



March 31, 2009

Mr. Russell G. Golden
Director, TA&ł
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Re: Proposed FSP FAS 157-e

Dear Mr. Golden,

Pluris Valuation Advisors LLC¹ appreciates the opportunity to comment on proposed FSP FAS 157-e, Determining Whether a Market Is Not Active and a Transaction Is Not Distressed (the "FSP"). Please find our responses to the FASB's questions below.

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

This rule represents a significant change in practice. The FSP's proposed effective date is too accelerated with respect to both operations and further development. Many of our clients would face challenges in evaluating and adopting its provisions within the proposed time frame. We will describe below why this guidance is operationally challenging and requires significant additional development, and why the benefits of further development outweigh the cost of delaying its implementation. If this guidance is finalized in its current form, we highly recommend an effective date of no sooner than the fourth quarter to allow additional discussion and analysis to take place.

2a. Will this 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?

The proposed FSP, in its current form, will weaken the application of Statement 157 as follows:

¹ Pluris Valuation Advisors LLC is a valuation services firm based in New York that specializes in providing fair value measurements of illiquid and distressed securities that typically trade in secondary markets or not at all. An integral part of the firm's client-focused work is the research, data collection, and analysis of trading activity in inactive and secondary markets.

- The FSP dilutes the central "current price" objective of Statement 157 set forth in ¶5 and 13,
- severely limits the scope of Level 2 of the fair value hierarchy; many of our clients have suggested that it eliminates Level 2,
- requires reporting entities to interpret ill-defined terms,
- provides an example of fair value measurements that is vague, and,
- will lead to poorer comparability and greater inconsistency in financial reporting.

We understand that the project's objective was to develop tools to determine whether markets are inactive and whether transactions are distressed, in response to the SEC's recommendations in its congressionally mandated study, Report and Recommendations Pursuant to Section 133 of the Emergency Economic Stabilization Act of 2008: Study on Mark-to-Market Accounting (the "SEC Study").

However, we do not believe there is a direct relationship between market inactivity and distress, nor do we believe the SEC intended to imply such a relationship. Although both topics are grouped in one subbullet in the eight recommendations of the SEC Study, we believe the SEC contemplated separate and distinct solutions for these two concerns. For example, page 203 of the SEC Study states (emphasis added):

"In developing SFAS No. 157, the FASB set out to create an objectives-based standard that would allow for the use of judgment in determining fair value. The Staff found that issuers and auditors have faced challenges with the application of the standard in the current global economic crisis. As previously discussed, the Staff, the FASB, and the IASB have taken several steps to provide application guidance to alleviate confusion and to foster reasonable application of fair value measurements in the marketplace. However, the Staff believes additional assistance in the form of guidance, education, and training is warranted in several areas. Examples include further tools to make judgments regarding:

- How to determine when markets become inactive
- How to determine if a transaction or group of transactions is forced or distressed
- How and when should illiquidity be considered in the valuation of an asset or liability
- How should the impact of a change in credit risk on the value of an asset or liability be estimated
- When should observable market information be supplemented with and / or reliance placed on unobservable information in the form of management estimates
- How to confirm that assumptions utilized are those that would be used by market participants and not just by a specific entity"²

We think this FSP has succeeded in meeting the project's objectives of defining whether markets are active. However, the FSP needs significant further development before it can be used to adequately determine when and under what circumstances transactions are considered distressed.

Most important, the FSP should be revised to eliminate or modify the presumption that all observable prices in inactive markets reflect distress (the "Step 2 presumption"). Under the FSP, rebutting the presumption of a distressed sale would require the reporting entity to access transaction data and analyze the behavior of buyers and sellers. Because this information cannot be obtained from most

² Report and Recommendations Pursuant to Section 133 of the Emergency Economic Stabilization Act of 2008: Study on Mark-to-Market Accounting, page 203

public data-sources, there would be a tendency for reporting entities to reject relevant transaction data, which is contrary to both the original intent of Statement 157 and long-established fair value principles that predate the Statement.

The overall result would be less consistency in financial reporting, with some companies using valuation techniques that reflect quoted prices and some that do not. This would adversely affect investor confidence.

The FSP contains an implicit assumption, rather than an explicit assumption, that inactivity and distress are related, a topic that was discussed at the most recent meeting of the Valuation Resources Group in February. No conclusion was reached, perhaps because meeting participants lacked research indicating that many or most transactions in inactive markets are distressed. While anecdotal information in the press indicates that fire sales do occur, reliable statistical data indicating how often they happen is difficult to obtain.

Fundamental Measurement Goal: the Measurement Date Price

The fundamental measurement goal of Statement 157 is to arrive at a current exit price, as described in ¶5 and ¶7:

"Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date,"

"Therefore, the objective of a fair value measurement is to determine the price that would be received to sell the asset or paid to transfer the liability at the measurement date (an exit price)."

Based on this language, it is clear that the fundamental goal of Statement 157 is to provide guidance for determining exit price at the measurement date, not at some point in the future. Statement 157 demands that we consider market conditions as they exist on the measurement date. The FSP opens the door to fair value estimates that do not properly reflect market realities as of the measurement date.

By definition, any valuation technique that incorporates assumptions and parameters other than current observable market prices will, inevitably, reflect considerations of future events, circumstances and conditions. This is neither controversial nor, necessarily, undesirable. However, such considerations of future events must be primarily based on market assumptions and conditions as of the measurement date.

Furthermore, the FSP goes beyond merely allowing the use of other valuation techniques to supplement current observable market prices. Instead, the FSP introduces a vetting process which would eliminate a great deal of relevant observable market data from consideration (see our examples below). The FSP would also require reporting entities to imagine and apply market conditions such as liquidity and risk premiums that are not present as of the measurement date.

For example, in valuation literature, discount rates are market-specific, meaning they change when investor preferences change. The FSP would require reporting entities to apply discount rates other than

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those suggested by current market activity. However, if such rates are not anchored in market realities as of the measurement date, the very difficult question arises of how to measure and estimate them. The FSP leads reporting entities to base their valuations on their own view of future market conditions, rather than on conditions prevalent today. This not only runs counter to the central measurement goal of Statement 157, but also conflicts with fair value measurement practices that predate the Statement, for example, the practices suggested by Concept Statement 7.³

Impact on Level 2

In defending its premise, the FSP states in ¶6 that:

"...many believe that the fair value hierarchy within Statement 157 may be interpreted to emphasize the use of an observable market transaction even when...the market for that transaction may not be active."

This is not a question of interpretation. Statement 157 in its current form *does* emphasize the use of observable market data over unobservable assumptions. It is quite clear that the original intent of ¶28 in defining Level 2 valuation inputs was that data from inactive markets must have priority over Level 3 inputs.

The FSP should eliminate the presumption that a quoted price is associated with a distressed transaction or, at a minimum, require that every reasonable effort be made to rebut the presumption. Furthermore, the criteria for rebutting the presumption should be further developed to provide reporting entities with a less insurmountable task. Under the FSP, rebutting the Step 2 presumption would require analyzing for each transaction: (1) the time allowed by the seller before selling and (2) the number of bidders for the asset. Without further development, we expect that a great many valuation analyses which could be significantly improved using data from inactive markets will instead ignore such data. The result will be a decrease in the quality of valuation inputs and a less reliable measurement.

We recognize that fire sales or distressed transactions happen in inactive markets. Our observations and research on transactions in these markets indicate that such transactions attract multiple bidders, and that sellers carefully consider their options before selling, and that they only sell after a sufficient period of exposure to the market. This is one indication to us that useful observable market data is available in inactive markets. This observable data is timely, relevant, sufficient in quantity, and within a bandwidth that suggests comparability and consistency.

The term "forced liquidation or distress sale" in ¶7 of the Statement means a fire sale. It connotes the desperate sell-off of assets in a panic, below fair value, in order to make payroll or meet margin calls or some other urgent financial need. From our observations and research on inactive market transactions, true fire sales are relatively rare. In most inactive markets, there are typically multiple bidders, not necessarily for a specific asset, but sufficient to provide price discovery for the market as a whole. In such markets, sales are less likely to take place at prices significantly below fair value.

³ Several market-based inputs were suggested by Concept Statement 7 and were meant to reflect market conditions as of the measurement date.

Below are three examples of inactive markets that are not always distressed: (1) the market for illiquid warrants, (2) the market for municipal bonds, and (3) the market for collateralized debt obligations ("CDOs"). In these and many other secondary markets, many reporting entities would have difficulty rebutting the Step 2 presumption. Indeed, for almost any capital market segment, transaction data available through public sources such as Bloomberg does not include the identities of buyers or sellers, the nature or strength of their motivation for buying or selling, or the market exposure time allowed by the seller before the sale. Because such data is largely unavailable, many reporting entities would lack sufficient information to overcome the Step 2 presumption.

Example 1: Warrants

Warrants are often included as "sweeteners" when common stock or convertible debentures are issued. Warrants are not registered for resale in public markets and private transactions are rare. We have found that fair values for warrants are relatively lower than what theoretical valuation models, such as Black-Scholes, typically indicate. This is primarily due to the illiquidity of the warrants.

However, the secondary market for warrants has a significant number of participants, including hedge funds, institutions, and individual investors. This secondary market has historically had transactions crossing at prices materially below values determined under Black-Scholes. In other words, these illiquidity discounts existed well before credit market conditions took a turn for the worse in 2007.

Because markets for many warrants would meet the definition of inactive as outlined in the FSP, Step 1 in ¶13 would be triggered. Companies would then bear the burden of rebutting the Step 2 presumption that any available price evidence from this market is associated with distressed transactions. Since rebuttal would be difficult, if not impossible, for most reporting entities, illiquid warrants might be valued without reference to actual sales transactions in the only market that has ever existed for them.⁴

Example 2: Municipal Bonds

Nearly \$400 billion of municipal bonds were issued in 2008, with \$2.6 trillion in holdings in the 4th quarter of 2008.⁵ The market has a significant number of active buyers and sellers, including major institutions. Regardless, the market for most individual municipal bond issues would be considered inactive according to the provisions of ¶13 of the FSP, as trading activity might be as low as three or four trades per month for each security (CUSIP). Once Step 1 in ¶13 is triggered, companies would then be faced with rebutting the Step 2 presumption. Because of the anonymity of market data provided by vendors such as MRSB or Bloomberg, some reporting entities would be unable, or perhaps unwilling, to overcome Step 2. Once again, the result would be inconsistent financial reporting, with some companies using valuation techniques that reflect quoted prices and some that do not.

⁴ Due to the first-hand studies and databases on market transactions in inactive markets, Pluris has the tools required to rebut the Step 2 presumption. We believe, further, that any reporting entity relying on this data would also be able to rebut the Step 2 presumption. However, most firms do not have access to such data and would be forced to discard most market-based evidence and rely solely on models.

Securities Industry and Financial Markets Association (SIFMA). "Market Sector Statistics." 26 Mar. 2009. http://www.sifma.org/research/statistics/market-sector-statistics.shtml#muni

Example 3: Collateralized Debt Obligations

CDOs are another example of an inactive market for which many companies would have difficulty rebutting the Step 2 presumption. Historically, the secondary market for CDOs has been relatively inactive. In addition, the primary (new issue) market may not revive to previous levels of activity for several years. For a particular CDO, if recent trades in similar CDO tranches reflect an average discount rate of 20 percent, for example, those trades may be rejected as valuation inputs under this FSP. This would happen, not because there is evidence these trades reflect fire sales, but because there isn't enough evidence to the contrary. Reporting entities would then estimate discount rates based on assumptions and parameters that reflect how the CDO might be sold under conditions that may be more ideal than current market conditions. However, if a reporting entity exited its investments on the measurement date, regardless of whether there was sufficient marketing time or multiple bidders, it would receive prices much lower than those reported in financial statements as "fair value."

Reliance on Subjective and Vague Terms

As the analysis submitted above makes clear, the FSP misses the central point of fair value reporting: the estimation of a current exit price. The FSP fosters an environment in which reporting entities will be encouraged, or perhaps even forced, to ignore valuable evidence of how market participants behave around the measurement date, and will instead turn to a substitute valuation analysis that is hypothetical.

Because such hypothetical valuations are poorly understood and defined in the literature, the FSP relies on subjective and vague terms when referring to key inputs to an analysis, including: "abnormal" liquidity premiums, "reasonable" estimates of credit risk, "abnormally wide" bid-ask spreads, "reasonable" risk premiums, and "normal" liquidity premiums. These terms are not specifically defined in the FSP, which leaves a wide range of possible interpretations of their application. For example, liquidity premiums have historically experienced wide fluctuations in our capital markets. What is a normal liquidity premium?

Example provided: ¶A32

Because the FSP, in its current form, is a departure from the measurement date provisions set forth in ¶5 of Statement 157, and because it relies heavily on subjective and relative terms in describing how fair value should be estimated, the FSP needs highly detailed and specific examples to illustrate how the new rules would be applied. The chosen example (new ¶A32) is too vague to provide adequate guidance.

In the example, Entity A asserts that evidence indicates the market for a CDO was inactive. However, the example does not describe which factors Entity A considered, how these factors were analyzed, or how the conclusion was reached.

Entity A then concludes that it lacks sufficient evidence to overcome the Step 2 presumption. However, the example does not describe how Entity A reached this conclusion. Perhaps the entity performed its own market research or obtained other market information. We cannot tell. Entity A then uses "realistic

assumptions" to project cash flows. We are not told what those realistic assumptions were, how they were developed, why they were viewed as realistic, or how they might compare with an "unrealistic assumption".

In the example, Entity A then considers "reasonable assumptions" regarding liquidity and nonperformance risks that hypothetical (rather than actual) buyers or sellers "would consider" (rather than actually consider).

We are provided with a list of general factors that affect liquidity and nonperformance risks. However, the example does not state which of these factors were considered by Entity A, or how they were considered.

Finally, Entity A estimates a discount rate range of 7 to 15 percent. The explanation provided for the 7 percent floor could conceivably result in any percentage, as the underlying calculation for the 7 percent floor is not provided. We have been unable to decipher the explanation for the 15 percent ceiling.

In our view, ¶A32 provides insufficient practical guidance for reporting entities, particularly about how estimates should be developed. This is a critical omission. If reporting entities are to reject observable market data and instead rely on other valuation techniques, those other techniques must be very clearly defined and described. Otherwise, there will be a significant deterioration in comparability across financial statements, not to mention new challenges in the application of audit procedures.

2b. Do you believe the amendments to Statement 157 in this proposed FSP are necessary, or do you believe the current requirements in Statement 157 should be retained?

Further guidance on inactive markets and distressed transactions is necessary, but further development of this FSP before adoption is critical. We would rather see the current provisions of Statement 157 retained than see the FSP adopted as written. We agree with the SEC Study that we are in a "global financial crisis" and that tools need to be developed that can be useful in defining inactive markets and, separately, identifying distressed transactions.

To the best of our knowledge, users, preparers, and auditors of financial statements broadly agree that using the so-called last sale price, without consideration of all relevant facts and circumstances, is inappropriate. Therefore, potential misapplications of Statement 157 arising from a failure to consider all relevant information does not need to be addressed by this FSP.

Above all else, we must keep our focus on exit price at the measurement date. Financial statements must reflect the practical realities of the present rather than optimistic visions of the future. Observable market data, even from inactive markets, reflects important information regarding market conditions at the measurement date; this information is useful and relevant to investors.

The FSP, in its current form, does not reflect "guidance related to the application of Statement 157", as asserted in the FSP. Rather, the FSP is a departure from Statement 157's fundamental goal of estimating measurement date exit price and its framework for a three-level hierarchy.

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.

The proposed definition of an inactive market is understandable, operational, and auditable. However, we do not believe market inactivity is tantamount to distress. The criteria for overcoming the Step 2 presumption of distress will be extremely challenging for many reporting entities.

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 agree with the FSP's definition of an inactive market. We also agree that the primacy of Level 2 inputs over Level 3 inputs should not imply that using the so-called last trading price without supplemental analysis is acceptable.

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?

Pluris has developed substantial data and research on illiquid and inactive markets. As such, many of our clients may be successful in rebutting the Step 2 presumption that observable market data is associated with distressed transactions. However, because many reporting entities lack access to such data, they may be forced to substitute another valuation technique. Such companies will likely incur significant costs converting from market based valuations to other valuation techniques.

Recommendations

We appreciate the opportunity to make the following recommendations:

- We recommend the Board consider empirical data that may or may not support the presumption that all or many sales in inactive markets are distressed sales. We strongly urge the FASB to consider more data before making a change of this magnitude.
- 2. We recommend the Board consider further defining the "multiple bidder" provisions in ¶13. For example, in some inactive markets, while there may not be multiple bidders for a specific asset, there are often enough bidders participating in the market for similar assets to be sufficient to permit price discovery for all market participants.
- 3. Clarity is needed in ¶13 on what is meant by "there were multiple bidders for the asset". Please specify "multiple" and indicate whether "asset" is limited to an individual asset or similar assets trading in an inactive market.
- 4. We recommend the FASB consider further developing the concept of "time to market" as a tool to indicate distress. We define time to market as the number of days from solicit-to-bid to sale. Time to market may or may not be an indicator of seller desperation.

- 5. We recommend the FASB provide more detailed guidance on what constitutes "sufficient time before the measurement date to allow for usual and customary marketing activities for the asset" in ¶13. We have observed gaps of between one month and one year in inactive markets for which useful, observable market data was available.
- 6. We recommend adding an example from an actual historical financial statement where the value chosen for a specific financial instrument was not representative of fair value because data from distressed sales in an inactive market was included in the analysis. The example should illustrate how this FSP would value the same instrument on the same date, and how the FSP will cause the fair value of the instrument to be properly reported.
- 7. Example 11 in ¶A32 should be further developed. For instance, it needs to explain exactly how the evidence indicates that the market for the CDO was determined to be inactive, as well as why there is not enough evidence to rebut the Step 2 presumption. Please describe each assumption in detail, explain why the range of estimates is considered reasonable and supportable, and how the example is intended to be applied. Please also provide examples of unreasonable assumptions.
- 8. We recommend preserving Level 2. Without Level 2, many entities will be forced to classify many items at the less desirable Level 3.
- 9. We recommend, at a minimum, that values based on observable market inputs and other techniques such as discounted cash flow models be presented side-by-side in footnotes to financial statements.
- 10. Please provide definitions for the following terms: distressed (Webster defines it as a state of desperation), forced sale, fire sale, forced transaction, forced liquidation, distress sale, relevant market data, abnormal liquidity premium, reasonable estimates of credit risk, abnormally wide bidask spreads, reasonable risk premium, and normal liquidity premium.
- 11. The Step 2 presumption should be eliminated or developed further. If the presumption is retained, we recommend requiring the reporting entity to show evidence that a reasonable effort has been made to rebut.
- 12. If this FSP is made final in its current form, we recommend also amending ¶5, 7, 10, and 17 of Statement 157, as these paragraphs, as written, are not consistent with this FSP.

Conclusions

In its current form, this FSP reflects a significant departure from long established principles, particularly in deviating from the fair value measurement date and exit price principles.

If implemented as currently written, the FSP will result in a fundamental change of Level 2 which, in turn, will result in many items being classified as Level 3 which should otherwise have been classified as Level 2. This FSP will also cause valuation inputs to be less focused on measurement date transaction data. It will lead to inconsistencies in financial reporting as some companies use price inputs and some use other techniques.

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Pluris believes that transaction data in inactive markets, in most circumstances, will be more indicative of fair value than, for example, the assumptions and parameters employed in a typical discounted cash flow model. As such, any changes to Statement 157 should not diminish the importance of such data.

The FSP appears to be designed to help alleviate capital adequacy concerns at banks and credit unions, as many financial institutions that would benefit from this guidance have requested retroactive application. In our view, those issues are best addressed by regulators and law makers, not by the Board which has the vital role of setting U.S. GAAP.

While we appreciate the urgency felt by many financial institutions, an amendment this wide-reaching, and with such significant potential impact on investor confidence in the broader capital markets, ought to be given more extensive consideration and discussion than the proposed timetable would allow.

We thank the Board for the opportunity to provide these comments, suggestions, and recommendations.

Sincerely,

Rick Martin, CPA

Vice President

Head of Technical Accounting