Let us look at the current crisis and what is actually happening.

Look at the following graph:

This is from the economist. What you can see is that AAA rated bonds have been written down by 20% under these current rules and the misinterpretation of fair value that is currently occurring. The statistics show that for a AAA rated tranche of a mortgage book to be impacted by a downturn in the market, 29% of the portfolio needs to go into arrears. The figures for Northern Rock were published today – arrears are 0.75%. Not 1%, not 5%, not 25%... but Northern Rock bonds will have been written down by 20% without any prospect that there will be a default.

What this actually means is that anyone that has sold such bonds in the current climate has managed to crystallise a loss that does not exist. The provisions that have been made by many of the financial institutions also do not really exist. If they were to hold the assets to maturity then they would receive full value for such assets. Of course if they have sold such assets, probably under pressure from the media and people that should know better, then they have managed to incur an unnecessary loss.

What should be done? In our view if an asset does not have any long term impairment and is to be held to maturity then it should not be written down – the current speculative market price is irrelevant. In this case we have negative speculation caused by the asset no longer being suitable for the market for which it was designed.

All that this requires is a formal definition of fair value and a change to the terms of Held to Maturity Assets. What is clear is that accounting standards that are developed without considering their implications to business will likely be fatally flawed.

Come on IASB wake up and smell the roses.