

October 23, 2008

Mrs. Florence E. Harmon
Acting Secretary
Securities and Exchange Commission
100 F Street, NE
Washington D.C. 20549-1090

File Reference: 4-573

File Topic: SEC Study of Mark to Market Accounting

Mrs. Harmon,

Mark-to-Market (MTM) accounting proved to be a useful tool in liquid markets, as long-term investors were able to ascertain periodic market levels to validate the pricing of securities not listed on an exchange. As market quotes began to decline on mortgage related assets in mid-2007 due to the collapse of the subprime mortgage market, the level of trading began to decline as investors became nervous about the illiquid assets that they were holding. With fewer trades occurring, there were fewer data points from counterparties providing the market quotes to consider. The decline in prices of these mortgage related assets triggered unwind events in many Structured Investment Vehicles (SIVs), which held mortgage related assets along with Asset Backed Securities (Credit Card, Auto, etc), Collateralized Debt Obligations (CDOs), and Collateralized Loan Obligations (CLOs) . As a result, the market was flooded with billions of dollars of structured finance assets and very few buyers. With each respective unwind, the market quotes on the assets continued to trend downward even while much of the underlying collateral in the structured finance market continued to perform as expected.

During 1H08, many buyers deployed the capital they had available to purchase these illiquid assets, which led to fewer remaining buyers in the marketplace during the second half of the year. With fewer buyers, trading levels continued to decline and today market levels for leveraged loans are at historic lows, while spreads on structured finance assets are at historically wide levels once never thought possible. Potential buyers with existing structured finance exposure are less likely to provide bids, as the lower bids would then force market quote adjustments on their own book and in turn force a writedown of their existing performing securities. In addition, hedge fund buyers have become more focused on cash management than reinvesting principal proceeds as financed positions continued to be marked down in line with liquidation prices from distressed sellers prompting a dramatic increase in margin calls. The impact of MTM accounting during this very illiquid market has caused long-term investors that are focused on fundamentals to become speculators that see asset valuations in a MTM "death spiral." These MTM writedowns have driven the trend of ongoing liquidations of assets in Market Value structures, most of which have not seen an actual dollar loss. These MTM paper losses have driven down investor returns but most importantly have caused financial institutions to writedown almost half a trillion dollars worldwide and have caused thousands in job losses.

Recently, FASB released revised language on other ways to value illiquid assets in an illiquid market. The statement provided no additional clarity on other ways to value these assets. The premise behind MTM

accounting has been to rely heavily on market quotes provided by financial institutions that structured or sold the asset. With many of these institutions now out of business, pricing levels for entire asset classes are now being set by fewer counterparties.

Alarming, the method in which counterparties price assets has very little transparency, nor does the process have any consistency amongst the counterparties. Often a counterparty will quote a price based on a trade that may not have occurred or a trade that did not transpire within their respective firm. There are absolutely no guidelines set forth that prescribe acceptable model inputs for the valuation systems used by these firms. Therefore, a counterparty providing financing for assets could assume unreasonable inputs (i.e. defaults, recoveries, etc) that drive model values down further causing additional margin calls, which take further liquidity out of an already illiquid marketplace. This lack of regulation has given a small number of counterparties the ability to price hundreds of billions of dollars of assets, while completely ignoring the fundamentals of the asset. The disclaimers provided in conjunction with the market quotes provided by these counterparties support the fact that they are very unreliable and include language such as:

- The above estimated values are as of the date indicated and **do not represent actual bids or offers**
- *In the absence of sufficient or meaningful market information available to us, such valuations, or the components thereof, **may be theoretical** in whole or in part.*
- *may not necessarily reflect Counterparty or its affiliates' **internal bookkeeping**; does not imply firm bids or offers, or actual traded levels; may not contain **all factors** that may affect Counterparty's valuation of the securities*
- **have not been confirmed by actual trades**, may vary from the value Counterparty assigns any such security while in its inventory

These bullet points support the notion that market quotes completely and utterly disregard the fundamental value of an asset. In addition, the process used to derive market quotes is flawed and lacks any visible transparency. It is equally alarming to discover that the counterparties providing valuations on these assets may NOT be valuing the assets at the same levels on their own balance sheets. If this is permitted to occur, I would expect that the counterparties pricing assets would continue the trend of marking the assets down, buying them, and then marking the assets higher on their own books to create an artificial paper gain. With the recent injection of capital into a number of financial institutions, it would be punitive to existing investors if proceeds from the TARP were used by these financial institutions to purchase assets in this manner.

In summary, I was once taught that if a process is not working in a certain environment, determine how that process would work in other settings, and if it does not work anywhere then the process itself may be flawed. In what may seem like an oversimplified example, consider the impact of applying MTM accounting to a market outside of Wall St.

Let us assume briefly that I purchased a new car six months ago for \$30,000 from a local dealership and financed it with a \$25,000 loan. If in six months I made the decision to trade in the vehicle, which now has 10k miles, I would expect that in an active market, the dealer would offer me \$23,000-\$25,000 for the vehicle; however, if the dealer offered me \$5,000 because he the market was not as active, I would

respectfully decline his offer and would simply keep the car because I recognize the value of the car is much greater than the dealer has quoted. Using MTM accounting, after hearing the “offer” the dealer made on my vehicle, the bank providing financing would then contact me after recording the new market quote of \$5,000 for the vehicle and margin call me for \$20,000. Not being able to make the margin call, I would lose the car, the dealer would likely end up buying it below market at \$4,000 in a fire sale, and the bank would have a write-off. Sound familiar?

This example lays out exactly why MTM accounting only works in a very transparent and very liquid market. Our financial system has experienced a great deal of realized losses but has been devastated by paper losses due to inaccurate and overly punitive market quotes. In order for this trend to stop, it is vital to either suspend MTM accounting while the existing MTM model is dramatically improved or to withdraw MTM accounting entirely.

Sincerely,

Jason Ziegler
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