NAHB
NATIONAL ASSOCIATION OF HOME BUILDERS

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LETTER OF COMMENT NO.

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Mr. Russell Golden
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FSPFAS157E 347

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File Reference: **Proposed FSP FAS 157-e**
Proposed FSP FAS 115-a, FAS 124-a, and EITF 99-20-b (collectively FSP FAS 115-a)

Dear Mr. Golden:

On behalf of the over 200,000 members of the National Association of Home Builders (NAHB), I welcome the opportunity to respond to the two proposed Financial Accounting Standards Board (FASB) staff positions (FSPs) FSP FAS 157-e, *Determining Whether a Market Is Not Active and a Transaction Is Not Distressed*, and FSP FAS 115-a, *Recognition and Presentation of Other-Than-Temporary Impairments (OTTI)*. The proposals are intended to provide additional application guidance regarding fair value measurement and impairments of securities. NAHB supports the FSPs and we commend FASB for its prompt response to provide additional guidance related to fair value measurement.

The NAHB has a number of concerns with the current application of fair value accounting. The fair value concept has equated price with value and the disparity between these measurements can be substantial in illiquid, dysfunctional and dislocated markets. Many financial institutions have recorded unnecessarily large non-cash fair value losses on highly subordinated private label mortgage-backed securities (MBS) tranches because of the freezing of the credit markets. A good example is the recent earnings announcement of the Seattle Federal Home Loan Bank. The Seattle Bank attributes its 2008 net loss of $119.4 million primarily to $304.2 million in OTTI charges on private-label MBS that are classified as held-to-maturity. *The Seattle Bank currently estimates a principal loss of $12.0 million over the life of these securities.* Thus relatively minor credit impairments result in a massive depletion of regulatory capital when most of the contractual payments will be collected as scheduled.

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OTTI losses, driven by the lack of liquidity in the private label securities markets, have impacted much of the Federal Home Loan Bank System, a major source of funding for affordable housing projects and the primary credit provider to community banks. A continuation of the current application of fair value accounting threatens the ability of the Federal Home Loan Banks to continue to provide this credit which will have serious consequences for both affordable housing programs and for the ability of community banks to provide credit to consumers and businesses. We therefore welcome the proposed FSPs.

Summary of Proposed FSPs on Fair Value Measurement and OTTI

Proposed FSP FAS 157-e provides guidelines for making fair value measurements more consistent with the principles presented in FASB Statement No. 157 *Fair Value Measurements (FAS 157)*. Proposed FSP FAS 115-a provides additional guidance designed to create greater clarity and consistency in accounting for and presenting impairment losses on securities. If approved, both FSPs would be effective for interim and annual periods ending after March 15, 2009.

Proposed FSP FAS 157-e provides a two-step model for determining whether a transaction is inactive or distressed for fair value measurement under FAS 157:

Step 1 - provides a list of factors that indicate a market is not active (few transactions, wide price variances, abnormal liquidity risk premium, abnormal bid/ask spread.) If Step 1 concludes that the market is inactive, the entity proceeds to step 2.

Step 2 – presumes that a price is associated with a distressed sale unless there is evidence to the contrary that (a) there was sufficient time before the measurement date to allow for unusual and customary marketing activities for the asset and (b) there were multiple bidders for the asset. If both factors are present, then the quoted price is presumed not to be associated with a distressed transaction and should be considered in estimating fair value. If both factors are not present, then the quoted price is presumed to be associated with a distressed transaction and the entity must use an alternative valuation technique (such as present value).

FSP FAS 115-a proposes significant changes to the operational aspects of other-than-temporary impairment (OTTI) guidance that will separate fair value losses into a credit and liquidity bucket. Only the amount of the total impairment charge related to credit losses would flow through earnings and impact regulatory capital. In addition, for securities not intended to be sold and not likely to be sold prior to recovery, only the credit losses associated with such impaired assets would be recognized in earnings. This is a substantive change from current guidance that requires management to demonstrate its intent and ability to hold an instrument, a more challenging standard.

NAHB Position

While we support the proposed FSPs and believe they are a major improvement to the current guidance and relevant standards, some modifications and improvements should be made to assist auditors and reporting entities apply the new standards. NAHB is respectfully submitting suggested modifications to the proposed guidance that would provide even greater clarity for the reporting of financial instrument valuations.

FSP FAS 157-e: *Determining Whether a Market Is Not Active and a Transaction Is Not Distressed*

FASB Two Step Process

The proposed 2-step approach is a much more straightforward method to measure the fair value of an instrument in the Level III (mark-to-model) category. While it is recognized that this 2-step model is a strong improvement in guidance, it is recommended that if Step 1 results in a determination of an inactive market, Step 2 is unnecessary.

The determination in Step 1 that a market is inactive and the presumption that prices are associated with a distressed sale should be sufficient to allow management to employ Level III or mark-to-model valuation techniques using appropriate assumptions for such valuations under the guidance. This should also relieve pressure by auditors to rely upon "fire-sale" exit prices, which has resulted in unjustifiably harsh capital adjustment, due primarily to market illiquidity.

For example, consider the hundreds of billions of dollars of jumbo, subprime and Alt-A securitizations that were issued annually from 2004 through 2007. This private label securitization market is virtually non-existent today with the exception of a few resecuritizations. This is clearly an inactive and distressed market and many of the Step 1 requirements can be easily met. However, under Step 2, if there is evidence that there was sufficient time to allow for usual and customary marketing activities and there were multiple bids, an auditor may conclude that the market is not distressed and bids for those securities should be used as observable inputs to value identical or similar securities in a reporting entities portfolio.

Managerial Judgment in Fair Value Determination

On October 10, 2008, FASB provided interpretive guidance on how financial institutions should value assets in a distressed market (FSP FAS 157-3). The guidelines emphasized the importance of reasonable ***managerial judgment*** in fair value determination, particularly in distressed markets, and that participants did not have to use broker indicative values for impairment analysis. However, these guidelines have not been effectively employed due to continued uncertainty regarding the circumstances under which such managerial judgment should be applied. NAHB believes that the proposed FSP FAS 157-e may also fall short of providing sufficient guidance.

Paragraph 15 of the FSP allows for use of a present value technique to estimate fair value, reflecting an orderly transaction, and that the transaction should *reflect all risks inherent* in the asset. Paragraph A32E indicates that an appropriate discount rate would include a *credit spread for current issuances for similarly rated securities*. While this language provides some clarification of existing guidance (assuming orderly markets for example), what is not clear is whether an auditor would translate this guidance in a manner that would substantively alter the current practice of formulating fair values. In contrast, FAS 114, which is a standard related to loan accounting, explicitly mentions using a discount rate that is the "effective rate of the loan" for determining impairments. Similar clarification should be included in the new guidance for debt securities.

FSP FAS 115-a: *Recognition and Presentation of Other-Than-Temporary Impairments (OTTI)*

Effective Date

The provisions of this FSP are being applied prospectively. This is a significant shortcoming, since extensive damage from misapplied fair value accounting has already occurred. This FSP will provide inadequate remedies unless FASB sanctions cumulative accounting adjustment that would apply the currently proposed guidance to 2007 and 2008, a period where many financial institutions reported massive fair value losses. This would allow for a cumulative "catch-up" in retained earnings that would restore an appropriately measured fair value of assets.

Assets Held-to-Maturity (HTM)

The proposed standard will apply both credit and liquidity related losses to HTM securities, with only the credit portion of loss flowing through income. While this is a major improvement to current practice, we are recommending a modification to the proposed FSP. For entities maintaining a buy-and-hold strategy, it is not appropriate for securities values to fluctuate based on market volatility and illiquidity. Only the estimated credit losses should be reflected in a lending institution's financial statements for HTM debt securities. Non-credit-related losses should continue to be fully disclosed in the notes to the financial statements but they should not affect an institution's earnings or capital. This modification to the FSP would make securities accounting more consistent with loan accounting which does not require fair value marks associated with liquidity constraints.

Conclusion

NAHB again thanks the FASB for the opportunity to comment on the proposed FSPs and it is our hope that they will be applied as intended. The proposed FSPs should address the unnecessarily inflexible practices and interpretations that have led to securities valuations that are not based on economic reality. The FSPs should provide the necessary authority and

guidance to reverse these practices and allow entities to conduct asset valuations in accordance with the way their business is managed. While it has been argued that changes to the current standards will not stand well with investors, we believe that the proposed FSPs will result in more accurate and relevant data on economic values based on the ability of an entity to generate cash flows and meet its obligations. This will allow for a longer term view of the prospects of an entity as opposed to the short-run catastrophic snapshot investors get from last transaction pricing in disorderly and dysfunctional markets.

We appreciate the opportunity to submit these comments. Please contact John Dimitri, (800) 368-5242, ext. 8259; jdimitri@nahb.com, with any questions on our letter.

Respectfully,

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