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March 30, 2009

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



LETTER OF COMMENT NO.

205

File Reference: Proposed FSP FAS 157-e.

Dear Mr. Golden:

Citigroup 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 FSP” or “the proposed FSP”).

Citigroup supports the Board’s objective to clarify practice issues for the application of FASB Statement No. 157, *Fair Value Measurements*, in an inactive market. In particular, we understand that some preparers and auditors have concerns about identifying distressed transactions in inactive or illiquid markets and we agree that it is helpful and appropriate for the FASB to provide guidance that will increase consistency in practice regarding those judgments. In addition, we understand that while Citigroup, as an active dealer in many markets around the globe, has access to a variety of pricing sources and is able to observe a variety of transaction prices and other valuation inputs even in inactive or illiquid markets, most preparers do not have similar access to this type of information and therefore have even fewer data points to use as resources in guiding valuations in these markets. Due to this variety of access to relevant information, we believe it is important for the FASB to provide guidance that is flexible and provides for an appropriate amount of management judgment, recognizing the differences in the amount and type of information available to various market participants.

We believe that certain aspects of the proposed FSP fail to meet the Board’s objective and would, in fact, increase the difficulties experienced by preparers and auditors by limiting the number of data points that preparers may consider in making valuation estimates. In addition, we are concerned that the example provided in the proposed FSP is confusing and may lead to conclusions that are not consistent with the concepts and framework of Statement 157, further resulting in significant inconsistencies in the fair value measurements estimates for the same financial instruments among various preparers.



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Our specific concerns with this FSP are discussed briefly below. We have also suggested specific changes to the proposed FSP to address these concerns.

Presumption to Disregard Transactions in Inactive Markets

The FSP creates a presumption that all transactions in inactive markets are distressed unless proven otherwise. This contrasts with the current presumption in Statement 157 that a transaction is not distressed unless there is sufficient evidence to the contrary.

We do not think there should be a presumption that transactions in inactive markets are distressed. We believe that there are many examples of transactions occurring in inactive markets that do not meet any reasonable definition of a “distressed transaction” and that creating such a presumption will lead to the exclusion of many relevant valuation data points. Some markets (mortgage servicing rights, for example), have always had a limited number of transactions yet these observed transactions have always been considered relevant guides for valuing similar assets, and pricing these products has not been contentious. In addition, many foreign emerging markets have historically been considered inactive due to the developmental stage of the countries’ economies and the capital market environment. For example, in many countries, equity and other exchanges are still developing and do not yet have sufficient volume or frequency of transactions to be considered “active.” However, the majority of transactions that occur in these markets are certainly not “distressed,” rather the markets are still developing and the trading activities are not yet robust. We are concerned that the proposed FSP could label transactions occurring in these developing markets as “distressed” and would preclude the use of observed transactions as a source for fair value measurements.

In our experience, most transactions in illiquid markets are not distressed which means the proposed FSP will dramatically increase our data gathering efforts necessary to prove such actual transactions are not distressed. This change in bias will create significant operational challenges because there will rarely be sufficient information to overcome the presumption that a transaction is not distressed unless the reporting entity participated in the transaction. First, information regarding the amount of time before the measurement date that would allow for usual and customary marketing activities is generally not available. Second, the reporting entity would not know how many bidders participated in the process, which is generally private. These issues are especially acute for preparers that use pricing services to estimate or validate values for certain assets. Even though indicative quotes may be received from multiple pricing services, they do not constitute offers to buy the asset. While pricing services may provide some information regarding the sources and methods used, that information would rarely be sufficiently detailed to know the nature of the transactions considered in preparing the estimates provided by the pricing service. Maintaining sufficient documentation to substantiate the fact that transactions are not distressed would be operationally burdensome and sometimes impossible because of limited access to the relevant information to overcome the presumption in the proposed FSP.



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We believe that limiting the use of comparable transaction data from inactive markets will pose significant limits on a preparer's ability to develop appropriate estimates of fair value. If all or most transactions from inactive markets are disregarded because they are presumed to be distressed, comparable transaction data (which form the basis for trader prices), broker quotes and pricing service quotes may become irrelevant in valuations, even as inputs to valuation methodologies. Preparers would be forced to develop alternate pricing methodologies with no or limited benchmarks to use to calibrate or validate those methodologies or results.

Citigroup suggests that the FSP remove any bias one way or another regarding whether transactions in inactive markets are distressed. Companies should be allowed to use judgment about whether transactions appear distressed based on all facts available to the preparer. There should not be a bias to disregard transactions presumed to be relevant, just as there should not be a bias to use a transaction that is not viewed to be relevant (even if proving that the transaction is distressed is difficult) in estimating fair value. We expect that this neutral approach would provide relief to those preparers who believe they are currently being required inappropriately to value assets at distressed transaction prices, because they do not have sufficient information to meet the burden of proof to overcome the current presumption in Statement 157 that all transactions are not distressed, while avoiding the issues created by the opposite presumption in the proposed FSP.

Appendix I provides our proposed marked changes to paragraphs 13 and 15 to address these concerns.

In the event that FASB retains the original language in the FSP regarding distressed transactions, we recommend the scope of the FSP should be limited to markets that historically were active and become inactive. Although this is implied in paragraph 6 of the background section, which states that many constituents believe that FAS 157 does not provide sufficient guidance on how to determine whether a market for a financial asset that historically was active is not active, we would urge FASB explicitly to limit the scope of the FSP to such markets. We do not think that there should be a presumption that transactions in markets that have never been active are distressed, as maintaining sufficient documentation to substantiate the fact that the transactions are not distressed would be operationally burdensome and sometimes impossible, as that information is not readily available and pricing vendors may not have such detail.



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Guidance for Determining Whether a Market is Not Active and a Transaction is Not Distressed

We agree that the factors included in paragraph 11 are appropriate to use in determining whether a market is active. To emphasize that the list is not all-inclusive, the words “all” and “each” in paragraph 12 should be deleted.

We believe that paragraph 13 should be changed to provide suggestions for indicators that preparers may use in assessing whether a particular transaction in an inactive market is distressed. We believe that the existence of multiple bidders for an asset may not necessarily indicate that the transaction is not distressed, as bids submitted may not always represent legitimate offers but could be included as placeholders in an auction process.

Appendix I provides our proposed marked changes to paragraphs 12 and 13 to address these concerns.

Inputs to Present Value

Paragraph 15 and paragraph A32F in the proposed FSP state that, in an orderly transaction, the entity needs to consider the reasonable risk premium that willing buyers and willing sellers would consider for bearing uncertainty. While the prices offered by willing buyers will be evident, the entity will not be able to determine what price willing sellers other than itself would be willing to accept. Therefore, we recommend that “sellers” be made singular, rather than plural.

Inconsistency with Concepts of FAS 157

The example in paragraph A32F has created significant confusion because of two issues. First, the example uses language suggesting that the two data points for possible rates of return of 7% and 15% are ask and bid levels, respectively. “7% is not a rate that willing buyers would accept” implies it is an “ask” level and “15% is not a rate that willing sellers would accept” implies that it is a “bid” level. Second, the example selects the exact rate to use indicating a “midpoint” and refers to paragraph 31 of Statement 157 (which refers to the acceptable use of midpoint pricing).

The primary problem is that in the example, there is no discussion regarding whether Entity A concluded that the 11 percent discount rate results in a value that is an “exit price for an orderly transaction in the current inactive market.” It is difficult to reconcile the statement in the example that the 15% discount rate is a bid level yield in the current market, yet the 11% discount rate actually used still results in an exit price in the current market. Therefore, it is not clear whether this example is attempting to permit Entity A to price the asset above a level that Entity A believes would be an exit price in an orderly transaction in the current market.



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Also, the reference to paragraph 31 of Statement 157 is confusing because paragraph 31 directly references “bid-ask” spreads and also permits mid-market pricing as a practice expedient. This reference reinforces the implication in the example that 7% is an ask and 15% is a bid, and that Entity A can simply invoke “mid-market pricing” as a reason to choose the midpoint, even though Entity A may have no expectation that it could exit at that level.

Because of these issues, the example creates confusion regarding the FASB’s intent in the proposed FSP:

- If the FASB intends to maintain the exit price notion of Statement 157, we believe the example needs to be clarified. Appendix I includes our proposed marked changes to paragraph A32F. Our suggestion would clarify that the 7% and 15% discount rates each represent bids (from a hypothetical active market and from a distressed transaction, respectively) and that Entity A must use judgment to determine an appropriate discount rate within that range. The result should be the preparer’s best estimate of fair value which represents an orderly transaction in the current inactive market.
- In contrast, if FASB’s intent is to modify the fundamental exit price notion in Statement 157, then we believe the FASB must express that intent explicitly in both the text and the example in the proposed FSP. Such a change would require changes to the text of Statement 157 and could be implemented by suggesting that fair value is not the most relevant measurement attribute for an asset in an illiquid or inactive market where the only transactions are considered to be distressed. Instead, the FASB could amend Statement 157 to replace the use of fair value in those circumstances with a net realizable value model consistent with FASB Statement No. 114, *Accounting by Creditors for Impairment of a Loan (Statement 114)*. Under this model, financial instruments would be valued at net realizable value based upon a preparer’s expectations of an instrument’s future cash flows discounted at the instrument’s original effective rate and would be carried at the lower of current book value or the value calculated using the refined valuation methodology. If the Board adopts this approach, we recommend that the Statement 157 exit price amounts be disclosed in the footnotes to financial statements in order to provide transparency. We also note that IFRS impairment accounting guidelines follow a net realizable value model (similar to Statement 114) for Held to Maturity (HTM) and certain other securities.

Effective Date and Transition

We believe that the proposed effective date of interim and annual periods ending after March 15, 2009 does not provide sufficient time for many preparers to adopt the proposed requirements of the FSP. Given that the final FSP will not be issued until April, adopting the requirements for the first quarter reporting period would be extremely challenging, in particular if significant groups of transactions move into the level 3 classification of the fair value hierarchy. Determining the fair values using new valuation



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methodologies would take a significant amount of time and effort. Additionally, creating a reconciliation of beginning and ending balances for the new level 3 measurements will impose significant operational burdens. We are concerned that entities may be unable to effectively compile such data in the limited time frame between issuance of the FSP and filing of the first quarter financial statements. Therefore, we recommend that the FASB change the effective date to no earlier than interim and annual periods ending after June 15, 2009 with early adoption permitted.

We agree that adoption of the proposed FSP should be accounted for as a change in estimate in the period of adoption.

We thank the Board for its consideration and would welcome the opportunity to further discuss our comments with Board members and their staff. We also ask the Board to consider its efforts to converge U.S. GAAP with IFRS, especially in critical accounting areas such as fair value measurement. Please do not hesitate to contact me at (212) 559-7721.

Very truly yours,

A handwritten signature in cursive script that reads "Robert Traficanti".

Robert Traficanti
Vice President and Deputy Controller
Citigroup Inc.



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APPENDIX I

12. After evaluating **all** factors and considering the significance and relevance of ~~each~~ those factors, the reporting entity shall use its judgment in determining whether the market is active.

13. If the reporting entity concludes in step 1 that the market for the asset is not active, then the reporting entity will proceed to step 2. ~~In step 2, the reporting entity must presume that a quoted price is associated with a distressed transaction unless the reporting entity has evidence that (a) there was sufficient time before the measurement date to allow for usual and customary marketing activities for the asset and (b) there were multiple bidders for the asset.~~ In step 2, the reporting entity should consider all facts and circumstances known to the reporting entity to assess whether a quoted or observed price is associated with a distressed transaction. The following factors, while not all-inclusive, may indicate that the price is associated with a distressed transaction:

- a. there was insufficient time before the measurement date to allow for usual and customary marketing activities for the asset
- b. the bidding process lacked multiple offers to purchase the asset at prices a reasonable seller would accept
- c. the quoted or observed price is substantially different than other quoted or observed prices for similar transactions within a reasonable time period
- d. the seller is a special purpose vehicle that was required to sell the asset in a mandatory liquidation or other contractual requirement
- e. the seller is forced to sell the asset as a result of capital or liquidity constraints or other regulatory matters
- f. [consider others]

14. After evaluating **all** information available to the reporting entity and considering the significance and relevance of all such information utilizing the above factors, the reporting entity shall use its judgment in determining whether the quoted or observed price is based on a distressed transaction. ~~If the reporting entity has evidence that both factors are present for a given quoted price, then that quoted price is presumed not to be associated with a distressed transaction. In that case,~~ If the quoted or observed price is determined not to be based on a distressed transaction, the quoted or observed price may be a relevant observable input that should be considered in estimating fair value. However, the reporting entity should consider whether any other factors or conditions warrant making an adjustment to the quoted or observed price as discussed in paragraph 29 of Statement 157. For example, if a quoted or observed price that is not associated with a distressed transaction is not current or



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is a consequence of a trade with an insignificant volume relative to the total market for that asset, the reporting entity should consider whether that quoted or observed price is a relevant observable input (that is, whether the quoted price requires adjustment).

15. If the reporting entity determines that the quoted or observed price is associated with a distressed transaction, ~~When that is the case,~~ the reporting entity ~~must~~ should consider all available evidence and may use other methods of determining fair value including, but not limited to, using a valuation technique other than one that uses the ~~quoted observed price for the distressed transaction~~ without significant adjustment. For example, the reporting entity could use an income approach....

If the FASB intends for the example to be consistent with the exit price concept in Statement 157:

A32F. Entity A estimates a range of possible rates of return from 7 percent (based on an estimated **bid-level** rate of return for the collateralized debt obligation in a hypothetical active market at the measurement date) to 15 percent (based on bid-level yields implied by an observed or quoted price associated with a distressed transaction in the current market)~~the difference between the contractual cash flow amount and the most likely cash flow estimate adjusted for a reasonable risk premium due to uncertainty). Because 7 percent is not a rate that willing buyers would accept and 15 percent is not a rate that willing sellers would accept, Entity A uses the midpoint of 11 percent (see paragraph 31).~~ The 7% rate of return is not appropriate, because it was derived from an active market rather than the current inactive market. Similarly, the 15% rate of return is not appropriate, because it was derived from a distressed transaction. Therefore, Entity A should use judgment within that range to estimate the rate of return that would be required in an orderly transaction in the current inactive market. Entity A determines that a 12% rate of return is the most representative discount rate for an orderly transaction in the current inactive market, considering discount rates and liquidity premiums implied for other similar asset classes in non-distressed transactions, and the amount of uncertainty regarding management's estimates of cash flows.