# FEDERAL HOME LOAN BANK OF CINCINNATI

April 1, 2009

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 Cincinnati (the "FHLBank") 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," (hereinafter referred to as the "proposed FSP"). Our specific comments to the questions raised in the Proposed FSP are attached. Our general comments are outlined below.

The proposed FSP is a step in the right direction. The proposed FSP appropriately shifts the burden of proof to using quoted market prices only if evidence exists that such quotes were not distressed in an inactive market. 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," (hereinafter referred to as "FSP FAS 157-3") placed the burden of proof on entities to support that quoted market prices were distressed or the result of forced sales in order to use a valuation model approach such as the income approach. This means that entities would have to know the circumstances to trades to which they were not a party to in order to know which trades were with willing or forced participants. Such a standard may not be operational.

## General Comments on the Two Step Approach

Outlined below are our comments on the two step approach.

- Though the proposed two step approach seems to be an improvement over FSP FAS 157-3 guidance, we believe that further enhancements are necessary to make it more operational.
- The FSP could be clarified by explicitly addressing the use of pricing services and provide examples of evidence that could be obtained from such services or other sources to document meeting the requirements of the proposed FSP.
- A definition of a quoted market price is needed. In particular, the final FSP should clarify or provide examples illustrating when a quoted market price provided by a third party service or broker may not represent an exit price between a willing buyer and seller. The FSP would be

more operational if it contained more detailed examples of Steps 1 and 2. In particular, for Step 1, it would be useful to have examples highlighting when an active market exists and when it does not exist. For Step 2, it would be useful to have examples highlighting when a quoted market price should be used and when a model should be used. Further, the concept of significance could be more clearly defined and utilized to apply both Steps. We also request additional Step 2 guidance to be included in the final FSP addressing how to assess and document whether multiple bid scenarios represent non-distressed transactions. Given the current market environment, we do not believe that the existence of multiple bids in and of itself is a strong indicator that a transaction is not distressed.

- We believe that the concept in Statement 157, paragraph 29, should be added as an alternative criterion under Step 2. Specifically, we believe that, if an adjustment is needed that is significant enough to cause the security to be lowered from Level 2 to Level 3 in the fair value hierarchy, then this evidence supports that a distressed transaction has occurred.
- We are concerned that Step 2 of the proposed FSP may be applied more broadly than the FASB intended. For example, in the present economic environment, application of paragraphs 13 and 15 may have the unintended consequence of requiring pricing information to be discarded even if the preparer considers those inputs to be relevant to the fair value measurement. We recommend that the FASB allow preparers to exercise reasonable judgment when evaluating whether a financial asset's price is associated with a distressed transaction rather than creating a presumption that is practicably impossible to overcome. As an alternative, 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 conclusion.
- We strongly recommend that the proposed FSP include guidance as to what effort will be required of an entity in terms of gathering evidence with respect to applying the two step process. Such guidance is necessary to facilitate financial statement preparation between an entity and its auditors and regulators. In this regard, we recommend that the final FSP explicitly reference Statement 157, paragraph 30 as applying to the two step process. Specifically, an explicit reference should be made to the following provision in paragraph 30:

"Unobservable inputs shall be developed based on the best information available in the circumstances, which might include the reporting entity's own data. 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."

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#### Good Faith Estimate Provision/Discount Rate Guidance

We believe the good faith valuation concept cited in ASR 118 should be incorporated into the final FSP. In short, the inability to value a security because a quoted market price is not readily available is not new. The good faith estimate concept provides the necessary flexibility and safe harbor for both preparers and their independent public accountants when valuing financial assets. In particular, it is essential that such a concept exist with respect to determining assumptions between willing buyers and sellers.

In addition, the proposed FSP lacks detailed guidance to determine fair value based on appropriate market-based discount rates as of the measurement date in an orderly market. It may be difficult for independent public accountants to consistently apply this guidance without additional practical and specific guidance. In this regard, we recommend that the final FSP add guidance in selecting an appropriate discount rate.

#### Effective Date

We believe the proposed FSP is operational for interim and annual periods ending after March 15, 2009 provided additional guidance is provided. Otherwise, we recommend that the effective date be deferred to interim and annual periods ending after June 15, 2009 with early adoption available to those who wish to do so.

We thank the Board for its consideration of the FHLBanks' views and welcome the opportunity to discuss this matter with the Board and its staff. Please do not hesitate to contact me at (513) 852-7533.

Sincerely,

Donald R. Able

Senior Vice President - Controller

Mary

Federal Home Loan Bank of Cincinnati

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## Responses to Specific Questions

## Question 1:

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

## Response to Question 1:

Yes, we believe it is operational for interim and annual periods ending after March 15, 2009 if additional guidance is provided as described in our comments above.

# **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 the amendments of the proposed FSP are necessary. Further, we believe amendments related to our comments in the letter above would further enhance the proposed FSP.

## 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:

In general, we believe further enhancements should be made as discussed in our general comments to make the two-step model more operational.

#### 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.

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# Response to Question 4:

We believe the factors are appropriate; however, as discussed in our general comments, we believe detailed examples on how to apply these factors should be included in the final FSP.

# 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?

# Response to Question 5:

We do not expect to incur significant incremental costs; however, we believe costs would be lowered if the Board adds a provision similar to Statement 157, paragraph 30 as discussed in our comments in the letter above.