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LETTER OF COMMENT NO. 313

April 1, 2009

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

Re: File Reference – Proposed FASB Staff Position No. FAS 157-e, *Determining Whether a Market Is Not Active and a Transaction Is Not Distressed*

Dear Mr. Golden:

The American Council of Life Insurers ("ACLI")¹ welcomes the opportunity to comment on the proposed FASB Staff Position (FSP) No. FAS 157-e, *Determining Whether a Market Is Not Active and a Transaction Is Not Distressed* ("Proposed FSP").

We appreciate the FASB revisiting existing guidance, and we agree with the FASB's overall objective of providing additional guidance on determining whether a market for a financial asset is not active and a transaction is not distressed. However, we believe that further clarification is needed in order for the FSP to achieve the objective. Our main concerns with the Proposed FSP and our recommended changes are discussed below.

Contrary to concerns raised by certain organizations, we believe that the guidance is not counter to the FAS 157 exit value concept. We believe that the Proposed FSP clarifies how to apply the FAS 157 "hypothetical transaction", "orderly market", and "market participant" terms when selling an asset or transferring a liability in an inactive market. For example, it is broadly agreed upon that there is no current active market for non-agency residential mortgage-backed securities and for certain commercial mortgage-backed securities. Insurance companies, pension funds and other institutional buyers have avoided these markets due to uncertainty about future housing prices, the state of the economy, potential ratings action and uncertain governmental intervention. Absent these ordinary market participants, hedge funds and other speculative investors have entered the market. Unfortunately these acquirers were levered investors and as markets declined were forced to sell securities due to margin calls and to fund customer withdrawals. This forced sale activity has resulted in deeply distressed prices that no longer reflect the economic reality of the underlying assets. Using these prices does not reflect an exit value as defined by FAS 157 but instead represents a forced liquidation value.

¹ The American Council of Life Insurers represents 340 member companies operating in the United States, of which 332 are legal reserve life insurance companies, and 8 are fraternal benefit societies. These 340 member companies account for 93% of total life insurance company assets, 94% of the life insurance premiums, and 94% of annuity considerations in the United States.

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SCOPE

In order to prevent unintended consequences for entities such as mutual funds and insurance company separate accounts, we strongly recommend that the scope of the guidance be modified to either exclude or make the application optional for companies that produce financial statements based on a net asset value such as investment companies. *The reporting of assets in an inactive market at liquidation value is appropriate for such preparers.*

INACTIVE MARKET/DISTRESSED TRANSACTIONS

The Proposed FSP includes a two-step approach to determine whether a market is not active and a quoted price for a transaction that is distressed.

Step 1

Step 1 of the two-step approach provides indicators of whether a market is inactive. Overall, we agree with Step 1 of the two-step approach. The key to Step 1 is the ability of an entity to use judgment in making the final determination of whether a market is inactive. This is important as whenever a list of factors are provided for consideration, some may interpret that to mean completing a checklist, when in reality some of these factors may be difficult to determine.

While we agree that the indicators included in Step 1 should be considered when determining whether a market is inactive, we believe that there should be a comment added to the Proposed FSP making it a presumption that a market is active unless factors are known to exist that indicate a market is inactive. We believe that as currently written, auditors may force preparers to document all indicators for each asset class, whether or not management believes the market for a particular asset class is active or inactive. This will establish a precedent that a preparer needs to consider and document the entire population, rather than an exception based model (i.e. just the inactive markets), as we believe is the intent of the guidance. This could place an undue operational burden on the preparer to document market factors for certain asset classes that are clearly in an active market.

Step 2

Step 2 of the two-step approach evaluates whether a quoted price is distressed or not. Overall, we agree with Step 2 of the two-step approach; however, we have several concerns which are documented below.

We agree, as proposed in the FSP, that there should be a presumption that a quoted price in an inactive market is associated with a distressed transaction. As currently written, the Proposed FSP does not provide clear guidance on what level of documentation is needed to demonstrate that the criteria established under Step 2 are met or are not met depending on the case. We recommend that these criteria be removed to strengthen the presumption and to encourage the application of Step 2 based on facts and circumstances rather than provide the criteria. A comment should be added to this section of the Proposed FSP to reiterate management's judgment in determining whether or not the price is associated with a distressed transaction.

When it is determined that there is an inactive market and that the quoted price is distressed, the Proposed FSP states that a preparer must use a valuation technique other than one that uses the quoted price without significant adjustment. We believe it needs to be clearly stated that once it is established that there is an inactive market, any quoted price ceases to be a value that the entity needs to use for any form of calibration of the ultimate fair value it calculates.

Further, the Proposed FSP states that the inputs into the valuation model should “reflect an orderly transaction between market participants at the measurement date”, and that the “orderly transaction would include all risks inherent in the asset, including a reasonable risk premium... that would be considered by willing buyers and willing sellers in pricing the asset in a nondistressed transaction at the measurement date.” Our concern is that audit firms and others will view the “market participant” and “willing buyers and willing sellers” as the buyers and sellers of that asset at the measurement date and not determine an inactive market and related valuation as intended in the Proposed FSP. We recommend that the FASB stress that the “willing buyers and willing sellers” that constitute a “market participant” are not the same in a “nondistressed transaction” as in a “distressed transaction.” An example of this approach would be to look at the willing buyers and sellers of a financial instrument with a similar risk profile in the current market where the market for that similar asset is active. Another example would be to look to a market participant for that instrument during the period when the market was active – not the current market participant.

Proposed FSP Example

The Proposed FSP includes an example of how to apply the two-step approach to determine whether a market is not active and a quoted price for a transaction is distressed. We believe that if issued as currently written, auditors may attempt to inappropriately apply the specific circumstances that are laid out in the example to every situation. Also, we believe that the example is not fully consistent with the guidance contained within the Proposed FSP as noted below:

- Paragraph A32E discusses examples of information that a preparer can consider when estimating a range of a rate of return. However, these items may not be indicative of an orderly transaction in an inactive market, such as relevant reports issued by analysts and rating agencies.

In addition, item (3) states “Reasonable assumptions regarding liquidity and nonperformance (for example, default risk and collateral value risk) risks that willing buyers and sellers would consider in pricing the asset in an orderly transaction based on current market conditions.” We do not believe the reference to “current market conditions” is consistent with the guidance provided in paragraph 15 and should be removed from the guidance.

- Paragraph A32F of the example discusses a range of possible outcomes and the use of a midpoint. This is an example of how a preparer may determine their best estimate of fair value, but constitutes only one example. Based on other models, a preparer may determine the best estimated fair value as one amount rather than a range.
- Paragraph A32F of the example discusses a discount rate “based on bid level yields.” This seems to imply it is appropriate to use a distressed market quote in the valuation of the financial instrument. This is not consistent with the guidance provided and should be removed from the guidance.

We recommend removing the example in its entirety and to rely on the actual guidance. The example includes a number of references that could be interpreted to require consideration of current market activity that is not consistent with the Proposed FSP. Eliminating the example will avoid inconsistent or misapplication of an example.

EFFECTIVE DATE – CHANGE IN ESTIMATE

We agree with the Proposed FSP that revisions resulting from a change in the valuation technique or its application should be accounted for as a change in accounting estimate. However, we suggest that the

reference to FASB Statement No. 154, *Accounting Changes and Error Corrections*, ("FAS 154") paragraph 19 be expanded to also include FAS 154, paragraph 20. Paragraph 20 states that "The effect of the change in accounting principle, or the method of applying it, may be inseparable from the effect of the change in accounting estimate. Changes of that type often are related to the continuing process of obtaining additional information and revising estimates[...]" Due to the Proposed FSP providing additional guidance for measuring fair value in inactive markets by allowing for a two-step valuation approach, we believe FAS 154, paragraph 20 is better correlated to the changes that will result from the Proposed FSP since it represents a change in the application of U.S. GAAP that is inseparable from the *effect of a change in accounting estimate*.

We welcome any additional questions or concerns you wish to discuss.

Sincerely,

A handwritten signature in black ink, appearing to read "M. Monahan". The signature is fluid and cursive, written in a professional style.

Michael M. Monahan
Director, Accounting Policy