



March 30, 2009

LETTER OF COMMENT NO. 282

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

File Reference: Proposed FSP FAS 157-e

Dear Mr. Golden:

The Federal Home Loan Bank of San Francisco (the "FHLBank of San Francisco") appreciates the opportunity to comment on the proposed FASB Staff Position FAS 157-e, "*Determining Whether a Market is Not Active and a Transaction is Not Distressed*," (the "proposed FSP"). The FHLBank of San Francisco agrees with the Board that it needs to provide additional guidance in determining fair value of assets with inactive markets as the current guidance is not sufficient for (i) determining when a market has gone from active to inactive, (ii) determining if sufficient evidence has been gathered to substantiate that a market transaction is a distressed transaction, and (iii) determining when an organization has the ability to move from an observable market transaction to another valuation technique using both market data and management judgment. As a result, the FHLBank of San Francisco believes that it has had to continue to place a significant level of emphasis on last available, externally-generated price quotations regardless of the substance of the underlying quotes (which may have included distressed transactions in an inactive market).

While we believe that the proposed FSP is an improvement over the existing guidance in FSP FAS 157-3, "*Determining the Fair Value of a Financial Asset When the Market for That Asset is not Active* (FSP FAS 157-3)," the FHLBank of San Francisco believes that it will still have difficulties in substantiating the factors which may indicate that a market is inactive for many of its private label mortgage backed securities. Further, we are concerned that instances can occur where independent auditors or regulators may have evidence that would support that transactions are not distressed that we cannot readily obtain.

In order to address these concerns, we strongly suggest that the Board revise the proposed FSP in order to make it more operational and provide the users of financial statements more relevant information. Further, if the proposed FSP is issued in its current form, we do not believe that proposed effective date is operational.

## General Observations

- **Use of Preparer Judgment.** We believe that the Board should consider revising the prescriptive guidance included in paragraph 15 of the proposed FSP to allow for preparer judgment in determining when a transaction is distressed. In addition, we believe that the proposed FSP should be modified to include guidance regarding the effort that will be required by an organization in terms of gathering evidence with respect to applying the two step process.
- **Preparer Operational Effort.** We are concerned without additional guidance, the terminology used in the proposed FSP is subject to interpretation and could lead to future challenges of an organization's application of the guidance by independent accountants, regulators, or other authoritative bodies and could lead to significant operational complexities. Given our experiences with the existing accounting guidance, we don't believe that the proposed FSP enables preparers of financial statements to be in the position of using good faith efforts in establishing fair value measurements. The proposed FSP needs to provide a practical means to allow preparers reasonable means to obtain evidence without having to incur undue cost and effort.
- **Use of Discount Rates and Third Party Pricing Sources.** We believe that the proposed FSP does not provide sufficient detail and practical guidance to determine fair value based on appropriate market-based discount rates as of a measurement date in an orderly market. The proposed FSP states:

"Reasonable assumptions regarding liquidity and nonperformance (for example, default risk and collateral value risk) risks that willing buyers and willing sellers would consider in pricing the asset in an orderly transaction based on current market conditions."

We believe that the proposed FSP should incorporate additional guidance to assist an organization in selecting appropriate discount rates for financial assets with an inactive market.

Many organizations obtain prices or market quotes for investment securities from third party sources, which may include market transactions, broker quotes, matrix pricing or other alternative methods employed by third party pricing services. In order to make the proposed FSP operational, we suggest that it be amended to include a definition of what constitutes a quoted market price, including examples of how a third party pricing source may or may not meet that definition. Additionally, we suggest that the Board consider explicitly addressing the use of pricing services and provide examples of evidence that could be obtained from pricing services or other third party sources to demonstrate that it meets the

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requirements of Statement No. 157, *Fair Value Measurements* (Statement 157), and any additional guidance issued in FASB Staff Positions.

- *Allow for the Use of Hypothetical Markets.* We believe that the proposed FSP should incorporate additional guidance to allow the use of a hypothetical market price for financial assets in inactive markets, specifically for held-to-maturity securities. For example, the discount guidance for held-to-maturity securities with inactive markets should direct an organization to utilize discount rates that are reflective of an orderly transaction in normal, functioning markets (which may be represented by the use of a "hypothetical" market during the time of illiquid and inactive markets). This could allow an organization the ability to provide a representative fair value of a held-to-maturity security during times of an inactive market.

Additional information regarding these concerns and our responses to several of the specific questions posed by the Board are presented in the pages that follow.

We thank the Board for its consideration of the FHLBank of San Francisco's views and welcome the opportunity to discuss this matter with the Board and its staff. Please do not hesitate to contact me at (415) 616-2603.

Sincerely,



Vera Maytum  
Senior Vice President and Controller  
Federal Home Loan Bank of San Francisco

cc: Robert H. Herz, Chairman, Financial Accounting Standards Board

**Responses to Questions Posted by the Board:**

Question 1:

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

Response to Question 1:

If the proposed FSP is issued in its current form, the proposed effective date is not operational. The proposed date would not provide organizations with sufficient time to evaluate their current valuation methodologies to determine if they will be in compliance with the proposed FSP. Further, organizations may need substantial time to implement the guidance given that new valuation methodologies may need to be developed for entire portfolios. Therefore, we urge the Board to amend the presumptions and requirements as described in our response to question 3 to provide operable relief to organizations as soon as practicably possible with the least impact to valuation methodologies.

Question 2:

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? 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?

Response to Question 2:

We believe that if the modifications we suggested above in our general observations and in response to question 3 are made, that the proposed FSP will improve financial reporting by addressing fair value measurement application issues related to determining inactive markets and whether a transaction is distressed. We also believe that the amendments to Statement 157, should be made. However, as mentioned above, we believe that the proposed FSP lacks detailed guidance to assist organizations in selecting appropriate market-based discount rates and risk premiums for estimating fair value. To avoid differing interpretations among organizations, independent accountants, and regulators, we recommend that the final FSP amend Statement 157 to provide specific guidance regarding appropriate discount rates and risk premiums.

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.

Response to Question 3:

We are concerned that the presumptive nature of Step 2 of the proposed FSP, which does not allow organizations to apply judgment, could lead to measurements that do not faithfully

represent an organization's best estimate of fair value. For example, the Step 2 factors may not be readily evidenced in inactive markets and may not be evidenced on a reliable basis even in active markets (e.g., just the existence of multiple bids is not definitive evidence that a transaction is not distressed). This may result in the application of paragraphs 13 and 15 of the proposed FSP having the unintended consequences of requiring pricing information to be discarded even if the preparer considers those inputs to be relevant to the fair value measurement. Therefore, we recommend that the Board allow preparers to exercise judgment when evaluating whether a financial asset's price is associated with a distressed transaction rather than creating a presumption that may be impossible to overcome. The final guidance could be modified such that the two conditions in paragraph 13 of the proposed FSP represent factors that are considered when determining whether a price is distressed and also permit judgment to be applied in arriving at a final conclusion.

We also recommend that the proposed FSP be modified to include guidance regarding the effort that will be required of an organization in terms of gathering evidence with respect to applying the two step process. Without additional guidance, this terminology is subject to interpretation and could lead to future challenges of an entity's application by independent accountants, regulators or other authoritative bodies. In this regard, we recommend that the proposed FSP provide guidance consistent with paragraph 30 of Statement 157, specifically the following provisions:

In developing unobservable inputs, the reporting entity **need not undertake all possible efforts to obtain information** about market participant assumptions. However, the reporting entity shall not ignore information about market participant assumptions that is reasonably available without undue cost and effort. Therefore, the reporting entity's own data used to develop unobservable inputs shall be adjusted if **information is reasonably available without undue cost and effort** that indicates that market participants would use different assumptions. [emphasis added]

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.

Response to Question 4:

We believe the factors provided as examples for reaching a conclusion under Step 1 are appropriate but should be clarified to state that they are not considered to be all-inclusive.

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?

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Response to Question 5:

If the proposed FSP is issued in its current form as a final FSP, we would expect to incur substantial costs if we are unable to support our current fair value methodologies based on the presumptive nature of the Step 2 factors. While we have not yet quantified this amount, we would expect these costs could be reduced if our recommendations in response to question 3 are implemented.