



LETTER OF COMMENT NO. 3

February 18, 2008

Mr. Russell G. Golden
Director of Technical Application & Implementation Activities
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

File Reference: Proposed FSP FAS 157-c

Dear Mr. Golden:

We appreciate the opportunity to comment on proposed FASB Staff Position (FSP) No. FAS 157-c, "Measuring Liabilities under FASB Statement No. 157." We agree that additional guidance is needed to clarify the application of FASB Statement No. 157, *Fair Value Measurements*, to the measurement of liabilities that are rarely, if ever, transferred to a third party. We believe the guidance in the proposed FSP will provide that clarification. However, we have comments on the following matters:

- The use of quoted prices for liabilities;
- Inconsistency with the transfer notion;
- Proposed transition method; and
- Other matters.

The Use of Quoted Prices for Liabilities

We are concerned that the guidance in paragraph 6 of the proposed FSP may inadvertently create a conflict with the guidance in Statement 157. Paragraph 6 of the proposed FSP states, in part, that the

... quoted price for the identical asset in an active market shall be used as the fair value measurement for both (a) the obligor of the liability and (b) the asset holder.

Paragraph 25 of Statement 157 states, in part:

If the reporting entity holds a large number of similar assets or liabilities ..., a quoted price in an active market might be available but not readily accessible for each of those assets or liabilities individually. In that case, fair value may be measured using an alternative pricing method that does not rely exclusively on quoted prices ... as a practical expedient.

We assume the Board did not intend for paragraph 6 of the proposed FSP to amend paragraph 25 of Statement 157. If our assumption is correct, we believe the FASB staff should clarify paragraph 6 to avoid any unintended consequences.

We understand that some companies may believe that the quoted prices for trades of their debt in the market are not representative of the amount they would have to pay to transfer the entire debt issuance because of differences between the amounts being traded and the recorded amount subject to the fair value estimate. If the staff provided the guidance in paragraph 6 to address that issue, we agree that guidance is necessary. However, rather than stating that the “quoted price ... shall be used” (thus implying that the guidance in paragraph 25 would not apply), we suggest providing guidance similar to the guidance on the appropriateness of block discounts in paragraph 27 of Statement 157. For example, paragraph 6 could be modified to state:

A quoted price for the identical liability¹ (unadjusted) in an active market (Level 1 input) is the best evidence of fair value for that liability. ~~Entities that purchase the reporting entity’s obligations as assets incorporate the nonperformance risk of the liabilities, as well as other factors, in determining the prices they are willing to pay for the assets. The quoted price for the identical liability in an active market shall be used as the fair value measurement for both (a) the obligor of the liability and (b) the asset holder. The quoted price shall not be adjusted because of the size of the position relative to trading volume. Adjustment of the quoted price is prohibited, even if a market’s normal daily trading volume is not sufficient to absorb the quantity for which the company is estimating the fair value and transferring the position in a single transaction might affect the quoted price.~~

Possible Inconsistency with the Transfer Notion

We believe the principle outlined in paragraph 7 of the proposed FSP (that the reporting entity may measure the fair value of a liability at the amount it would receive as proceeds if it were to issue that liability at the measurement date) is inconsistent with the transfer notion described in paragraph 15 of Statement 157. We recommend modifying paragraph 7 so that the principle is consistent with Statement 157. The remaining guidance provided in paragraph 7 (including the sentence that is identified as the principle) retained to illustrate the application of the principle. As modified, paragraph 7 would read as follows:

~~In the absence of a quoted price for the identical liability in an active market, the reporting entity may measure the fair value of its liability at the amount that it would receive as proceeds if it were to issue that liability at the measurement date.~~ A reporting entity shall evaluate fair value inputs and prioritize observable inputs over unobservable inputs in determining whether it should use the amount that it would receive as proceeds if it were to issue that liability at the measurement date. ~~Consistent with the transfer notion of Statement 157, the~~**The amount that would be paid to transfer a liability at the**

measurement date is the amount that market participants with the same level of nonperformance risk (including credit risk) would require to assume that liability or to issue an identical liability. The reporting entity may measure the fair value of its liability at the amount that it would receive as proceeds if it were to issue that liability at the measurement date. Consequently, because ~~Because~~ the reporting entity and the market participants to which the liability would theoretically be transferred have the same level of nonperformance risk, the amount that the reporting entity would receive as proceeds if it were to issue that liability at the measurement date provides an equivalent measure of the amount market participants would demand to assume the reporting entity's liability (that is, fair value).

Transition

For companies that early-adopted Statement 157, we believe the effects, if any, of applying the guidance in the proposed FSP should be recognized by restating previously-issued financial statements. We are concerned that recognizing the full effect of a company's nonperformance risk in the quarter in which the final FSP becomes effective will result in misleading disclosures to investors, particularly if the company's nonperformance risk did not change substantively in that quarter. Our concern in this area is heightened given the focus on fair value estimates as a result of the crisis in the credit markets. As explained in the summary to FASB Statement No. 154, *Accounting Changes and Error Corrections*, the Board concluded that retrospective application of a change in accounting principle was desirable because it "enhances the consistency of financial information between periods" and that "improved consistency enhances the usefulness of financial information."

We would prefer that the guidance in the final FSP be applied in accordance with the guidance in Statement 154, which would allow a company to apply that guidance prospectively if it determines that it would be impracticable to obtain the information necessary to apply the guidance retrospectively.

If the Board retains the prospective transition method, we believe it should require disclosure of the effects of applying the guidance in the final FSP in the period of adoption, if the effect is material.

Other Matters

If the staff does not adopt the changes to paragraph 7 proposed above, we believe it should revise the last sentence of that paragraph as it appears to be missing a word (or words) that should follow "equivalent." The sentence states, in part, "the amount that the reporting entity would receive as proceeds if it were to issue that liability at the measurement date provides *an equivalent of the amount market participants would demand* to assume the reporting entity's liability (that is, fair value)" [Emphasis added].



We also recommend that the final FSP include an example showing how the guidance should be applied to a liability that is rarely, if ever, transferred. We suggest using a common financial instrument, such as an interest rate swap, to illustrate the application of the final FSP. An example would be particularly helpful if it explained the process that a company would follow to quantify the nonperformance risk.

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We would be pleased to discuss any of our comments with the Board or the FASB staff. Please direct any questions or comments to Jeff Ellis at 312-880-3019 or Ken Evola at 202-565-6860.

Sincerely,

/s/ Jeffrey H. Ellis

Jeffrey H. Ellis
Managing Director

/s/ Kenneth Evola

Kenneth Evola
Managing Director