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Financial Accounting Standards Board 401 Merritt 7 PO Box 5116 Norwalk, CT 06856-5116

Re: Proposal for a Principles-Based Approach to U.S. Standard Setting (File Reference 1125-001)

Ladies and Gentlemen:

The Bond Market Association (the "Association")¹ welcomes the opportunity to comment on the above-referenced proposal (the "Proposal") issued by the Financial Accounting Standards Board (the "Board").

Recent events have confirmed the critical importance of clear, consistent and operational accounting standards to the preservation of fair and efficient global financial markets. The Association believes the Board's proposal to be particularly timely, in light of current stresses on the accounting standards framework. We applaud the Board's willingness to consider potentially far-reaching changes in the basic approach to accounting standard setting in the United States.

The Association believes that many of the criticisms of the current financial accounting standard setting process articulated in the Proposal have merit. As a matter of general application, we agree that too much of the guidance issued by the Board and related entities has become excessively rule-driven and overly complex. The increasing volume of detailed accounting rules has driven a concomitant increase in the demand for, and issuance of, exceptions and interpretations to those rules. This dynamic has slowed the overall process of developing and issuing clear guidance in a timely fashion, and has contributed to an acute perception of accounting standards "overload" in the U.S. financial markets.

¹ The Bond Market Association represents securities firms and banks that underwrite, distribute and trade debt securities, both domestically and internationally. The Association's members are active participants throughout the fixed income and debt capital markets. The views expressed in this letter were prepared principally in consultation with the Association's Accounting Policy Committee. Additional information about the Association is available on our Internet website, located at www.bondmarkets.com.

Taken as a whole, the accounting standards framework that results is often unable to provide acceptable guidance for new and different transactions that continuously emerge in the financial marketplace. In addition, the issuance of a large quantity of individual and highly specialized accounting rules has made it extremely challenging to retain, within each of those rules, a sufficiently clear connection to the underlying conceptual bases or unifying themes that can guide their broader application. As the rules, exceptions, and implementation guidance become more and more detailed, clarity and consistency are frequently sacrificed. Entities increasingly find that the twin objectives of complying with U.S. GAAP and capturing the economic substance of transactions are at odds with each other.

For these reasons, the Association would support steps toward introducing a principles-based approach to accounting standard setting in the United States. We do not regard such an initiative as a complete "cure" for deficiencies in the current accounting standards framework, including those outlined above. However, the Association believes that a movement toward principles-based accounting standards would be a step in the right direction. We believe that the goal of such an initiative should be the gradual and incremental adoption of higher-level accounting standards, or guiding principles, to guide the preparation and presentation of financial statements. Such principles should enable enterprises to exercise professional judgment and allow flexible application to a broad range of factual settings and transaction structures. We believe that the result of this initiative could yield higher-quality accounting standards, promote greater responsibility and accountability on the part of market participants who utilize them, and ultimately, produce greater faith and confidence in the relevance and accuracy of financial statements.

We recognize the potential drawbacks to a principles-based approach, in comparison with current practice. In particular, some have criticized a principles-based approach in that broader and more general underlying standards may lead to wider divergence in their application. This, it is argued, could render financial statements less consistent and comparable. In addition, some believe that a principles-based system facilitates greater opportunities for abuse, to the extent that general standards provide greater leeway for applying them in bad faith or in ways that are inconsistent with their spirit and intent. On balance, however, the Association does not believe that these concerns outweigh the potential benefits of moving toward a principles-based approach.

In the first instance, the above-cited criticisms of principles-based accounting may be equally leveled at the current rules-based system. The present network of detailed rules, exceptions and implementation guidance can, through its very complexity, lead to situations in which economically identical transactions yield different accounting outcomes, thereby frustrating the goals of comparability and reliability of financial statements. Moreover, persons motivated to abuse accounting guidance will likely do so whether that guidance takes the form of detailed "rules" or general "principles." In fact, many of the most widely publicized accounting abuses of the recent past relate to

situations in which entities appear to have knowingly circumvented existing rules to achieve their goals. Principles, like rules, can be broken or ignored by those intent on doing so.

In any case, the debate concerning rules-based versus principles-based accounting standards is not, in our view, an "all or nothing" proposition. Any principles-based system still needs to offer sufficient specificity and detail regarding its application and implementation. Current U.S. GAAP is premised on a series of broad, underlying principles. Over the years these principles have been supplemented — in some cases excessively — with detailed and highly prescriptive rules. Incremental movement toward a greater reliance on principles-based accounting in the United States would neither require nor result in the evisceration of specific guidance that would need to remain in place for a wide range of financial products and transaction structures.

Importantly, we believe that a shift in favor of principles-based accounting would and should occur gradually and incrementally, as existing detailed guidance in discrete areas is replaced over time (with input from affected constituencies) with principles of broader and more general application. This gradual conversion process, if properly implemented and managed, would yield extremely valuable feedback to accounting standard setting bodies and market participants alike regarding the appropriate balance of rules and principles as part of a more workable and efficient accounting standards framework.

Finally, many of the concerns articulated in the Proposal regarding the ultimate feasibility of a principles-based system relate to whether there would be sufficient "buy-in" for such a system by affected constituencies—users and preparers of financial statements, accountants and auditors, and accounting standard setting and regulatory bodies, among others. Similarly, the Proposal identifies concerns about SEC enforcement actions and related litigation that may ensue from an environment in which financial statement preparers and auditors are called upon to apply a greater degree of professional judgment in a wider range of circumstances. The Association agrees that these are valid concerns, and that significant cultural, behavioral and attitudinal shifts will be needed for a principles-based system to achieve its potential.

We believe that financial market participants—and at a minimum, the Association's members—are willing and able to adapt over time to a new accounting standards paradigm that is based to a greater degree on broader principles guiding the preparation and presentation of financial statements. As the principal accounting standards body in the United States, the Board is uniquely positioned to take the first steps toward establishing a principles-based system. However, both at the outset and at various points along the way, it will likely be necessary for regulatory, enforcement and standard-setting bodies to support and reinforce the Board's goals and directions. Such steps may include both direct action (e.g., the issuance of complementary regulations and guidance) and forbearance (e.g., acceptance of a wider range of good faith divergence in practice) to

facilitate the broader cultural, behavioral and attitudinal changes that movement toward a principles-based system will require.

Again, the Association appreciates the opportunity to comment on the Proposal, and we look forward to continuing our dialogue on this subject with the Board. Should you have any questions or desire clarification of any of the matters addressed herein, please do not hesitate to contact the undersigned at 212.449.2048, or George Miller, Deputy General Counsel of the Association, at 646.637.9216.

Sincerely,

/s/ Esther Mills

Esther Mills

Merrill Lynch & Co.

Chair, Accounting Policy Committee of

The Bond Market Association