



Deutsche Bank



Deutsche Bank AG London
1 Appold Street
London EC2A 2HE
Tel +44 20 7545 6000

LETTER OF COMMENT NO. 152

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Russell G. Golden,
FASB Technical Director,
FASB,
401 Merritt 7,
PO Box 5116,
Norwalk,
CT 06856-5116,
United States of America
director@fasb.org

cc: gfrancis@iasb.org (in response to request for views from members of the Expert Advisory Panel)

File Reference: Proposed FSP FAS 157-e

Dear Mr. Golden,

Deutsche Bank appreciates the opportunity to provide comments on the FASB Staff Position (FSP) Determining Whether a Market Is Not Active and a Transaction Is Not Distressed.

Overall we do not believe the proposed changes will improve financial reporting or investor confidence. We do not agree that there should be a presumption that a transaction in an inactive market is distressed unless proven otherwise. We believe that the guidance issued by the IASBs Expert Advisory Panel 'Measuring and disclosing the fair value of financial instruments in markets that are not active' provides more appropriate guidance than the proposed FSP. Our detailed comments are as follows:

Scope

- The scope of the proposal currently applies to financial assets only. We believe that the guidance could equally be applied to liabilities that are measured at fair value on



a recurring basis. Certain instruments such as derivatives can be either assets or liabilities and it would be inconsistent to have different fair value guidance for an asset position than a liability position.

Factors indicating a market that is not active

- The factors provided in paragraph 11 may be indicators that a market is not active but not necessarily so; certain of these indicators may be present whilst the market remains active. For example indexes that previously were highly correlated with the fair values of the asset may become uncorrelated for a variety of reasons including changes in the market, not only illiquidity in the market. Likewise, wide bid-ask spreads may be indicative of an inactive market but also could exist where there is an active but volatile market. We believe paragraph 11 should be amended to reflect that the indicators may be indicative of a market that is not active and that if some of the factors are present further analysis is required to determine whether the market is active or inactive.
- The factors describe price quotations, we believe the factors are equally applicable to quotations for rates which are inputs to valuation techniques.
- It should be highlighted that some of the factors should be assessed with comparison to the normal level of activity present in that particular market. Particularly, the number of transactions that represent 'few recent transactions' as described in paragraph 11a will differ in different markets – few recent transactions for securitisations will be lower than few recent transactions for US government bonds, for example.

Presumption of a Distressed Market

- In an inactive market we disagree with the presumption of a distressed transaction unless it can be proven otherwise. This presumption results in market information that may represent an orderly transaction not being allowed to be used, without significant adjustment, to determine fair value. We believe the existing approach of using all market information unless the transaction can be shown to be distressed and the application of management judgement is the best approach to determine fair value.
- The proposed FSP is contradictory to the guidance issued by the IASB Expert Advisory Panel 'Measuring and disclosing the fair value of financial instruments that are not active' which describes indicators of a forced transaction and requires management judgement to determine whether a transaction is forced or orderly. If the transaction is not forced then all relevant information is considered in the



determination of fair value. The Expert Advisory Panel included a wide range of participants including valuation experts from major financial institutions. The paper was subject to a reasonable comment period and appropriate due process. Whilst we understand the driver for the proposed FSP was that some institutions have been pressured to mark to the last transaction price we believe that this would be better addressed by using the approach outlined in the Expert Advisory Panel paper rather than a presumption that transactions in an inactive market are distressed.

- In the current financial crisis it is important not to undermine investor confidence in financial reporting. Fair value is a key aspect of financial reporting and any new guidance should increase the credibility of fair value. We believe the new guidance could result in different institutions using significantly different valuation techniques and inputs for the same instruments. It could reduce comparability and decrease the reliability of level 3 valuations.
- Additionally we foresee practical difficulties in the application of the proposed FSP:
 - The new rules may make the independent price verification controls more difficult to perform. We believe it will be difficult to independently verify that the factors described in paragraph 13 have been met to rebut the presumption of a distressed transaction. We believe establishing the appropriate control framework will take significant time and effort to implement.
 - Once a transaction is deemed to be distressed the inputs to the valuation technique must be one that does not use the quoted market price, unless it is subject to significant adjustment. We believe there is a risk that the presumption of a distressed transaction will only be overcome in rare circumstances for less sophisticated institutions. The fair value of a wide range of instruments will then be based upon prices for instruments in an active market which may not be appropriate proxy instruments. We believe that this could reduce the credibility of fair values reported and reduce investor confidence.
 - Further the valuation technique used needs to be subject to calibration to the market. If institutions cannot overcome the presumption of a distressed transaction then the calibration will have to be to transactions in active markets which may not represent the risks and nature of the actual instrument. We are concerned that valuations from this methodology will not necessarily be representative of an exit price for the instrument.



Example

- Paragraph A32F states that the entity uses a midpoint of the ranges of possible discount rates to determine fair value. We believe it is more appropriate to indicate that the entity should use management judgement to estimate the point in the range that best represents the discount rate for the instrument to reach an exit price.

Timing

- We believe that the current drafting of the FSP could potentially lead to a pervasive change to the calculation of fair value in many markets. We believe that the change should not be mandatory for periods ending 31 March 2009. We believe a longer comment period and complete due process on such a change is appropriate. A key part of the process should be to fully understand and challenge the compatibility of the changes with the definitions in FAS 157 and relevant aspects of the accounting framework.

Other

- Fair value is a fundamental concept in financial reporting. We do not believe that there should be differences in the definition of fair value or application guidance between the IASB and the FASB. This change would explicitly create a difference in fair value measurement with immediate effect. This will not aid investor confidence.

We hope you find these comments helpful. Should you have any questions or wish to discuss these matters further, please contact me on +44(207)54-76640 or via email to charlotte.jones@db.com.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Charlotte Jones'.

Charlotte Jones
Global Head Accounting Policy and Advisory Group
Deutsche Bank AG