



LETTER OF COMMENT NO. 50

Deutsche Bank

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File Reference: Proposed FSP FAS 157-d

Dear Mr. Golden,

Deutsche Bank appreciates the opportunity to provide comments on the FASB Staff Position (FSP) Determining the Fair Value of a Financial Asset in a Market that is Not Active. We welcome the Board's efforts to provide illustrative guidance of the principles of FAS 157 in determining the fair value of financial instruments in markets that are not active.

We believe that the FSP is broadly consistent with current practice for financial institutions with sophisticated valuation processes. Further, we believe that it is useful for the Board to reiterate that fair value is a current exit price and the illustrative example provides reinforcement of this principle.

However, we have some concerns with the example provided in the FSP. We believe that it raises several additional questions and is open to potential misinterpretation.

Our comments are as follows:

- Paragraph 7: The current scope of the FSP is for financial assets. We believe the scope should include both financial assets and financial liabilities;
- Paragraph 11.A32A: Whilst we appreciate this is setting the scene for the later discussion, we do not believe that a CDO would be classified in Level 1 of the fair value hierarchy since there has never been an active quoted market in an individual tranche and all CDOs are seen as bespoke. We are concerned that this could be potentially be taken out of context to imply that thinly traded markets or broker quotes could be used to classify an instrument in Level 1 of the fair value hierarchy;

- Paragraph 11.A32B: As currently worded, it could be implied that an entity is able to ignore observable inputs and use entity specific inputs in a Level 3 valuation. It should be stated that this is only possible where the observable inputs are either stale or only indicative and even then the inputs should be considered in fair value determination;
- Paragraph 11.A32C: The example suggests a single valuation approach (the income approach). We believe it would be better to suggest that a number of different valuation techniques should be used and judgement should be exercised to select a fair value within the range provided by these valuation techniques. Using multiple techniques results in there being less bias to one sensitive parameter in a single technique where there may be little observability;
- Paragraph 11.A32D: The example states that "Entity A determines that credit spreads have widened (100 basis points) and liquidity risk premiums have increased during that period (400 basis points)." There is no discussion as to how these values are derived. These values are not observable and since CDOs are bespoke, the values for these parameters should not be taken from generic market yields without placing the necessary emphasis on collateral risks, capital structure and other structural nuances. In order to derive an appropriate change in credit spread, the underlying pool of collateral needs to be examined (rather than just relying on ratings of the tranche.) In addition, the liquidity premium is difficult to estimate if these CDOs are illiquid. We believe the example should be amended to include appropriate focus on the specific collateral, capital structure and structural nuances of the specific CDO to determine the movement in credit spread and liquidity risk premium;
- Paragraph 11.A32D: In order to determine a fair value using an income approach there needs to be estimates of future cash flows and an estimate of a discount rate. The current example focuses on the discount rate. A discussion of the cash flow projections should be included which illustrates the estimation of prepayment, default, recovery rates for the particular collateral pool and *consideration of the capital structure and any structural nuances*;
- Paragraph 11.A32D: The second paragraph implies that broker quotes and independent pricing sources provide a similar quality of information. This is not necessarily the case. Further, the example is currently silent on whether binding quotes would give a different answer. Other examples could be introduced to

cover a wider range of data and / or products;

- Paragraph 11.A32E: There is no guidance on how a value of 22 was determined and how the different factors could be weighted. It should be stressed that management needs to exercise significant judgement to determine the point in the range which is most representative of fair value.

We hope you find these comments helpful. Should you have any questions or wish to discuss these matters further, please contact me on +44(207)54-76640 or via email to charlotte.jones@db.com.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Charlotte Jones', with a stylized flourish at the end.

Charlotte Jones
Global Head Accounting Policy and Advisory Group
Deutsche Bank AG