking system. But that's not to say that the accounting standards we set for the benefit of investors cannot also serve the needs of regulators. Usually they do. Indeed, my experience has been that by working together and sharing perspectives we can often find common ground and develop accounting and reporting solutions that help the regulators while preserving the integrity of reporting to investors and the capital markets. And, clearly, we recognize that ongoing communication between us and the bank regulators is particularly critical in times of financial and economic crisis as we both work to address issues.

But it may not be possible to find common ground in every case, not because we aren't communicating, but because our different missions take us down different roads.

For example, while investors might benefit from seeing bank assets such as tradable securities and even loans reported at "fair value," regulators might deem cost accounting as the proper way of valuing certain assets for the purpose of assigning capital reserve requirements. Bank regulators and the institutions they regulate may be less enthusiastic about the use of fair value measurements because of concerns over potential procyclical effects, volatility in reporting, and impacts on reported capital, while many investors view such information as very important in understanding and evaluating the financial condition, risks, and performance of these institutions. And, in dire situations, bank regulators may be appropriately concerned that public release of data on severe losses and asset impairments could spark a run on a bank. But investors would likely want to know the extent of the problems on a timely basis.

Handcuffing regulators to GAAP or distorting GAAP to always fit the needs of regulators is inconsistent with the different purposes of financial reporting and prudential regulation.

Regulators should have the authority and appropriate flexibility they need to effectively regulate the banking system. And, conversely, in instances in which the needs of regulators deviate from the informational requirements of investors, the reporting to investors should not be subordinated to the needs of regulators. To do so could degrade the financial information available to investors and reduce public trust and confidence in the capital markets.

For these reasons, in my view there should be a greater decoupling of bank regulation from U.S. GAAP reporting requirements. Doing so could enhance the ability of both the FASB and the regulators to fulfill our critical mandates. We can continue to work with independence and an unwavering dedication to market transparency; at the same time the bank regulators can utilize their authority to take whatever actions are required to keep the financial system stable and healthy. But in line with our open due process for setting accounting standards, a decoupling should be accompanied by a transparent process that would assure the public that the banks are not receiving arbitrary or inappropriate forbearances from the regulators. We learned that lesson in the 80's with the S&L crisis.

It should be made clear that the results of GAAP financial statements do not dictate regulatory requirements. Rather, they are but one source of data to inform the prudential judgments made by regulators. While they begin with GAAP, they are decoupled from it as far as the proper consequences of the information and appropriate regulatory responses are concerned. Thus, for example, bank regulators may want to implement countercyclical policies by requiring banks to bolster capital buffers in periods of economic growth and release them in times of economic stress in order to spur increased lending. But for financial reporting, such changes in required levels of regulatory capital should not go through reported earnings; rather, they should be treated as movements in appropriations within stockholders' equity.

This kind of decoupling already exists in insurance regulation, where the companies report to the markets using GAAP, but their reserve and capital requirements are the subject of independent regulatory standards.

Clear enunciation and reaffirmation of the differences in the objectives of accounting standard setters and prudential regulators are important both here in the U.S. and at the international level. For as we look to the international stage, as we and the IASB work collegially and constructively with groups such as the Basel Committee, the Financial Stability Board of the G20 and the International Association of Insurance Supervisors, the differences in the roles of accounting standard setters and prudential regulators should be made clear and respected in the formulation of global policy objectives and recommendations.

Let me now talk a bit about fair value. Critics have said that current standards, particularly those relating to the use of fair value measurements, impose "procyclical" burdens on financial institutions and can cause instability in the financial system. For example, they contend that fair value can overstate the "true" value of financial assets in "irrationally exuberant" up markets and understate their true value in times of market turmoil and decline. They also contend that reporting declining asset values in down markets constrains banks' ability to make loans and causes them to sell assets at depressed prices to conserve capital, thereby exerting further downward pressure on asset values. I am not an expert in macroeconomics or organizational and market behavior, but I would pose two questions: first, does fair value accounting actually have a "procyclical" effect? And, second, to the extent that the answer is "yes," should that fact lead to a conclusion that accounting and reporting should to be purposefully altered to avoid such procyclical effects?

On the first question, I concede that the use of fair value can have procyclical effects. But so can any information that accurately reports current economic and market conditions and trends. As I said, the purpose of financial reporting is the communication of transparent, relevant, reliable, timely, and unbiased information to investors to help them to make informed decisions. Therefore, it is axiomatic that information contained in financial statements is likely to spur action by investors, managers of reporting enterprises, and regulators. It also seems intuitive that there is a natural "wealth effect" that can occur from observing rising asset values in rising markets and falling asset values in falling markets. Think about your own investment portfolio. When it's up, you feel wealthier and may spend more, thereby adding to economic growth. When it's down, you feel less well off and may start curbing your spending, thereby reducing economic growth. You may also sell investments to try to protect your net worth from further declines in the value of your assets.

So, it is hard to deny that information about market movements can cause actions that can move the market further in that direction. But does that mean that masking these movements is preferable? There seems to be a considerable body of evidence based on studies of the S&L crisis and the "lost decade" in Japan that strongly suggests that the use of historical cost accounting approaches masked mounting problems and exacerbated and prolonged those crises, delaying recovery, and that the use of fair value might have provided an early warning of the impending problems. Indeed, back in 1991, following the hundreds of bank failures during the S&L crisis, the GAO issued a report to Congress entitled "Failed Banks, Accounting and Auditing Reforms Urgently Needed." That report concluded that "The key to successful bank regulation is knowing what banks are really worth." That powerful insight is also of critical importance to investors and capital providers. But the GAO report found that regulatory call reports significantly overstated the values of loans and debt securities (and hence the financial condition and capital) of failed banks. Accordingly, it urged the immediate adoption, for both GAAP and regulatory reporting, of mark-to-market accounting for all debt securities and rapid study of the potential merits of a comprehensive market-value-based accounting and reporting system for banks in order that "banks' true financial condition could be reported promptly. . . ."

Unfortunately, nearly 20 years later we are experiencing "deju vu all over again" in the current financial crisis. Again, we are witnessing the failure of numerous banks and other financial institutions, many of which reported positive net worth and regulatory capital just prior to their failures. And, again, this seems due, in considerable measure, to the apparent overstatement of their capital resulting from the use of historical cost accounting methods and highly subjective and inadequate loan loss reserves as determined by the banks' management. As noted in the 1991 GAO report,

> "Accounting rules are flawed in that they allow bank management considerable latitude in determining carrying amounts for problem loans and repossessed

> collateral. Recognizing decreases from historical cost to market value has an adverse effect on a bank's reported financial condition. This gives bank management an incentive to use the latitude in accounting rules to delay loss recognition as long as possible."

It is not surprising, therefore, that the December 2008 SEC report to Congress on mark-to-market accounting, which examined bank failures during 2008, concluded that, contrary to the assertions of some parties, the credit crisis in the U.S. did not result from fair value accounting but, rather, from growing (and often masked) credit losses, asset quality problems, and eroding investor and lender confidence.

The results of the "stress tests" of the 19 major U.S. bank holding companies also seem to provide further evidence of the problem with the current historical cost approach to loan accounting, as the bulk of the $600 billion of potential additional losses revealed by that exercise under the "more adverse scenario" related to loans and other receivables carried on a historical cost basis and not to items carried on a mark-to-market or fair value basis. And, as in the S&L crisis, there have been subsequent revelations of large overstatements of the carrying values of loan portfolios of failed banks. So while some banks, their industry groups, and some in the bank regulatory community have been "cautioning" and criticizing us for even exploring the use of fair value for loans, others note the continuing stream of failures of supposedly "well capitalized" banks and other financial institutions with the result of hundreds of billions of dollars in investor losses and taxpayer costs and wonder why we wouldn't be moving quickly to require full fair value reporting by financial institutions.

In that regard, a recent academic study entitled "Bank Leverage and Credit Risk: What do fair values tell us?" by Blankespoor, Linsmeier, Petroni, and Shakespeare concluded that fair value is a better and more timely indicator of bank credit risks than current GAAP. That result is even more pronounced when compared to regulatory capital, which the study concluded is uncorrelated with credit risks at banks. If so, this would seem to further support what the GAO so emphatically concluded in 1991 that proper regulation of banks requires knowing what a bank is worth.

My conclusion is that while the use of fair value in reporting can have procyclical effects on behavior, timely recognition of problems at financial institutions can have countercyclical effects through lessening the impact of financial downturns by providing an early warning of developing problems. With that perspective in mind, what should we conclude about the use of fair value in setting accounting standards? The answer lies in the purpose of such standards. The criteria we use relating to relevance, reliability, comparability, understandability, and cost/benefit are, consistent with our role, aimed at providing relevant, transparent, and decision-useful financial information to investors and the capital markets.

Thus, to the extent there are valid concerns about potential procyclical effects, these would seem to be better dealt with through other means, including fiscal and monetary policy and regulatory measures rather than by altering the financial information reported to investors and the capital markets. Taking my earlier example about personal investment portfolios and potential procyclical wealth effects, would anyone seriously suggest that we alter people's monthly 401(K) and brokerage statements to report lower values in up markets and higher ones in down markets? Yet our economy is heavily dependent on consumer spending that is affected by what people learn from their investment account statements. I could go on and on with such examples, but I hope you get the drift—just how far do we want to take the concern about procyclicality in altering the reporting of financial and economic data to the public?

With that background, let me report on our ongoing project on accounting for financial instruments. The subject of accounting for financial instruments is a very important area affecting financial institutions and many other entities. There are numerous complex and difficult issues we need to carefully examine including the use of historical cost vs. fair value, approaches to impairments and allowances for loan losses that are more forward-looking than the current incurred loss approach, whether and how to value financial liabilities (including customer deposits), hedge accounting, and methods of presentation and disclosure. All of this must be considered in the context of operationality, auditability, and cost-benefit considerations including whether there should be differences, for example, by industry, size of entity, or public vs. private status. And then there are issues of effective date and transition. We are systematically examining these matters in a thorough and measured way, with a goal of issuing a proposal for public comment in the first quarter of 2010. That will mark the beginning of the next phase of our extensive outreach and due process, which will include public roundtables, field visits, and other discussions with investors, financial institutions, and other affected entities, auditors, and regulators—to ensure we maximize the input we receive.

In the meantime, the IASB has also been working on these issues. Although there have been differences in approach and timing, both Boards are committed to seeking to achieve converged solutions. Next year, once we have received comments and other input on our proposal, we will redeliberate at public Board meetings all the key issues identified including discussing them with the IASB and making changes as appropriate. Only after having completed this very extensive and thorough public due process will we issue a final standard carefully considering effective dates and transition.

First, on fair value, we clearly recognize that it is a very controversial subject on which informed and reasonable people disagree. Although most agree that fair value is a more relevant measure than historical cost for financial instruments that are part of a trading portfolio or are otherwise held for sale, there is strong disagreement when it comes to financial instruments that are being held for investment or collection of contractual cash flows. Critics of fair value offer numerous arguments against its broad use beyond trading activities. They argue that it doesn't properly reflect the business model or the way management runs the business and that it results in misleading volatility in reporting and can misstate underlying economic values. They also see issues around operationality and auditability, particularly in estimating fair values for nontraded and illiquid items, and around the effects of changes in an entity's credit standing on the measurement of financial liabilities. They express concerns over potential negative impacts on management incentives at financial institutions and on the perceived stability of institutions and the financial system. We need to carefully consider these matters.

At the same time, we need to address why, in the face of all these arguments against fair value, many investors, financial analysts, economists and others believe that fair value is more relevant than historical cost even where the business model does not involve the trading or sale of financial instruments. First, as I previously mentioned, some believe that fair value is a better and more timely indicator of underlying credit problems in financial assets. Some might say, "OK, but that's when you compare fair value to historical cost measures using the current incurred loss approach to recognizing credit losses as opposed to using a more forward-looking expected loss approach." That may well be so, and we together with the IASB are exploring potential ways to replace the incurred loss approach with a more forward looking approach to estimating loan losses and impairments of debt securities. I am hopeful that we can develop an approach that is operational and has sufficient rigor and avoid creating a tool for earnings management. And as I mentioned earlier, bank regulators may want to separately require additional capital reserves.

However, the perceived superiority of fair value goes beyond the belief that it better reflects underlying credit risks. This point is illustrated by some highly simplified examples where credit risk is not an issue. Looking at Table 1, let's assume you have four high-credit-quality loans with the following contractual cash flows: Loan A—a loan with $100 principal due in 15 years and annual interest of $4; Loan B—a 30-year loan that was originated 21 years ago at the then prevailing interest rates with $100 due in 9 years and 8% annual interest.; Loan C—with $100 principal due in 6 years and 5% annual interest; and Loan D—a variable-rate loan with $100 due in 3 years. The total cash to be collected on each of these loans is quite different. For Loan A it is $160, for Loan B it is $172, for Loan C it is $130, and for Loan D it is $100 plus whatever the variable rate interest will be for the next 3 years, which based upon a current yield curve, let's say is $112. The discounted present values of each of these loans will also be very different, say $90 for Loan A, $125 for Loan B, $103 for Loan C, and $100 for Loan D. And, in this simple scenario, the fair values should closely approximate these present values. But under historical cost accounting each of these loans would be measured at $100, the amount of the principal, even though they are very different in terms of interest rates, total cash flows, present values, term, and duration. Under today's accounting (and also under the accounting model we are exploring) the two financial statements that are intended to present period flows, namely the income statement and the statement of cash flows, will properly reflect the actual interest income and cash interest received, that is $4 for Loan A, $8 for Loan B, $5 for Loan C, and the variable rate for Loan D. That's good and properly reflects the differences in interest income and cash flow for each of the loans. But, alas, the balance sheet, which is supposed to be a statement of financial condition, does not reflect the fact that each of the loans is very different. Rather, it shows them all at $100. To supporters of fair value, this seems to violate basic principles of finance and economics. As a standard setter, it seems inconsistent with the goal of trying to account for similar things in a similar fashion and different things differently.

Now let's add a bit of complexity to the mix by contemplating the effect of different funding strategies. I won't go through it in detail, but Table 2 uses the same four different loans as the asset side for four hypothetical financial institutions with different liability structures, each with a total principal amount of $80. The liabilities could be in the form of deposits or term debt, or revolving commercial paper or various combinations thereof, all with different interest rates and different term structures. Under today's accounting, despite the economic differences in each financial institution's assets and liabilities, the balance sheets of all of the institutions would show total assets of $100 and total liabilities of $80. Again, to supporters of fair value this masks underlying differences between the institutions. Of course, these are highly simplified examples that assume away some of the important real world issues relating to estimating fair values for loans, deposits, and other financial liabilities, including issues relating to the variety of often customized features of loans, to operationality and auditability, and to overall cost-benefit considerations. But I think the examples help explain why some believe that fair value is more relevant for financial instruments, regardless of whether the "business model" involves a trading activity or relates to collection and payment of contractual cash flows. They believe that fair value reflects the underlying economics better than historical cost, that it enhances relevance and comparability, and that it provides a better starting point for understanding and analyzing credit risks, interest rate risks, duration mismatches, sustainability of net interest margins, and liquidity risks. And some also view fair value as an essential tool in proper risk management of financial institutions and as providing an early warning system for developing problems at institutions and across the financial system that they believe are masked by historical cost based accounting.

While I see merit in many, if not all, of these pros and cons of fair value vs. amortized cost for financial instruments, I doubt that we are going to convince many on either side of this debate to change their views. Accordingly, in our major project on the accounting for financial instruments, we are seeking ways to "bridge the divide." The approach we are exploring would build upon the guidance we issued in April on impairments of debt securities by providing more transparent information on financial instruments on the face of balance sheets and income statements. Trading assets and liabilities, derivatives and equity securities would be accounted for at fair value with the changes in fair value included in net income. However, for portfolios of loans and debt securities where the business model and the characteristics of the instruments indicate that the company will realize most of the value from cash collection, both amortized cost and fair value would be presented on the balance sheet, with the changes in fair value included in other comprehensive income and not in earnings. As is done today, net income would continue to include interest and dividends and realized gains and losses. Also similar to the guidance we issued in April on impairments and consistent with the amortized cost model, net income would include only the estimated credit portion of declines in the values of loans and debt securities held for collection. A further important change both we and the IASB are evaluating would require the components of other comprehensive income to be shown on the same page as the components of net income, in effect creating a single "performance statement." The performance statement would still have a subtotal with net income and earnings per share. Underneath net income would be a separate display of the comprehensive income items (including the fair value changes on loans and other debt securities as described above, as well as pension and foreign exchange items and cash flow hedges too if applicable).

Recognizing that there are strongly held views on both sides of the fair value debate, the model that we are exploring may offer a number of potential advantages by reflecting both points of view in the financial statements. On the one hand, by continuing to reflect a "business model" approach to what gets reported in earnings, it preserves most of the current aspects of reporting net income and earnings per share. On the other hand, by presenting both fair value information and amortized cost information on the face of financial statements for instruments that are being held for collection or payment of cash flows, it could enable investors to more easily incorporate either or both in their analyses. Also, the fair value information would now be available at the time of earnings releases rather than only being disclosed later in the footnotes in SEC filings. And while I believe this approach might also better help to inform the bank regulators, it would continue to provide them with the information necessary to compute regulatory capital in the same way as today.

Our attempt to bridge the divide on fair value is unlikely to stem continued criticism from certain parties, but my hope is that all interested parties will respect our process and choose to participate in it. As I said, there are many issues we need to carefully examine and extensive public due process ahead before we reach final decisions on changes to the accounting in this important area.

I know that most of you at this conference agree that we should aspire to financial reporting that's geared to providing relevant, "decision useful," and transparent financial information to investors and the capital markets, based on accounting standards established through an open and thorough due process that strives to be as independent, objective, and neutral as possible. So whether it's the FASB or the IASB, it's absolutely critical that these basic tenets underpinning accounting standards, standard setting, financial reporting, and our capital markets be preserved and protected. Our thanks to the many organizations and individuals that have been working hard to ensure that this continues to be the case through their strong support and participation in our activities.

Table 1

Hypothetical Loan Scenarios

4 High Credit Quality Loans

	Loan A	**Loan B**	**Loan C**	**Loan D**
Principal	$100	$100	$100	$100
Maturity	15 Years	9 Years	6 Years	3 Years
Annual Interest	$4	$8	$5	Floating Rate
Total Cash to be Collected	$160	$172	$130	$112
Approximate Present Value of Cash Flows	$90	$125	$103	$100

Accounting Representations:

	Loan A	**Loan B**	**Loan C**	**Loan D**
In Income Statement	$4	$8	$5	$3.8
In Cash Flow Statement	$4	$8	$5	$3.8
On Balance Sheet	$100	$100	$100	$100
In FAS 107 Footnote	$90	$125	$103	$100

Table 2

Hypothetical Financial Institutions

Assets	**Institution A**	**Institution B**	**Institution C**	**Institution D**
Loan A-15 Years 4%	$100			
Loan B-9 Years 8%		$100		
Loan C-6 Years 5%			$100	
Loan D-3 Years Floating Rate				$100
Total Assets—at Face	$100	$100	$100	$100
Total Assets—at Present Value/Fair Value	$90	$125	$103	$100
Liabilities				
Non Interest Bearing Deposits	$70	$40	$30	
10 Year 7% Debt	$10	$40		
5 Year 6% Debt			$30	$30
3 Year Floating Rate Debt			$20	$30
90 Day Commercial Paper				$20
Total Liabilities—at Face	$80	$80	$80	$80
Total Liabilities—at Present Value/Fair Value	$72	$78	$76	$82
Annual Net Interest Margin				
Interest Income	$4	$8	$5	$3.8
Interest Expense	$.7	$2.8	$2.6	$3.7
	$3.3	$5.2	$2.4	$.1