

# **GMAC FINANCIAL SERVICES**

February 18, 2008

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



LETTER OF COMMENT NO. 6

## **File Reference: Proposed FSP FAS 157-c**

Dear Mr. Golden:

GMAC Financial Services (GMAC) is pleased to comment on the Financial Accounting Standards Board's ("FASB") Proposed FASB Staff Position FAS 157-c, *Measuring Liabilities under FASB Statement No. 157* ("FSP FAS 157-c"). GMAC is a leading, independent, globally diversified, financial services firm with operations in 40 countries and approximately \$248 billion of assets as of December 31, 2007. Our principal lines of business include automotive finance, mortgage (Residential Capital, LLC), and insurance.

We appreciate the amount of work the FASB staff has undertaken with regard to providing implementation guidance to assist constituents in measuring the fair value of liabilities, especially when there is a lack of observable markets or observable inputs for the transfer of a liability. While we believe there is a need for clarification of the underlying principles for measuring an entity's liabilities under FASB Statement No. 157, *Fair Value Measurements* ("FAS 157"), several concepts within the FSP are in conflict with various measurement principles within FAS 157. Moreover, we believe the FASB staff should provide guidance on whether the entry price concept contained in FSP FAS 157-c should be applied more broadly to other financial instruments.

### **Exit vs. Entry Price Concept**

In its definition of fair value, FAS 157 establishes a fundamental concept of exit price in determining what price an entity would pay to transfer a liability in an orderly transaction between market participants. However, in the absence of a quoted price (Level 1 input) for the identical liability in an active market, the proposed FSP FAS 157-c prescribes measuring the fair value of an entity's liability at the amount that it would receive as proceeds if it were to issue that liability at the measurement date—an entry (or re-entry) price concept. Such guidance appears inconsistent with the Board's decision that the objective of fair value should embody current expectations about the future outflows associated with the liability *from the perspective of market participants*<sup>1</sup> [emphasis added].

<sup>1</sup> FASB Statement No. 157, *Fair Value Measurement*, Appendix C-Background Information and Basis for Conclusions, Par. C26.

In order to work around the inconsistency, the proposed FSP guidance presumes that a reporting entity's expectations about the future outflows associated with a liability are the same as the expectations of market participants with the same level of nonperformance risk. In other words, there exists an underlying presumption in the proposed FSP guidance that market participants with the same level of nonperformance risk will measure their liabilities similarly. However, there are aspects of entry price outside of nonperformance risk that are unique to individual market participants and, therefore, unique to liabilities an entity may incur. For example, a market participant may receive favorable financing rates because of its relationship with or the volume of transactions with its lenders. The last sentence in paragraph 7 of the FSP is especially confusing as it seems to suggest that the nonperformance risk of a borrower is the only entity specific attribute that influences the proceeds an entity will receive. The concept of market participants under FAS 157 does not contemplate "similar levels of nonperformance risk" among participants, only that such participants would transact within the same principal (or most advantageous) market. Limiting the number of market participants to those with similar nonperformance risk only further undermines the fundamental concept of exit price and creates confusion when attempting to apply the guidance.

Further, during the deliberations of FASB Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*, one of the factors in scoping out deposit liabilities was that there are other non-financial factors included in the fair value. At the August 31, 2006 Board Meeting, Mr. Trott indicated in discussion regarding both loan commitments and demand deposits that

*"In many cases the amount exchanged is not solely for the obligation, but also includes other items that would not meet the definition of a financial instrument, such as a customer relationship, which is not included in Phase 1 and in fact is rarely recorded except for when it is acquired in an exchange."<sup>2</sup>*

By considering only the nonperformance risk of the reporting entity and excluding the other attributes, such as recognizing advantageous pricing due to the reporting entity's relationship with the lender, the reporting entity will be recognizing a gain upon the issuance of the liability. This gain would be akin to recognizing a relationship intangible that is not directly part of the cash outflows of the liability being measured. Moreover, we believe it would be very difficult to bifurcate certain entity specific attributes in measuring liabilities.

### **Applicability to Other Financial Instruments**

We are uncertain whether the FASB staff believes the guidance in FSP FAS 157-c should be applied to other financial instruments. For example, the terms of agreement between counterparties of interest rate swaps may differ with respect to collateral requirements, rights to terminate, exercise terms, and default provisions such as set-off rights and interest on defaulted payments. The presumption under the proposed guidance is that such contractual terms would transfer unvaryingly to a market participant with similar levels of nonperformance risk. It is unclear that such would be the case under a hypothetical entry pricing concept. Furthermore, given the nature of the interest rate swap market, we believe that pricing is generally negotiated by "market takers" and will be significantly influenced by the volume of transactions and the relationship with the counterparty. If the FASB staff believes there is only one entrance price for contracts with similar contractual terms and nonperformance risk, there are other potential unintended consequences that need to be considered. For example, under this principle many interest rate swaps that were once considered to have an initial value of zero at inception would

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<sup>2</sup> FASB Board Minutes, August 31, 2006, Par 15

now have an asset or liability value (unless all entity specific attributes were considered in measuring the initial fair value). While Statement 133 Implementation Issue No. E23, *Issues Involving the Application of the Shortcut Method under Paragraph 68*, allows an exception for non-zero fair values based solely on bid/ask spread differences, we are uncertain whether the FASB staff would view these additional types of non-zero fair values as preventing such interest rate swaps from qualifying for the short-cut method under paragraph 68(b) of FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*.

## Conclusion

We appreciate the opportunity to offer our views on the FASB staff's proposal on measuring liabilities under FAS 157. As we have pointed out in our comments, we believe the entry price concept is inconsistent with the objectives of fair value. Moreover, we believe the anomalies, such as requiring certain entities to record a gain or loss upon initial recognition of a liability at fair value and subsequently recognizing an offsetting loss or gain as the liability is settled, warrant further consideration by the FASB staff. If the FASB staff intends for measurement of liabilities to only consider certain attributes of the reporting entity, we believe the approach outlined in FSP FAS 157-c will result in financial statements that lack representational faithfulness. As such, we strongly suggest that the FASB staff acknowledge that various entity specific attributes will influence the entry price and provide guidance indicating that it may be appropriate to consider all entity specific attributes when measuring liabilities. Finally, we believe there may be unintended consequences to short-cut hedge accounting if the FASB staff intends the guidance in FSP FAS 157-c to be applied to interest rate swaps, especially if nonperformance risk is the only reporting entity specific attribute that can be considered in measuring fair value. We would be happy to discuss these and other examples with the FASB staff directly.

We urge the FASB staff to provide additional guidance and consider our aforementioned comments when finalizing the FSP. If you have any questions on any of the comments contained in this letter, please contact me at (215) 734-4886.

Sincerely,



Michael R. Anspach  
Director, Global Corporate Accounting Policy  
GMAC

cc: Mr. Robert Hull, EVP, Chief Financial Officer  
Mr. David DeBrunner, VP, Controller and Chief Accounting Officer