

From: Clifford Stoops [mailto:CStoops@hfplp.com]
Sent: Thursday, October 09, 2008 8:19 PM
To: Director - FASB
Subject: File Reference: Proposed FSP FAS 157-d

October 9, 2008

Mr. Russell G. Golden
FASB Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, Connecticut 06856-5116



LETTER OF COMMENT NO. 92

File Reference: Proposed FSP FAS 157-d

Mr. Golden:

Thank you for the opportunity to comment on the proposed FASB Staff Position (“FSP”) Financial Accounting Standard 157-d, “Determining the Fair Value of a Financial Asset in a Market that is Not Active.” Before issuing a final statement, we would appreciate the Board’s consideration of the following issues:

(1) Reliance on Broker Quotes

The securities and loan markets have experienced unprecedented valuation write-downs over the last twelve months. In particular, the velocity of the write-downs in the CLO/CDO market accelerated during the first quarter of 2008, as the overhang of leveraged loans from 2007 far exceeded the demand. Although these loan prices recovered temporarily in the second quarter of 2008, liquidity in the CLO asset class remained almost non-existent and CLO valuations remained depressed. The only noteworthy activity in the market has primarily been the instances where other market-value vehicles, including SIVs, CLOs, CDOs, and TRS programs breached their respective triggers and were forced to liquidate, which flooded the market with additional CLO paper and depressed prices on the assets even further.

As these assets are not exchange traded, holders are required to look to 3rd party brokers for monthly marks. For the past twelve months, we have noted that a significant number of the valuations provided by brokers are based on subjective liquidity haircuts or the lowest price that any similarly-rated asset traded at during a given month, even though the trade was often the result of a forced or distressed sale. As such, the valuations are not based on the specific deal structure, the quality of the underlying assets, expected future cash flows, or any other factor that reflects the fair value of the asset.

In light of these conditions, we ask that you amend paragraph 9, part C of the FSP to state that an entity may choose not to place any reliance on broker quotes when it (a) determines

that the quotes are not based on actual or proposed market transactions; and (b) does not have sufficient information to determine if the models and inputs used by the brokers are indicative of fair values as defined by FAS 157. Without this clarifying language, entities (and independent accountants) may be required to incorporate meaningless broker quotes into their fair value analyses, which is counterproductive.

(2) Present Value Techniques

Assuming the available broker quotes do not provide an appropriate measure of fair value, we understand that an entity would be required to use one of the present value techniques described in FAS 157. The FSP specifically states that these techniques must incorporate “appropriate risk adjustments that market participants would make for nonperformance and liquidity risks.”

Nonperformance Risk

When discussing valuation techniques with peers in our industry, we have discovered that there is no standard approach for assessing non-performance risk. As a result, assumptions can vary significantly and produce materially different estimates of fair value for the same security. For example, an entity may choose to measure nonperformance risk based on current default rates, implied default rates, stress tests that attempt to measure worst case scenarios, or some combination of the three.

FAS 157 defines fair value as “the price that would be received to sell an asset . . . at the *measurement date (emphasis added)*.” Based on this definition, we believe that a published market consensus regarding expected future default rates would provide the most appropriate estimate of nonperformance risk since the fair value of a security at any point in time always incorporates some element of its expected future performance. We believe the use of unrealistic implied default rates and worst-case scenarios produces overly punitive results that are not reflective of fair value by any measurement.

Liquidity Risk

The FSP reiterates the existing principle within FAS 157 that the objective of fair value measurement is to determine the price that “would be received in an orderly transaction that is not a forced liquidation or distressed sale.” We believe the requirement to incorporate liquidity risk premiums into present value techniques directly contradicts this principle.

Ordinary transactions are only possible if the markets are functioning properly and willing entities have access to the credit necessary to fund the purchase of securities. In that case, the liquidity risk is nominal because an entity seeking to sell an asset is able to find a ready buyer, and the purchase price is based primarily on the credit quality of that asset. Therefore, the inclusion of a liquidity premium within valuation models implicitly assumes that a liquidation or distressed sale scenario is likely to occur.

Even if we assume that it is appropriate to incorporate a liquidity risk premium based on current market conditions, we believe it should reflect an entity's ability and intent to hold an asset until the credit crisis is resolved. For example, if an entity has sufficient capital to satisfy its existing obligations and has no need to raise additional cash through asset sales, we would consider the liquidity risk for that entity to be minimal because it can continue to hold a given security until overall liquidity conditions in the market improve. Another entity that holds the same security may face severe capital constraints, in which case its liquidity premium could be significant. The ultimate result is that two entities holding the same security could assign very different fair value estimates to it, which presents another compelling argument for excluding the concept of a liquidity risk premium from valuation techniques.

Finally, it has been our experience that quoted prices which are not based on actual trades or firm bids are often justified by the inclusion of higher liquidity premiums. This variable is essentially being used as the "catch-all category" for rationalizing declines in valuation that exceed the performance risk inherent to the assets being marked. Given the subjective nature of quoted prices in an illiquid market, it is not possible for the recipient of the marks to prove or disprove the validity of the perceived liquidity premium. Under the current guidance, however, the recipient of such a mark is required to consider it as a data point in *the analysis on the asset, which skews the ultimate valuation of the asset.* For these reasons and in the absence of additional guidance, we believe the concept of a risk premium based on liquidity is entirely too subjective in an illiquid market and is not meaningful in the context of fair value measurement.

Sincerely,

Clifford Stoops
Chief Financial Officer
Highland Financial Partners, L.P.