

September 7, 2004

Letter of Comment No: 64
File Reference: 1201-100
Date Received: 4-8-44

Ms. Suzanne Q. Bielstein Director of Major Projects and Technical Activities Financial Accounting Standards Board 401 Merritt 7 P.O. Box 5116 Norwalk, CT 06856-5116

File Reference No. 1201-100: Exposure Draft of Proposed Statement of Financial Accounting Standards, Fair Value Measurements

Dear Ms. Bielstein:

Washington Mutual, Inc. (WMI) is a financial services company with over \$278 billion in total assets as of June 30, 2004. Based on those total assets, WMI was the largest savings institution and one of the largest financial institutions in the United States. It also is one of the largest residential mortgage loan originators and mortgage loan servicers in the nation.

We appreciate the opportunity to comment on the Exposure Draft of the Proposed Statement of Financial Accounting Standards, Fair Value Measurements (ED). We support the objective of the ED to provide guidance regarding the measurement of fair value. The proposed guidance will assist preparers of financial statements in measuring fair value on a consistent and comparable basis when required under other existing accounting pronouncements.

With regards to the specific provisions of the ED, however, there are four matters that we believe should be reconsidered or clarified by the Board in order to enhance the proposed guidance. Our thoughts on each of those matters are explained in more detail below.

Blockage Factors

We believe that consideration should be given to reducing the fair value of large blocks of equity securities under certain conditions. For example, companies sometimes invest in start-up (non-public) companies that subsequently are acquired by a public entity through the issuance of the acquiring entity's common stock. Often, the investment in the start-up company is accounted for under the cost method. Consequently, the shares of the acquiring entity received in exchange for the investment in the start-up would be recorded at fair value, normally resulting in the recognition of a gain upon the exchange.



However, if the shares received are expected to realize a lower value because a large block of stock would be sold, it would seem that both the recognition of the stock at fair value and the gain at the date of the exchange would be overstated. Furthermore, readers of the financial statements would be misled into believing that the subsequent loss that was realized upon the sale of the public entity's shares was due to poor management when in fact, the fair value initially assigned was never expected to be realized.

We do not believe that the concept of block discounts should be extended exclusively to broker-dealers and certain investment companies as current practice stands. We recommend that the Board address this inconsistency by permitting block discounts to be applied as necessary to derive an appropriate fair value for large holdings of equity securities. Further, we recommend the Board to establish conditions and circumstances for determining when blockage factors can be utilized in the guidance, for example, providing threshold criterion of blocks for measurement purposes. The current guidance, AICPA Audit and Accounting Guides on Investment Companies, does not provide clear instructions in terms of applying the blockage factors. It only indicates that the size of position held and the liquidity of the market is one of the factors to be considered in estimating the fair value of instruments (paragraph 2.36). With the absence of specific criterion in the guidance, the decision of determining how large positions of securities is subjective, creating reliability and comparability issues.

Fair Value Hierarchy

We agree in principle with the fair value hierarchy concept, where the greatest reliance is placed on quoted prices in active markets or other observable market data and the lowest reliance is placed on inputs that reflect an entity's internal estimates and assumptions. We believe that with the additional guidance suggested below, this concept will assist entities in selecting and applying relevant inputs in a consistent and comparable manner.

We have learned through a discussion regarding the ED with other entities that the fair value measurement hierarchy classification for certain derivative instruments was being interpreted differently by different entities. For example, while we believe that the fair value estimate for a plain vanilla interest rate swap would be a Level 1 estimate due to the liquidity of the instrument and the availability of quoted prices from markets in which identical or very similar swaps are traded, other entities thought that a Level 3 estimate applied because the value was determined internally. We noted that a consensus of the appropriate fair value hierarchy classification could be reached for more common financial instruments (e.g., Treasury, agency, and corporate bonds). The differences of opinion arose more on certain derivative instruments (e.g., interest rate swaps, swaptions, and forward sales or purchases contracts of mortgage-backed securities) and more complex financial instruments (e.g., residual interests in securitized mortgage loans).



In order to minimize any confusion in the proper application of the ED and the assignment of the fair value measurement classification, we suggest that the Board provide additional guidance with a greater range and variety of comprehensive examples.

Pricing in Active Dealer and Markets

In discussing Level 1 estimates of fair value, the ED states that "in an active dealer market where bid and ask prices are more readily and regularly available than closing prices, fair value shall be estimated using bid prices for long positions (assets) and asked prices for short positions (liabilities). For offsetting positions, mid-market prices shall be used for the matched portion. Bid and asked prices shall be used for the net open position, as appropriate" (paragraph 17).

While we agree with the Board that bid prices generally should be used for long positions (assets) and asked prices for short positions (liabilities), this rule would be difficult to apply to certain types of derivative instruments (e.g., interest rate swaps and forward sales or purchases contracts of mortgage-backed securities). Depending on market interest rates or other conditions, their value could move between being assets and liabilities over the holding period. Further, in cases where those derivative instruments are also used for hedging activities under FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities, the guidance would create a significant operational burden to track spread movements in the hedge effectiveness analysis even though the spread between bid and asked prices move just slightly. Consequently, the benefits would not outweigh the costs.

Companies would need to make significant modifications to their current accounting systems used for tracking and valuing such instruments and likely would incur substantial costs.

Multiple Valuation Techniques

The ED requires a Level 3 estimate to be based on multiple valuation techniques consistent with the market approach, income approach, and the cost approach when the quoted prices for identical (Level 1) or similar (Level 2) assets or liabilities in active markets are not available. Paragraph C58 of the ED states that "in some cases, the information necessary to apply valuation techniques consistent with all valuation approaches might not be available without undue cost and effort. The Board concluded that regardless of whether one or more valuation techniques (and approaches) are used, the objective is to select the valuation technique that best approximates what an exchange price would be in the circumstances." Our interpretation on this requirement is that multiple techniques would be applied only if more than one valuation approach is utilized (e.g., market, income, or cost approach). We believe that the ED would not require an entity to apply multiple techniques within a single type of valuation approach. That



conclusion is based on the examples provided in the implementation guidance (paragraphs B11-16) where two different types of valuation approaches are used but only one technique is applied under each approach. Because our independent auditors have indicated that multiple valuation models might be needed under a single type of valuation approach, we believe that the Board should clarify its intent regarding the use of multiple valuation techniques.

Summary

We believe that with the suggestions noted above, the proposed guidance significantly would improve consistency and comparability in the measurement of fair value, which would lead to greater transparency for readers of financial statements.

If you have any questions about our comments, please contact me at (206) 377-5957 (or robert.miles@wamu.net) or Larry Gee, Deputy Controller, at (206) 377-3684 (or larry.gee@wamu.net).

Very truly yours,

Robert H. Miles Senior Vice President and Corporate Controller