



LETTER OF COMMENT NO. 206

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By email: director@fasb.org

Technical Director
Financial Accounting Standards Board
401 Merritt 7, P.O. Box 5116
Norwalk, CT 06856-5116

Re: Response to Invitation to Comment; File Reference Proposed FSP FAS 157-e

Dear Sir:

Interactive Data Pricing and Reference Data, Inc. ("Interactive Data") welcomes the opportunity to respond to the Financial Accounting Standards Board's invitation to comment on Staff Position FAS 157-e (the "FSP"). Interactive Data is a leading provider of pricing and fixed income evaluations for the financial industry in support of our clients' pricing, research, and portfolio management activities. We also offer a Fair Value Information Service for certain international equity securities as well as valuations for certain derivative instruments. Following the issuance of FASB's Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* ("FAS 157"), we have been actively engaged with clients and other industry participants regarding the role of market data providers and the information that we can supply to support financial statement preparers in connection with their fair value requirements.

We recognize that market participants have diverse views on the merits of different approaches to fair value measurement, especially in the current market. A primary role of financial reporting is to present a realistic financial picture to management, investors, regulators and other stakeholders, and arguments have been made that current market values do not present an accurate picture for many financial instruments. The challenge we are faced with today is how to reconcile the increased application of management's judgment with the requirement to present financial results clearly, with comparability across reporting entities and time periods, while using an efficient and manageable process. In this comment letter, we take no position regarding the relative merits of fair value or "mark-to-market" accounting. Rather, we would like to point out several potential implementation issues in the FSP and suggest where clarification might benefit both preparers and users of financial statements.

Determining whether a market is not active

Paragraph 11 of the FSP sets forth seven factors that are to be considered in determining whether a market is inactive. These factors include consideration of the volume and level of transaction activity; the timeliness of and variations in price quotations; changes in the correlation of fair values to indices; and abnormal (or significant increases in) liquidity risk premiums, implied yields and bid-ask spreads. We believe these factors are sufficiently expansive that a preparer could determine the markets for nearly all fixed-income asset classes are inactive (in discussions with market participants, many suggest that only U.S. Treasury securities may categorically be identified as an active market.) This could lead to inconsistent application by financial statement preparers. This is not only true with respect to the present markets, but even in periods generally not described as exhibiting market dislocation. For example, in 2006, prior to the current market dislocation, only 0.45% of the corporate debt outstanding traded on an average day (as reported by the Securities Industry Financial Markets Association). This vagueness means that fixed income markets that are generally not considered to be dislocated could be determined to be inactive under the FSP, and that other markets that are dislocated could continue to be treated as inactive after such markets have stabilized to be more consistent with historical norms.

Furthermore, the vagueness in the paragraph 11 factors leads to a risk for inconsistent application in measuring and documenting management's judgment with respect to inactive markets. In practice, statement preparers will select different historical periods as a baseline to determine whether the current markets or index correlations are abnormal; and these considerations may be determined, in part, by such arbitrary concerns as what data is readily available. This is especially true for the structured finance market where there is no central mechanism for trade dissemination. The vagueness of the factors and the lack of guidance in how to apply or weight each factor relative to the others could result in unintended consequences with respect to the determination of inactive markets for a wide range of fixed income asset classes. As a result, we believe the FASB should consider providing additional guidance regarding the scope, weighing, measurement and application of the factors to determine inactive markets.

We also note that the FASB may want to provide guidance regarding the classification of markets and that those markets may be identified on an asset class or subsector basis (e.g. auto loan or home equity asset-backed securities). A market can exhibit different characteristics across sectors and subsectors and even within the same sector based on differences in credit quality, for example. Financial statement preparers should have the flexibility to define markets by subsectors, and correlate market activity for comparable bonds, consistent with current market practice.

Determining whether a transaction is distressed

Once a market is determined to be inactive, the FSP states a presumption that the quoted price is distressed. A financial reporting entity may only determine otherwise with evidence of "usual and customary marketing activities" and "multiple bidders." Were financial reporting entities to obtain quoted prices by routinely requesting bids from other market participants, this would likely be feasible. In practice however, the vast majority of fixed income instruments trade over-the-counter and most firms do not routinely put the bulk of their fixed income holdings out to bid. Consequently, information as to the number of bidders may not be available for any individual market quote or to every market participant, and evidence of the effort applied to marketing activities is accessible to few market participants, if at all.

The FSP states that once the financial reporting entity has determined a market is inactive and there is insufficient evidence to demonstrate the market quote is not the result of a distressed transaction, "the reporting entity must use a valuation technique other than one that uses the quoted price without significant adjustment." The language in paragraph 15 seems to preclude the entity from considering the quote, or at least not without significant adjustment.

We believe that even when there is no such evidence, a financial reporting entity may reasonably believe that the quote provides information about fair value, and that a lack of evidence should not prohibit management's ability to consider this information in their fair value judgments. As stated in FSP FAS 157-3, "determining fair value in a dislocated market depends on the facts and circumstances and may require the use of significant judgment about whether individual transactions are forced liquidations or distressed sales." Moreover, the presumption of distressed sales in inactive markets may create a disincentive for certain reporting entities to appropriately seek out market information. This also contravenes the principles set forth in FAS 157-3 that the entity should consider "all available market information that could be obtained without undue cost and effort." We believe FASB should consider replacing the prohibition, in this instance, of the use of a quoted price with a more discretionary alternative that emphasizes the use of significant judgment. In addition, the use of evidence for determining whether a transaction is distressed should be applied at a sector or broader level, rather than on a trade by trade basis. As a provider of fixed-income evaluations, Interactive Data uses a similar process in our methodologies to determine the weight to be provided to certain market data inputs. We examine each quote in the context of available transaction and other market

information observed for the security and the sector. In this way, quotes that appear to be outliers can be investigated further and/or assigned less weight in the evaluation process. Similarly, financial statement preparers could examine evidence for similar securities within a sector to evaluate whether the quoted price represents a distressed transaction.

If management loses the discretion to use market information to determine fair value measurements it could have dramatic unintended consequences for reporting entities that need to liquidate securities to meet redemptions. Consider the following example of a hypothetical fund ("Fund A") that faces redemptions at net asset value ("NAV") and must sell the underlying assets at market price. Fund A has three shareholders with holdings of three asset-backed securities (ABS) currently valued at \$20 each and \$30 in cash. The NAV is \$30. If Fund A determines the market for ABS is inactive and does not have evidence to rebut the presumption that quotes are distressed, it may use a present value technique to determine the fair value of each of the securities is \$40. Using these assumptions, the new NAV is \$50. If one investor redeems his share, Fund A is forced to sell one of the ABS at a current market value of \$20. Fund A is now left with two ABS and no cash, resulting in a NAV of \$40, and the other two investors' holdings have been diluted by \$10 each. Structurally, this is equivalent to the dilution experienced by buy and hold fund investors which was brought to light by the market timing scandals earlier this decade. Arbitrageurs, anticipating when funds may adjust between quotes and a present value technique, could develop a trading strategy to maximize returns at the expense of buy and hold investors.¹ Accordingly, it may be appropriate to revise paragraph 15 to permit financial statement preparers to use their judgment in considering available market information.

Conclusion

We support the FASB's goal of providing additional clarity regarding the determination of inactive markets and distressed transactions. We believe that the FSP would benefit from additional guidance regarding the scope, weighting, measurement and application of the factors to determine inactive markets. In addition, we believe FASB should provide additional guidance regarding the evidence required to determine whether transactions are distressed and permit the use of management's judgment when considering quoted prices for distressed transactions. Without such guidance, we are concerned that the FSP may result in diminished clarity and comparability of financial statements, unintended consequences for financial statement preparers and investors, and a difficult and costly implementation. We are grateful for the opportunity to provide our perspective on the FSP.

Sincerely,



Ray D'Arcy
President and Chief Executive Officer

¹ Note that this example does not address any applicable liquidity requirements, e.g. with respect to funds registered under the Investment Company Act of 1940.