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FSPFAS157C

LETTER OF COMMENT NO. 10

February 15, 2008

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

Re: File Reference: Proposed FSP FAS 157-c

To Mr. Golden:

Merrill Lynch is pleased to have the opportunity to comment on the Financial Accounting Standards Board's ("FASB") Proposed Staff Position No. FAS 157-c, *Measuring Liabilities under FASB Statement No. 157* (the "proposed FSP").

We understand the Board's efforts to clarify the principles in FASB Statement No. 157, *Fair Value Measurements,* ("SFAS 157") in light of constituent concerns regarding a lack of observable markets and inputs for the transfer of liabilities and the notion that SFAS 157 contains a hypothetical measurement attribute related to the measurement of liabilities. Generally, we do not believe there is a need for much clarifying guidance in the form of FSPs regarding fair value measurement since SFAS 157 is a principles based standard. However, based on conversations with our clients, we understand that practice issues have arisen for corporate institutions, particularly related to considering creditworthiness in valuing derivative instruments and would support additional guidance in this instance. We have noted several observations on the proposed FSP, which are highlighted below.

Proposed Scope

Paragraph 5 of the proposed FSP states that the guidance is applicable to the fair value measurement of liabilities under SFAS 157. We interpret this to apply broadly to the fair value measurement of liability instruments as a whole. However, the background discussion in paragraph 3 of the proposed FSP implies that the guidance intends to clarify the principles of fair value measurement related to nonperformance risk when a lack of observable markets/inputs exists. As a result, we suggest the FASB clarify that the scope of the proposed FSP is applicable to the nonperformance risk component of the fair value measurement of liabilities under SFAS 157 versus the overall fair value measurement of the instrument.

Initial and Subsequent Measurement

Paragraph 6

The guidance in paragraph 6 of the proposed FSP notes that quoted prices (unadjusted) for identical liabilities in active markets (i.e., Level 1 inputs) represent the best evidence of fair value. However, the use of Level 1 inputs to value instruments such as over-the-counter ("OTC") derivatives and corporate debt instruments is rare. For the purpose of measuring credit risk in OTC derivatives, generally there are not any points on the credit curve (i.e., interest spreads over LIBOR over a period of time) that fall within Level 1 of the fair value hierarchy. Most of the curve is interpolated or extrapolated resulting in the majority of inputs falling within Level 2. Corporate debt instruments do not trade actively enough to be considered Level 1 (with limited exceptions for a few specific securities) and are generally valued using pricing models for which the majority of inputs are Level 2, as with OTC derivatives. We therefore recommend paragraph 6 of the proposed FSP either be expanded to encompass Level 2 inputs given their prevalence in valuing liabilities or removed from the proposed FSP.

Paragraph 7

Paragraph 7 of the proposed FSP states that "[i]n 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 the liability at the measurement date." Measuring the fair value of a liability instrument based on the amount of proceeds received essentially results in the instrument being valued based on a transaction or entry price concept versus an exit price concept, which is noted in SFAS 157 as the objective of fair value measurement. We believe the concept conveyed in paragraph 7 of the proposed FSP is contradictory to the key principles in SFAS 157 regarding an exit price notion as it provides a situation where an entity refers directly to the entry price. As exemplified in paragraph A27 (a) of FAS 157, the principles of FAS 157 already permit an entity to consider that, depending upon the determination of the principal market, there may be justification to determine that the exit price equals the entry price. As such, paragraph 7 of the proposed FSP seems unnecessary.

Practice issue

Our understanding of the existing practice issue is that corporate institutions in particular are struggling with the requirement in paragraph 15 of FAS 157 that, "An entity shall consider the effect of its credit risk (credit standing) on the fair value of the liability…", in particular whether they can "consider" that their credit risk is not a component of the fair value of the liability as opposed to being required to incorporate it into the fair value. For instance, a corporate institution with collateral and netting agreements with a securities dealer may not see an impact for their own creditworthiness in the pricing of that instrument, as evidenced by comparing it to an internal model that prices the instrument off of LIBOR flat. If an entity is having difficulty identifying the impact of credit risk on an interest rate swap at inception, then the guidance in paragraph 7 of the proposed FSP will not be helpful. We believe that this issue is one about principal markets – financial institutions may incorporate credit risk into its assumptions about fair value, while corporate institutions are much less likely to do so. If the FASB wishes to address this practice issue, then we suggest that further examples be incorporated to address the issue of how credit could be considered yet not have an impact in the pricing of a liability instrument.

In light of the above, we urge the Board to reconsider the concept articulated in paragraph 7 of the proposed FSP. We believe the guidance proposed is contradictory to the existing principles in SFAS 157 and, furthermore, does not resolve constituent concerns regarding how to measure credit risk when such risk is not readily observable.

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Thank you again for the opportunity to comment on the proposed FSP. We hope the FASB will give consideration to our comments. We are available to answer any questions should any clarification on the points above be necessary or helpful. Please feel free to contact me at (212) 449-2048.

Sincerely,

/s/ David Moser
Managing Director, Accounting Policy