



LETTER OF COMMENT NO. 20



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October 15, 2008

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

**File Reference: Proposed FSP FAS 140-e and FIN 46(R)-e**

Dear Mr. Golden:

We appreciate the opportunity to comment on the Proposed FSP FAS 140-e and FIN 46(R)-e (the "FSP"). As a large financial institution, Merrill Lynch is significantly affected by the guidance in SFAS No. 140 and FIN 46R and the related disclosure requirements. We agree with the Board that meaningful and transparent disclosure of on-balance sheet and off-balance sheet exposure is essential for users of the financial statements.

Although we generally support the objectives established in the FSP, we do have some concerns and suggestions regarding the implementation of this guidance. Our primary concern is that in certain cases it appears that the FSP focuses on *more* rather than *enhanced* disclosure. While we agree that transfers of assets where the transferor has continuing involvement with those assets can have a significant impact on the performance of an enterprise, we believe that requiring too much disclosure can result in overly complex financial statements and important details can be obscured by extensive quantitative disclosure of low risk transactions. For instance, based on our interpretation of the FSP, special purpose entities ("SPEs") where the only continuing involvement of the transferor is a simple interest rate swap would require the same level of disclosure as SPEs to which a transferor provides liquidity and credit protection. We do not believe that this should be the case.

Below we have provided suggestions that we believe could improve the guidance by better integrating the disclosure requirements in FAS 140 and FIN 46(R) and eliminating less relevant requirements.

***Disclosures of “continuing involvement” in the transferred financial assets***

The FAS 140 disclosures in paragraph B1.17i are required whenever the transferor has “continuing involvement” in the financial assets transferred to the SPE. Continuing involvement is defined very broadly and includes items like simple interest rate and currency derivatives. In our opinion, requiring disclosures where the only continuing involvement by the transferor relates to traditional market rate derivative instruments reduces the usefulness of the disclosures because:

- It unduly differentiates these exposures from other transactions that have similar terms but are entered into with either 1) non-SPE counterparties or 2) SPE counterparties where the reporting firm is not the transferor. In our opinion, it is difficult to understand why the detailed information in paragraph B1.17i would be required for these transactions when there are literally thousands of transactions with similar economics and terms for which this information is not deemed necessary.
- Including the disclosures for these transactions could confuse and distract users from the important types of continued involvement. Not all involvement with SPEs is equal, and without a significant amount of cautionary disclosure, users of financial statements could be misled to believe that the risks are similar. In our view, rather than adding extensive narrative that explains why certain disclosures are less important than others, only meaningful disclosures should be required.

In order to better address the meaningful risks associated with a reporting entity’s continuing involvement with the transferred assets, we recommend that the Board consider integrating the continued involvement disclosure requirements with the concepts in FIN 46(R). Rather than requiring disclosure where the transferor has continuing involvement with the assets, we believe that the disclosures should be required only where the transferor has a more than nominal variable interest in either the SPE or the assets of the SPE. This approach will effectively remove certain disclosures for routine instruments that are senior in priority and primarily derive value from external market movements (e.g., simple interest rate and currency derivatives). It is our view that this will be more useful for financial statement users as it highlights continuing variable exposure to the performance of the transferred assets.

***Sensitivity Analysis***

Merrill Lynch believes that the sensitivity analysis in paragraph B1.17i of the FAS 140 disclosures does not provide meaningful information to users of financial statements. It can be argued that the original purpose of this disclosure was to help users of financial statements to better understand how changes in assumptions may affect the valuation of retained interests held by a company. We disagree with this, as it has always been our view that the level of disclosure for these instruments unduly distinguishes them from other similar instruments held by the firm. For example, it has never been obvious to us why a senior interest in a securitization entity to which the reporting firm transferred assets should require more analysis than a senior interest in a securitization entity purchased from an unrelated third party.

We believe that another argument against the current sensitivity analysis requirement is evidenced in caveats in many if not all reporting firms' disclosure. For example, in Merrill Lynch's 2007 Annual Report we state under the sensitivity table:

"The preceding sensitivity analysis is hypothetical and should be used with caution. In particular, the effect of a variation in a particular assumption on the fair value of the retained interest is calculated independent of changes in any other assumption; in practice, changes in one factor may result in changes in another, which might magnify or counteract the sensitivities."

Essentially, firms reporting this information are telling their financial statement users that the information provided in the disclosures is not meaningful.

In our view, many of the concerns about the valuation of these instruments have subsequently been addressed by the FAS 157, *Fair Value Measurement* ("FAS 157") disclosure requirements. FAS 157 requires disclosure about the priority of inputs used to value instruments carried at fair value and a significant amount of detail for "level 3" financial instruments where the fair value incorporates a significant level of management judgment. Based on our experience, almost all instruments for which the sensitivity analysis is required are also reported in the FAS 157 disclosures.

We encourage the Board to take this opportunity to remove what we believe is an out-dated and not meaningful disclosure requirement.

Although we recommend that the Board remove this requirement, if the Board believes that it is necessary to continue to require the sensitivity disclosures, we respectfully request the reconsideration of the scope of these disclosures. Perhaps the Board could consider applying this requirement only to continuing involvement that arises from instruments that are not held at fair value.

#### ***Scope of disclosures for Variable Interest Entities***

We generally agree with the objectives and disclosure requirements for variable interest entities; however, we believe that the scope expansion for both the primary beneficiary and the significant/sponsor variable interest holder is too broad.

The primary beneficiary disclosures in the FSP are now required even when the primary beneficiary has voting control over the entity. Where voting control is substantive, e.g., provides the holder with the unilateral right to make significant decisions on behalf of the entity, we do not believe that the disclosures should be required because the primary beneficiary's relationship to the controlled VIE is no different from its relationship to any other consolidated subsidiary. It is our view that there is no reason why the relationship to these entities warrants additional disclosure.

If the Board determines that this disclosure is necessary, we request that they limit the scope to VIEs that have third party variable interest holders. Firms establish numerous subsidiaries, many of which are thinly capitalized. Requiring an extensive review of all

wholly owned subsidiaries to determine whether or not each is a VIE would be burdensome and in our opinion, would provide little useful information.

In addition, we believe that the FSP disclosure requirements for variable interests held by sponsors should be limited to those entities in which the sponsor has more than a nominal interest in the VIE. It is our view that reporting transactions where there is nominal involvement would not provide meaningful information to the users of financial statements.

***Alternative judgement in determining whether or not a VIE is consolidated***

Paragraph C1.22.C.a. (from the FIN 46(R) section of the FSP) requires firms to disclose 1) significant factors considered in the VIE consolidation determination and 2) significant assumptions and judgments made and whether a different assumption or judgment could reasonably have been made that would result in a different conclusion. We are concerned that this disclosure expands the purpose of financial statements, i.e., to provide information on a reporting entity's financial position and effectively enables users to second-guess management's decisions. We believe sufficient information related to the above is captured in the disclosure requirements of SOP 94-6, *Disclosure of Certain Significant Risks and Uncertainties* and in SEC required the critical accounting policies section of the MD&A as required by the SEC. Under a principle-based approach to accounting many accounting determinations require significant judgment. We do not understand why FIN46(R) is separately targeted for additional disclosure on this topic. In addition, we are concerned that the C1.22.C.a.2 requirement to include a statement that another conclusion could be reached may result in unnecessary litigation risk.

Further, it is our view that the requirement to provide alternative assumptions and judgments will result in either the excessive reporting of multiple scenarios or highly summarized information. In either case, it is not clear that requiring this information and the qualitative descriptions required elsewhere in the FSP would provide much additional insight to users of the financial statements and may actually be confusing.

Finally, we believe that this kind of disclosure would have been more useful where the determination was based on a quantitative analysis. Since the new FIN 46(R) approach (in FIN 46(R) ED) focuses on qualitative rather than quantitative factors, we feel that this information will have even less relevance as firms adopt the new guidance. We believe that this is even more likely to be the case if the quantitative analysis in FIN 46 (R) is removed. (Merrill Lynch strongly supports removing the quantitative analysis because we have found that in practice it is extremely difficult to consistently calculate cash flows and probabilities for what are often complex entities.)

***Effective Date***

Merrill Lynch understands the importance of the proposed disclosures to users of financial statements, and we are confident that we would be able to implement the qualitative disclosures within the proposed time frame. However, given the expansion of the scope and detail in both the FAS 140 and FIN 46(R) proposed disclosures,

implementation of the new quantitative requirements within the proposed time frame will be extraordinarily challenging for large financial institutions. This is especially true when considering the other guidance that will be implemented during this time period including: FAS 161, FSP FAS 133-1 and FIN 45-4, FAS 160 and FSP FAS 140-3. We urge the Board to provide reporting entities with a reasonable amount of time to analyze the new requirements and carefully implement the new disclosures. If our suggestions above can be addressed, we would support an implementation date for quantitative disclosure requirements for the first interim period beginning after the FSP is finalized. For most firms this would be the first quarter of 2009.

*Use of the term “special purpose entity” within the FSP*

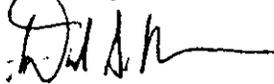
The revised FAS 140 disclosure requirements in paragraphs B1.17h and 17i of the FSP are specifically required for transfers of assets to “special purpose entities” (“SPEs”). Although this term is still widely used by financial institutions, it has never been formally defined in the accounting literature.

Therefore, we recommend that the Board consider eliminating the term SPE from the guidance and replacing it with the FIN 46(R) term “variable interest entity” (VIE). We believe that this will result in a more consistent application of the guidance as the term “VIE” is clearly defined. The VIE concept arose from the need to distinguish between entities that are controlled by their substantive share holders and entities that are controlled through other arrangements. It is our view that it is transfers to VIEs (i.e., entities that are not controlled by substantive share holders) that warrant additional disclosure.

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Thank you again for the opportunity to comment on this important project. We are available to give further input on this draft or on future proposals that are developed as this project progresses. If you have any questions regarding our comments, please do not hesitate to contact me at (212) 449-2048.

Sincerely,



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