

Fair Market Value and the Question of Symmetry
By Ann Rutledge

The concept of fair (market value) is as old as the 1587 edition of Blacks Law Dictionary. It is exactly the same in the Merriam-Webster dictionary (1901):

...A price at which buyers and sellers with a reasonable knowledge of pertinent facts and not acting under any compulsion are willing to do business.

Fair enough, but surely not a topic for heated controversy. That is, until the University of Chicago convinced an entire generation of finance and economics professionals during the last financial system crisis to seek the holy grail in tick data.

Alas, in today's debate some important elements have gone missing from a definition that had served this phrase well over the previous 350 years. First, even though the SEC and GAAP define fair value as the amount at which an asset could be bought or sold in a current transaction between willing parties, *other than in a liquidation*, it is clear from a large number of media articles that many are forgetting that a meaningful price is not forced:

"The crisis and fair-value accounting," The Economist,
http://www.economist.com/finance/displaystory.cfm?story_id=12274096
"Mark-To-Market' Isn't To Blame For Meltdown That Led To Crisis," Investor's Business Daily,
<http://www.ibdeditorials.com/IBDArticles.aspx?id=307234083390870>
"Suspending mark-to-market is for zombies," The Curious Capitalist, Time Magazine http://time-blog.com/curious_capitalist/2008/10/suspending_marktomarket_is_for.html
"Mark to market," Financial Times, <http://www.ft.com/cms/s/0/82a390b2-8f50-11dd-946c-0000779fd18c.html>
"About The Mark To Market Accounting Issue," Stefan Karlsson's Blog, <http://stefanmikarlsson.blogspot.com/2008/10/about-mark-to-market-accounting-issue.html>
"Don't Let Bankers Run the Asylum," The Wall Street Journal, <http://online.wsj.com/article/SB122282466609392901.html>
"Fair-value accounting becomes a political issue," The Economist, http://www.economist.com/finance/displaystory.cfm?story_id=12342697
"Mark To Market," Obsidian Wings Blog, http://obsidianwings.blogs.com/obsidian_wings/2008/10/mark-to-market.html
"Issue of the day: Mark to market accounting," Megan McArdle at The Atlantic, http://meganmcardle.theatlantic.com/archives/2008/10/issue_of_the_day_mark_to_marke.php
"Steve Forbes Interviews Neil Hennessy," Forbes, <http://www.forbes.com/intelligentinvesting/2008/10/01/intelligent-investing-transcript-neil-hennessy.html>

“The GOP Peddles Economic Snake Oil: Suddenly Republicans are against market values?”, The Wall Street Journal,
<http://online.wsj.com/article/SB122342526024513543.html>

Second, even citing to the GAAP definition, *willing* and *informed* are not the same. Symmetry of information between buyers and sellers, a crucially important part of the original definition, has been left out of the discussion. Why? Perhaps it is because the truth up-ends much of what is held sacred about capitalism: genius-priests, all-knowing institutions, liturgies of heat transfer equations, etc.

Finance is about neither data nor magic. Buyers and sellers must do the work themselves: take raw data and refine it into information, and use that information to determine value—and make prices. It’s not magic, religion or slavery. It’s lonely, intellectual work.

Strains of fundamentalism and literalism run deep in American populist culture; they have no place in the academy or the government, however. Our academic leaders and our financial reporting standards-setters need to admit that the current theories don’t work very well. The pervasive need for higher quality information in our financial services sector and better-trained financial professionals must also be acknowledged. We can expect a return to the market only when we become a market again: when the sellers and buyers of risky debt are able to make sense of the pertinent facts about securities by their own analysis.