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LETTER OF COMMENT NO. 16

September 14, 2007

Mr. Russell G. Golden
Director of Technical Application & Implementation Activities
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
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director@fasb.org

Re: File Reference: Proposed FSP FAS 140-d.

Merrill Lynch appreciates the opportunity to comment on the Financial Accounting Standards Board's ("FASB") proposed FSP FAS 140-d (the "FSP"). As a major financial services company that conducts significant financing transactions, we remain very interested in the final outcome of this project.

In summary, we generally support the underlying concept of the FSP for the limited type of transactions we believe the FSP was intended to address, but we have concerns about the broad impact the FSP as drafted will have on transactions not intended to be affected. We do not believe it is appropriate to link most asset sales with subsequent financings as these transactions are usually performed at arm's length, are not done in contemplation of one another, and the benefits of ownership remain with the purchaser of the assets. We do note agree the rules based approach outlined in the FSP is the appropriate route to take. We believe that item (a) in paragraph 6 of the FSP provides a principle with which preparers can analyze transactions on a facts and circumstances basis.

If the FASB decides to proceed with the approach as outlined in the FSP, we hope the FASB will consider our more specific views on the requirements of the FSP provided below.

Question 1: Are the criteria in paragraph 7 of this proposed FSP operational and do they appropriately identify those transactions that should be accounted for separately? If you disagree, please provide example transactions that do not meet the criteria but should be accounted for separately or that do meet the criteria but should not be accounted for separately. Explain the business purpose (or lack thereof) of the example transactions provided

In considering the criteria outlined in paragraph 7, we have the following comments:

<u>Paragraph 7a - Implicit linkage</u>

Paragraph 7a requires an entity to consider any implicit commitments that are entered into at or near the same time with the same counterparty. We are concerned that the term "implicit commitments" could be interpreted very broadly and bring into scope transactions that should not be considered linked under the FSP.

For instance, prime brokerage relationships provide customers with access to financing to support their asset purchases. For operational ease, it is in the client's best interest to transact the sale and financing with the same counterparty. Any linkage between the two transactions is driven by the client relationship. Similarly, margin accounts with customers are in effect purchase and financing arrangements whereby the purchased asset is received as collateral and then "returned" upon repayment of the respective financing. These counterparty relationships provide an implicit commitment to finance any purchase. We ask that the FASB clarify that counterparty relationship arrangements, including prime brokerage relationships and margin accounts, would not be construed as implicit commitments in this FSP. We believe the wording "entered into at or near the same time" in paragraph 7a is helpful, but suggest that our concern be more clearly addressed, perhaps in example form or in the basis for conclusions.

<u>Paragraph 7c – Marketability and level one securities</u>

We disagree with the criteria in paragraph 7c that only transactions that involve the transfer of level one assets under the FAS 157 hierarchy of fair value should be considered. As discussed in paragraph A8 of the basis for conclusions in the FSP, the criteria in paragraph 7c of the FSP is intended to limit the delinking guidance to transactions involving assets that are marketable to ensure that the asset is not so unique that the purchaser would be economically compelled to finance the transaction with the seller.

We do not agree that level one assets are the only marketable assets and believe that 1) many instruments in level two are marketable as well and 2) even in instances where a level two asset is less liquid, there is sufficient observability in inputs to demonstrate that the financing transaction is entered into at market rates. If a level two instrument does not have a quoted price, then the valuation needs to have significant observability in order to be classified as level two. The existence of observable inputs creates price transparency that prevents the instrument from being unique and difficult to price at arm's length.

Alternatively, we would support an approach whereby the marketability criteria are met if the asset is "readily obtainable". FAS 140 currently utilizes the concept of "readily obtainable" as a factor in determining when transferors that have some continued involvement with the transferred assets retain control over those assets. If the FASB is not comfortable extending the "marketability" criteria to all level two instruments, we recommend that the criteria in paragraph 7c include those assets that are "readily obtainable" rather than level one for the following reasons:

- "Readily obtainable" assets meet the marketability criteria that the FASB discusses in paragraph A8 of the FSP.
- By requiring level one assets for the 7c criteria, the FSP introduces a new "rule" into the overall FAS 140 control model. It is our view using a "readily obtainable" approach would be consistent with the preexisting control model established in FAS 140.
- Although the definition of "readily obtainable" can be subjective, it is our view that using this terminology rather than the level one hierarchy criteria would reasonably broaden the guidance in paragraph 7 to include all routine flow transactions without including more exotic securities and structured transactions.

The population of instruments included in the "readily obtainable" definition is broader than those included in the level one definition and incorporates those instruments that are frequently utilized as collateral in financing transactions. For example, the use of "readily obtainable" would include all US agency securities (classified as level two by Merrill Lynch), which are instruments utilized in standard repurchase arrangements.

Additionally, it is our understanding there is diversity in practice with regard to the financial instruments that meet the definition of a level one security. Some companies include most sovereign debt and US agency securities while others exclude all but on-the-run US Treasuries and G-7 or G-10 sovereign debt. These differences would likely lead to significant inconsistencies in the application of this FSP and would, for many companies, significantly narrow the population of routine flow transactions that, in our view, the guidance in paragraph 7 of the FSP was intended to address.

Paragraph 7d – Control over the assets

Notwithstanding the above comment, we recommend that the marketability criteria in 7c be incorporated into paragraphs 7a and 7d. We believe that there is already overlap between 7a and 7c. If transactions are not entered into at market rates then the transactions are at a minimum implicitly contingent upon each other.

In addition, we believe that the second criteria in 7d is currently unnecessary because this concept is already incorporated into paragraph 9b of FAS 140. Additionally, if paragraph 7c were to be maintained, the requirement that the assets are level one instruments would already scope out virtually all assets that are not readily obtainable making the second sentence in paragraph 7d redundant.

We recommend that 7a, 7c and 7d be changed as per below:

7a. The initial transfer and the repurchase financing are not contractually contingent on one another and *are entered into at market rates*. There are no implied commitments that are entered into at or near the same time with the same counterparty (or an affiliate or agent of the counterparty) that depends on or affects either of the transactions. For example, if the pricing or performance of either the initial transfer or the repurchase financing depends on terms and execution of the other agreement, an implied commitment likely exists.

7c. (remove)

7d. The initial transferee (the borrower) maintains the rights to the collateral (is able to take control of the transferred financial asset and substitute it with a different financial asset). ~~In addition, the initial transferor (the lender) cannot sell or repledge the collateral at any point prior to the settlement of the repurchase financing unless the asset is readily obtainable~~.

It is our view that the recommended changes above would be consistent with the current control requirements underpinning FAS 140 while still addressing transactions that are implicitly and explicitly linked. That is, as long as the asset sale and financing are at market rates and are not contingent, if control over the assets completely passes to the transferee that fact should sufficiently support an assertion that the transactions are not linked.

In addition, elements from paragraph A8 should be combined with paragraph A7 to include potential economic compulsion as an indicator of the counterparties' intent to engage in a series of related transactions. Further, it seems that the Board has included the marketability condition because it believes that this condition is needed to provide evidence that the transactions are entered into at market rates and/or that there has been no economic compulsion forcing the borrower to enter into the repurchase agreement with the lender. We do not agree that this is necessary. Instead, it is our view that each firm is responsible for developing policies and procedures to ensure that the "at market rates" criteria is adhered to.

"Simultaneous" requirement

We understand that this project had contemplated in its earlier stages only linking sales and repurchase financings that occur simultaneously. We agree that explicit or certain implicit agreements to provide financing at a future date are problematic, and thus the "simultaneous" requirement could be abused. However, we suggest that the FASB include language indicating that transactions which do not occur simultaneously are less likely to be implicitly linked. We believe the burden of searching for transactions that may be linked but did not occur simultaneously should be limited as much as possible.

Question 2: What costs would be incurred to implement this proposed FSP?

Question 3: What procedures, controls, and systems are required to implement this proposed FSP? Can such procedures, controls, and systems be in place by the proposed effective date—the beginning of the first fiscal year after November 15, 2007? If not, when can the procedures, controls, and systems be in place to implement this proposed FSP?

Question 4: Are there other implementation issues that the Board should consider?

We believe significant technological and manual controls would need to be put in place in order to comply with the guidance in the FSP. We do not believe such a system could be put into place in less than 12 months, with the start date of such a project beginning no earlier than the final date of issuance of this guidance. As such, we do not think it is realistic to suggest an effective date earlier than for financial statements issued for fiscal years beginning after November 15, 2008.

We have serious concerns that the limited scope of financial instruments in paragraph 7c and the inclusion of "implicit commitments" in paragraph 7a will prevent the on-going implementation of this guidance from being operationally feasible, even in the event that systems are built that attempt to identify associated sales and financings. A significant number of repurchase agreements are executed every day on instruments that we do not classify as level one under FAS 157.

Additionally, although financing transactions are typically short-dated, these transactions are often rolled. If over a 90 day period there were 90 overnight repurchase agreements entered into on the same security that had been sold 90 days prior, all of the transactions could be linked under the FSP's guidance. With such a large scope of affected instruments, the system requirements would be significantly greater than the requirements that would be needed on a smaller population of transactions.

The "implicit commitment" inclusion creates added operational risk as such considerations cannot be handled by systems alone. Unless the scope of "implicit commitments" is more strictly defined, significant manual intervention will be required to appropriately identify affected transactions.

Question 5: Are the transition provisions of this proposed FSP, to new transactions and outstanding repurchase financings, appropriate?

We do not believe that a limited retrospective application is appropriate and believe that the cost to implement the guidance on existing transactions far outweighs the benefits.

As noted above, we have significant concerns about the operationality of the guidance as presented in the FSP, even if systems and controls are put in place to track transactions that may be linked. Even with such systems in place, this guidance may be impossible to implement, given the volume of transactions affected. Therefore, we do not believe it is

possible to implement the transition guidance as contemplated in the FSP. In the example provided in the response to Question 3 above, if an over-night repurchase financing has been rolling for a long time, linking it to the original sale could be an enormous task that provides little benefit to the users of our financial statements.

The overall impact of adoption of this guidance will not result in a significant impact to the income statement in particular. If an entity sold a security and entered into a reverse repurchase agreement on that same security, the delinked accounting would result in a repurchase arrangement with accrual accounted interest income or fair valued interest rate risk where the fair value option was utilized. The linked accounting would result in fair value changes of the asset going through earnings (as nearly all securities in such transactions are classified as trading) and a derivative accounted for at fair value whose earnings impact would be related to the change in value of the underlying asset and changes in interest rates – the net effect of which is the fair valued interest rate risk. The difference between the two approaches is the recognition of the interest component at fair value or accrual, which is generally small given that the financing arrangements are generally short-dated. As such, the benefit of limited retrospective application does not outweigh the cost associated with its implementation.

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Thank you again for the opportunity to comment on the FSP. We hope the FASB will give consideration to our comments as you continue to deliberate this project. We are available to answer any questions should you require clarification on any of the points above. Please feel free to call me at (212) 449-2048.

Sincerely,

/s/ David Moser
Managing Director, Accounting Policy