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November 11, 2008

Members of the Commission:

There are many opinions on fair value. While many people recognize that SFAS 157 does not represent a fundamental shift in the application of fair value accounting, others have called for the repeal of the standard in hopes of soothing recent market chaos. It is our belief that the SFAS 157 debate may have been caused by the misconception that mark-to-market automatically equates to "fair value," which is not the case. While mark-to-market accounting is an important indicator of fair value for regulators and investors, SFAS 157 provides the flexibility to consider a wider range of valuation techniques to deal with situations when market prices are distressed and not representative of fair value. Fair value accounting should not be suspended or eliminated.

Investors must have confidence in the reliability of financial statements; without this confidence, there will be no investment—only speculation. With the level of focus and attention drawn to fair value accounting, "changing the rules" in the current market conditions will only diminish investor confidence. Many helpful statements have already been issued to try to clear up the confusion, but more clear guidance is needed to address incorrect interpretations and to communicate the intent of the standards.

Some opponents of SFAS 157 claim that companies may be required to mark positions to market based on "distressed" transactions; however, as clarified by the FASB, SFAS 157 does allow for the use of mark-to-model when observed transactions are distressed. But, recognizing those distressed situations is a challenge. In equity markets, indicators of market activity like trading volume and bid/ask spread are easily observed. However, for asset classes that have been making headlines, such as RMBS, CDOs, CLOs and credit default swaps—there is no exchange or centralized data source for volume, trade, or quote data. In fact, many of these structured instruments were designed to be bought and held, and not for short-term or day-to-day trading. Even in a normal market, transactions in these structured products were always conducted "by appointment only." As a result, in the current market condition, it is not a surprise that trades on these structured products are extremely infrequent and can occur at widely disparate price levels. Since it is impossible to know the mind of the parties in each transaction, clearer guidance on how to incorporate or consider these market data in a fair value analysis is important. However, it is important to note that "consideration" does not mean 100% reliance.

A distinction should be made between illiquid and distressed assets, or correspondingly between "volume illiquidity" and "funding illiquidity." Even in less troubled times, different markets exhibit varying levels of liquidity, and a body of research generally supports a discount on securities that are less liquid. For example, even in a normal market, there is a liquidity premium between on-the-run and off-the-run treasuries. Even in an orderly market, there is a difference in bid/ask spreads between agency paper and subprime mortgage bonds. Therefore, it is appropriate to include a volume liquidity premium in valuing the Level 3 assets.

However, many market participants, including structured investment vehicles, hedge funds, and financial institutions, have recently been forced to sell assets at prices they consider too low. This is caused by “funding illiquidity,” or illiquidity driven by certain participants’ need for immediate capital. It is our opinion that it may not be appropriate to include a funding liquidity premium in valuing the Level 3 assets, especially when investors have abundant financial resources to hold the assets in the foreseeable future. Calibrating valuation inputs for Level 3 models using distressed or fire-sale prices will certainly result in liquidity premium far in excess of a reasonable level for fair value purposes. Market participants should work toward a more comprehensive, economic-based liquidity premium model that incorporates orderly market transactions. It is our belief that this point has been confused by market participants, and in the current period when the liquidity of many instruments has declined so much, it is important that this factor is well-understood by preparers and users of financial statements.

The bottom line is: sometimes a market price is a fair value; sometimes a model price is a fair value.

Sincerely,

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