



**Investment Office**

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**Via E-Mail: [director@fasb.org](mailto:director@fasb.org)**

Russell G. Golden, Technical Director  
FASB Board Members  
Financial Accounting Standards Board  
401 Merritt 7  
PO Box 5116  
Norwalk, CT 06856-5116

Dear Mr. Golden:

**Re: File Reference No. 1810-100 Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities.**

I am writing on behalf of the California Public Employees' Retirement System (CalPERS), the largest public pension fund in the United States with approximately \$213 billion in global assets and equity holdings in over 9,000 companies in over 40 markets worldwide. CalPERS provides retirement benefits to over 1.5 million public employees, retirees, and their families and beneficiaries.

Thank you for the opportunity to comment on the Exposure Draft (ED) on accounting for financial instruments and revisions to the accounting for derivative instruments and hedging activities, Financial Instruments (topic 825) and Derivatives and Hedging (Topic 815). We support the Board as it develops standards that require the increased use of fair value in financial reporting for our investment portfolio companies.

We believe the proposed guidance will provide an improved and consistent financial reporting model for the recognition, measurement and presentation of financial instruments in an entity's financial statements. This will benefit investors in their analysis and decision making. Ideally, the project will contribute to the FASB's and IASB's respective work on financial instruments, ultimately assisting with convergence to a single high quality set of standards. CalPERS believes convergence is essential and considers this can be achieved without compromising quality. We believe these efforts provide the stepping stones towards achieving the objectives of the SEC's Roadmap towards a global set of high-quality accounting standards.

CalPERS is supportive that the FASB's proposal would require (1) presentation of both amortized cost and fair value on an entity's statement of financial position for most financial instruments held for collection or payment of contractual cash flows and

(2) the inclusion of both amortized cost and fair value information in determining net income and comprehensive income. We are supportive that the proposal would require that financial instruments held for sale or settlement (primarily derivatives and trading financial instruments) be recognized and measured at fair value with all changes in fair value recognized in net income (FV-NI model).

We believe investors are better served with a single measurement and reporting model that requires fair value which would be based upon an up-to-date assessment of the amounts, timing and riskiness of the future cash flows attributable to the asset or obligation; we believe the proposed standard is an improvement to the mixed-attribute model in place today. We agree that providing users with additional information on the face of financial statements by requiring a reconciliation from amortized cost to fair value for financial instruments for which an entity's business strategy is to hold for collection or payment(s) of contractual cash flows will provide as market conditions change, a more accurate and clear understanding of the effect of these changes.

### **Scope**

The current mixed attribute model does not provide investors with an accurate reflection of a company's financial position and risk management. CalPERS agrees that poor risk management at the large financial institutions played a critical role in the financial crisis. CalPERS believes that a FV-NI model cultivates sound risk management. We believe the FV-NI model better reflects the risks presented by volatility associated with financial instruments and are relevant because it provides information about the timing and amount of future cash flows that are subject to interest rate, credit and other market risks.

We are aware of concerns that accounting standards should not contribute to procyclicality but see an overarching systemic need for accurate and timely reporting which will ultimately be in investors' long-term interests.

### **Initial Measurement**

CalPERS supports the initial measurement guidance that financial instruments should be recognized at their fair value and that all subsequent changes in fair value should be recognized in net income, and that the initial measurement should follow the same principle with any initial gain or loss recognized in net income. We believe that fair value measurement guidance should be used in all circumstances and do not support the view that financial instruments for which qualifying changes in fair value are recognized in other comprehensive income (FV-OCI) would be initially measured at its transaction price.

We agree with the Board's recommendation that transaction costs and fees relating to financial instruments (FV-NI) should be recognized as an expense in net income when incurred. Although we do not necessarily support that certain transaction fees and costs relating to financial instruments measured at fair value with qualifying changes in fair value recognized in other comprehensive income (FV-OCI) would be deferred, we see that this is necessary to preserve amortized cost accounting for those that feel this continues to be necessary.

### **Subsequent Measurement**

CalPERS believes that the default measurement attribute for financial instruments should be fair value. We agree that fair value information and amortized cost information be provided for financial instruments an entity intends to hold for collection or payment(s) of contractual cash flows on the face of the financial statements. We believe the proposal provides adequate guidance on items that should be recorded through other comprehensive income for financial instruments meeting the qualifying criteria. CalPERS agrees that subsequent reclassifications should not be allowed for financial instruments characterized as FV-NI to FV-OCI to assist in consistent application and comparison of companies.

However, if a transaction meets the criteria for FV-OCI instruments and measurement at fair value would create a mismatch we would agree that the use of the amortized cost reporting may be more appropriate. CalPERS believes that providing both fair value and amortized cost on the face of the financial statements will be more informative to investors than providing fair value information in the footnotes.

### **Presentation**

CalPERS supports the separate presentation of financial liabilities measured at fair value with all changes in fair value recognized in net income with regards to changes in an entity's credit standing. We believe that including all such changes provides a clearer understanding to all of the factors that affect a firm's performance. While equity investors would want to know the information conveyed by debt market participants in their valuation of the firm's liabilities, they would not want to capitalize such gains in their valuation of equities, nor would they want to discount their valuations for any similar losses.

For financial instruments measured on an FV-OCI basis, we believe the information provided to reconcile amortized cost to fair value will be sufficient to inform investors of any divergence in the valuation views of management from the valuation views of market participants.

### **Credit Impairment**

The recommended proposal would require an entity to recognize in net income at each financial reporting period the amount of credit impairment related to all contractual amounts due for originated financial asset(s) that the entity does not expect to collect and all amounts originally expected to be collected for purchased financial asset(s) that it does not expect to collect. We believe the credit impairment model as outlined provides a clear objective and we support it. In our view, the credit impairment model would logically expand the loss allowances associated with financial instruments without permitting forecasts of future losses over their life as would be required under the IASB Exposure Draft, "Financial Instruments: Amortised Cost and Impairment."

We hold that the proposal's removal of the probable loss threshold is an improvement to the estimation process that will permit more timely recognition of credit impairments. We believe the proposal's requirement for immediate recognition provides more timely information about credit impairment than spreading it over the life of an instrument as an adjustment of interest income. We also support the proposal's approach for requiring historical loss rates for pools of similar financial assets as the results obtained from this approach should produce loss estimates that provide valid estimates in its value loss.

### **Interest Income**

The proposal would require interest income to be calculated on an instrument's amortized cost basis after consideration of credit impairments or recoveries of credit impairments. We support this approach; events that affect a financial instrument's basis, in turn, will have an effect on the income to be realized from that instrument. Also, we understand that the proposed guidance would allow firms with financial instruments presented on an FV-NI basis to separately present interest income on the statement of comprehensive income – without specifying a particular method of calculating interest income to be displayed in the statement of comprehensive income. We would prefer to see the standard contain guidance that will produce interest income consistently across all financial assets, whether they are carried on an FV-NI basis or an FV-OCI basis.

Overall, we believe that the methodology for recognizing interest income on financial instruments classified as FV-OCI will provide useful information to those that believe the amortized cost model serves their needs for information.

### **Hedge Accounting**

With all financial instruments reported at fair value, we hold that there is less need for specialized hedge accounting treatments. A full fair value balance sheet is effectively its own hedge. In that the hedged item and the hedging instrument are both reported at fair value, we believe that there will be a more transparent display of the activities occurring within the firm (the hedging activities) and the events occurring outside the firm that affect it (the effect of economic and market conditions on the values of those instruments.) We support the modification of the effectiveness threshold from highly effective to reasonably effective. However, we also believe that when firms find it necessary to employ hedge accounting, and they have determined a hedge relationship is effective at the outset of a hedged transaction, the relationship should still be monitored for effectiveness in accordance with the proposed guidance.

### **Disclosures**

We support the proposed disclosure requirements, including those related to purchased financial assets. We believe those particular disclosures will enable investors to better assess the effects of such purchased assets on the overall profitability of a firm. Overall, we find the required disclosures to be comprehensive.

### **Overall**

We encourage the FASB and IASB Board to continue to collaborate and resolve substantive differences in order to continue progress towards convergence to one set of high quality global standards. As investors become more globally based, the need for a set of quality accounting standards increases.

Thank you for considering our comments. If you would like to discuss any of these points, please do not hesitate to contact me at (916) 795-9672 or my colleague Mary Hartman Morris at (916) 795-4129.

Sincerely,



ANNE SIMPSON  
Senior Portfolio Manager  
Global Equity

cc: Joseph A. Dear, Chief Investment Officer - CalPERS  
Eric Baggesen, Senior Investment Officer - CalPERS  
Mary Hartman Morris, Investment Officer - CalPERS