



March 30, 2009

LETTER OF COMMENT NO. 3/0

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Re: Proposed FASB Staff Position (FSP) FAS 157-e

Dear Mr. Golden:

Grant Thornton LLP appreciates the opportunity to comment on proposed FASB Staff Position (FSP) FAS 157-e, "Determining Whether a Market Is Not Active and a Transaction Is Not Distressed." We support the Board's efforts to provide additional guidance on determining whether a market for a financial asset is not active and a transaction is distressed for fair value measurements under FASB Statement 157, Fair Value Measurements, but we believe that the guidance in the proposed FSP is not consistent with the objective of a fair value measurement set forth in paragraph 7 of Statement 157. The proposed guidance considers factors relative to the principal (or most advantageous) market for an asset to assess whether a transaction for an asset is forced or distressed, as opposed to factors specific to that asset. The proposed guidance appears likely to lead to the classification of observable transactions in inactive markets as distressed and the exclusion of those prices from being considered as inputs to fair value measurements.

In our opinion, the adoption of this proposed FSP could result in several unintended consequences, including

- Deterioration in confidence of investors in the reported financial information of entities
 holding financial assets at a time when investor confidence is critical to attracting capital
 investments in these entities
- Recognition of gains during the period of adoption that could not be realized by sale of the
 assets during that period
- Recognition of gains during periods of rising prices when markets are likely to be classified
 as active and deferral of losses during periods of falling prices when markets are likely to be
 classified as inactive
- Certain entities that calculate redemption and subscription amounts based on net asset value (such as certain open end funds, benefit plans, and hedge funds) that is derived from the fair



value of investments reporting those investments at amounts that could not be realized at the measurement date

Potential impact on public policy matters, such as the recently announced public-private
investment partnership initiative, if certain entities were to be more reluctant to sell financial
assets because the prices that would be paid could be higher than the entities' carrying
amounts

We believe that most financial assets that would be subject to this proposed FSP would not be measured at fair value. If the Board adopts the proposed FSP, it should employ different terminology that indicates that such measurements are not fair value but some other appropriately labeled amount.

We are concerned with the abbreviated comment period and proposed implementation timeline as it relates to due process in developing authoritative accounting guidance. The Board undertook extensive deliberations and re-deliberations that stretched over years when developing Statement 157. We understand that there is significant need to provide guidance related to fair value measurements in the current economic environment. However, there is significant risk that the short timeframe for developing and issuing this proposed guidance could impair the ability of constituents to provide useful input on the Board's guidance and impair the ability of the Board to adequately consider that input in developing a final FSP.

The comments in the remainder of our letter address certain operational issues in the proposed guidance if the Board proceeds with the proposed FSP.

General comments

We believe that the Board could improve the proposed FSP by addressing the concept of an active market as it relates to similar assets or liabilities. Also, it is our opinion that step 2 of the model in the proposed FSP will lead to estimates of fair value that would not be reflective of the hypothetical price received to sell an asset at the measurement date. In our view, changes in measurement resulting from implementation of the proposed FSP would constitute changes in the method of applying an accounting principle that should be recognized as changes in accounting principle at the transition date, rather than as changes in estimates as proposed.

Active markets for similar assets

Because the proposed FSP would amend paragraph 28b of Statement 157 such that entities evaluating transactions under that paragraph would be referred to paragraph 29a, we believe the Board will need to provide clarification on the applicability of paragraph 28a for the proposed FSP to be operational. For example, the vast majority of private label, mortgage-backed securities and collateralized debt obligations did not trade in an active market when evaluated at the individual security level prior to the current dislocation in the markets for these assets. When evaluating the identical asset, the market for these securities has historically been considered inactive because transactions at the individual security level did not occur with sufficient frequency and volume to provide pricing information on an ongoing basis. Pricing for these securities has historically relied on the transaction price for securities that would be



considered similar; however, markets for those similar securities would also not be considered active when evaluated at the individual security level.

If the Board believes that the evaluation of active markets in paragraph 28a should be considered from the perspective of an individual security that trades in an active market, then the market for a majority of debt securities will always be considered inactive and subject to consideration in paragraph 28b and the second step of the model in the proposed FSP. In our opinion, this would not be an appropriate application of determining whether an input is Level 2 or Level 3. If the Board believes that the evaluation of active markets in paragraph 28a should be considered from the perspective of an individual security that trades in an active market, then step 1 of the proposed FSP should indicate that the factors should be evaluated from the perspective of the collective market for the asset and similar assets rather than from the perspective of the market for the asset.

Inclusion of observable transaction prices in fair value measurements

Step 2 of the model in paragraph 29a of the proposed FSP will result in an almost automatic exclusion of quoted prices as relevant observable inputs without significant adjustment.

Observable transactions will nearly always be considered distressed for transactions in inactive markets because reporting entities will rarely have access to information about whether (a) a seller exposed an asset for a period of time to allow for usual and customary marketing activities, or (b) there were multiple bidders for an asset. Because there is no guidance as to how quoted prices for distressed transactions should be adjusted by a significant amount so that they might be considered relevant, we are concerned that entities might conclude that such prices should be disregarded entirely from fair value measurements, even though there will likely be no evidence that the specific transactions are distressed.

It is often very difficult to determine whether transactions meet the criteria to be considered distressed, because of their lack of transparency. Accordingly, we believe that an observable transaction price should not be disregarded as a data point in establishing the fair value of an asset or liability.

Our responses to the Board's specific questions in its Notice to Recipients are as follows.

Question 1

Is the proposed effective date of interim and annual periods ending after March 15, 2009, operational?

It is our view that application of this proposed FSP will likely result in entities being required to employ modeling techniques to determine the fair value of certain assets and liabilities that in prior periods were not deemed to require such techniques. Additionally, we are aware that pricing services often utilize matrix pricing or similar techniques employing prices and other observable attributes of similar securities to provide Level 2 measurements of fair value for their clients. Under this proposed guidance, pricing services may have to alter their techniques in relation to such securities to employ more complex modeling. Modeling techniques require substantial commitments of time and capital; therefore, we do not believe that the proposed



effective date of interim and annual periods ending after March 15, 2009 is operational. We would not object to allowing early application if the effective date were to be changed to a later quarter, for example, interim and annual periods ending after June 15 or September 15, 2009.

Question 2

Will the proposed FSP meet the project's objective to improve financial reporting by addressing fair value measurement application issues identified by constituents related to determining whether a market is not active and a transaction is not distressed? Do you believe that amendments to Statement 157 in this proposed FSP are necessary, or do you believe the current requirements in Statement 157 should be retained?

We believe the current requirements in Statement 157 should be retained. While the proposed changes do address constituents' fair value measurement application issues, they do so at the expense of the underlying principles in Statement 157, which were developed through unhurried, thoughtful deliberation. In particular, the proposed changes depart from the principle articulated in paragraph 21 of Statement 157 that valuation techniques should maximize the use of observable inputs and minimize the use of unobservable inputs. Additionally, the changes depart from the principles described in paragraphs 22 and 29 of Statement 157 that assessing the significance of, and appropriate adjustment to, an input depends upon factors specific to the asset or liability rather than factors related to the market.

In our opinion, the proposed guidance will result in entities no longer maximizing the use of observable inputs, and it will promote the classification of observable transactions as distressed. Under the two-step evaluation process in the proposed FSP, an entity must first determine whether the market for an asset or liability is inactive. Once an entity has determined that the market is inactive, a presumption arises that an observable transaction is distressed. That presumption may only be overcome by observable evidence that indicates the transaction was orderly. If that evidence is not readily available, the transaction is deemed not orderly. The result of this process is that observable inputs may not be appropriately used in the fair value measurement.

Under current guidance, observable inputs would be used in the valuation of an asset; the inputs would be appropriately adjusted if they are not quoted prices included within Level 1 of the fair value hierarchy. According to paragraph 29 of Statement 157, factors to consider in adjusting inputs include, "the extent to which the inputs relate to items that are comparable to the asset or liability, and the volume and level of activity in the markets within which the inputs are observed." Thus, entities are required under current guidance to maintain the primacy of observable over unobservable inputs by using judgment to take into account relevant factors. We believe that the current guidance promotes the proper use of observable inputs, and that the proposed guidance would promote improper removal of observable inputs from the consideration of the fair value of an asset or liability.

The proposed guidance moves the consideration of the significance of an input from the level of the asset or liability to the level of the market as a whole. An observable transaction in an inactive market may be orderly or not. Rather than requiring the evaluation of a transaction to



determine whether it was distressed, the proposed guidance would require an entity to presume that an observable transaction is distressed if the market is considered to be inactive, unless it has evidence that the criteria in step 2 of the proposed evaluation model have been satisfied. Applying the proposed guidance would result in valid inputs being rejected (rather than adjusted), which would limit the evidence that entities are allowed to consider. We do not view that result as an improvement in financial reporting.

Question 3

Do you believe the proposed two-step model for determining whether a market is not active and a transaction is not distressed is understandable and operational? If not, please suggest alternative ways of identifying inactive markets and distressed transactions.

Please see our general comments above.

Question 4

Are the factors listed in paragraph 11 of the FSP that indicate that a market is not active appropriate? Please provide any other factors that indicate that a market is not active.

We believe that the new factors listed in paragraph 11 of the proposed FSP would be more appropriate when considering whether transactions might be distressed. However, we also have significant concerns with the two-step process in which those factors are described, as noted in our general comments.

Question 5

What costs do you expect to incur if the Board were to issue this proposed FSP in its current form as a final FSP? How could the Board further reduce the costs of applying the requirements of the FSP without reducing the benefits?

It is difficult to assess the extent of the additional costs that would be incurred if the FSP were adopted as proposed because it depends on the nature and extent of the assets held by an entity. However, we believe that companies will incur significant costs to develop the valuation models that are required. It is also our view that the proposed FSP would result in additional audit efforts related to those valuations and the estimates that management use to develop them. It is difficult to assess those additional costs without further guidance from the FASB and the PCAOB regarding management's assertions about whether quoted prices are associated with distressed transactions.

We appreciate the opportunity to comment on the proposed FSP and would be pleased to discuss our comments with the FASB staff. If you have any questions, please contact Mark K. Scoles, Partner, Accounting Principles Consulting Group, at 312.602.8780 or <u>Mark.Scoles@gt.com</u>.



Sincerely,

/s/ Grant Thornton LLP