



September 24, 2007

Center for Audit Quality
c/o Mr. Michael Foley, Partner
KPMG LLP
Department of Professional Practice
775 Third Avenue, 9th Floor
New York, NY 10017

Jim Kroeker, U.S. Securities and Exchange Commission
Russ Golden, Financial Accounting Standards Board
Thomas Ray, Public Company Accounting Oversight Board
Zane Blackburn, Office of the Comptroller of the Currency
Charles Holm, Federal Reserve Board
Jeffrey Geer, Office of Thrift Supervision
Robert Storch, Federal Deposit Insurance Corporation
Karen Kelbly, National Credit Union Administration

Re: White Papers of the Center for Audit Quality (the “CAQ”) on “Measurements of Fair Value in Illiquid (or Less Liquid) Markets” (“First White Paper”) and “Consolidation of Commercial Paper Conduits” (“Second White Paper” and, collectively, the “White Papers”)

Ladies and Gentlemen:

The member banks of The Clearing House Association L.L.C.¹ (“The Clearing House”) appreciate the opportunity to comment on the White Papers and the efforts of the CAQ and the governmental agencies addressed to provide clarity in these important areas.

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The member banks of The Clearing House are: Bank of America, National Association; The Bank of New York; Citibank, N.A.; Deutsche Bank Trust Company Americas; HSBC Bank USA, National Association; JPMorgan Chase Bank National Association; LaSalle Bank National Association; UBS AG; U.S. Bank National Association; Wachovia Bank, National Association; and Wells Fargo Bank, National Association.

The Clearing House agrees with the basic proposition stated in the White Papers that this guidance should be designed to reaffirm, rather than modify, existing generally accepted accounting principles (“GAAP”).² Nonetheless, we are concerned that the overall tone of the White Papers is likely to lead to a departure from GAAP and substitute a mechanistic approach for the judgment that GAAP requires, which will provide less accurate financial statements and reduce their credibility.

GAAP in general, and FAS 157 and FIN 46(R) in particular, establish principles that are applied using judgment with consideration for the facts and circumstances of a specific situation. We are concerned, however, that the White Papers insufficiently recognize and value the importance of judgment as made in this context. Combined with what we believe is an unduly rigid or incorrect reading of certain terms, the consequence is likely to be that distorted and unreliable prices replace models that more accurately reflect true value.

(1) First White Paper

We acknowledge that FAS 157 requires that fair value be measured based on an exit price notion. We agree that an “imbalance” in supply and demand or “significantly lower” or “decreased” transaction volume does not, in and of itself, provide a basis for ignoring or overriding meaningful market data.

² Indeed, the CAQ does not have the authority to modify GAAP.

What the First White Paper fails to explain, however, is that a company should exercise its judgment as to whether current facts and circumstances require further consideration of market conditions. The First White Paper itself refers to the current “liquidity crisis” and “volumes [that are] far less”. A company may conclude that a liquidity crisis exists and, based on such a conclusion, determine that there are no longer the orderly transactions to provide or reliable and/or relevant market data for certain portfolios of financial instruments. FAS 157 requires that a company exercise its judgment in determining appropriate inputs to use in determining fair value. Stated differently, we believe that the use of models to determine fair value is permissible, and may be required if a company concludes that market volumes are not just “significantly lower” or “decreased”, but drastically lower or that the market is not just “relatively illiquid”, but illiquid (the title of the First White Paper) or highly illiquid.³

We believe that the First White Paper does not adequately recognize that the use of cash flow models is consistent with FAS 157 and may be the most appropriate approach to determine fair value. Although a company should not ignore observable market inputs, we believe a company must use its judgment in determining what observable or unobservable inputs are appropriately reflective of fair value. Therefore, we propose that statements negating the use of expected cash flows be deleted.

³ The White Paper cites a 2004 SEC accounting and auditing enforcement release. That release rejects, however, only the argument that an “imbalance” in supply and demand justifies reliance on sources other than external pricing sources.

The First White Paper appears to suggest that a transaction is either orderly or forced -- and only in the latter case can models be used. We submit that, although a transaction cannot be “orderly” if it is the result of a forced sale, a transaction may still not be orderly even if a sale is not forced. Because FAS 157 does not actually define an “orderly” transaction, it should be interpreted in accordance with its normal meaning: “regular” or “not marked by disorder”.⁴ Therefore, a company should be able to conclude that, in fact, the current markets are irregular and marked by disorder.

We also submit that the two examples of a “forced” transaction, a forced liquidation and a distress sale, are too limiting. We believe that a sale is forced if a seller -- left to its own devices -- would not sell because it believes that the price it will receive does not represent its true value. In some situations, the sale is made due to external requirements, such as capital requirements, or external pressures, whether regulatory or market.

The First White Paper asserts that “persuasive evidence” is required to establish that an “observable transaction” is “forced”. Although this standard is somewhat preferable to the prior draft’s “high burden of proof”, we believe this standard is still inconsistent with GAAP, which instead provides for the exercise of the best judgment of the company.

An additional concern with the First White Paper is the use the subprime mortgage loan market as the example for an active Level 1 market. Our banks would not normally classify subprime mortgage loans as Level 1 valuation. We believe it would be more appropriate for the example to refer to instruments that are widely considered to be in Level 1.

⁴ Merriam-Webster’s Collegiate Dictionary (Tenth Edition), p. 818.

We want to be clear that our concerns with the First White Paper are not motivated to avoid or reduce asset writedowns. Rather, writedowns that are not reflective of fair values are not consistent with FAS 157 and will produce inaccurate financial statements, not just in the period when the writedown occurs, but for the life of the asset as the excess is accreted back into income. The intent of our comments is to support application of the standards in a manner that provides the most accurate valuations.

(2) Second White Paper

We are concerned that the Second White Paper creates an undue bias towards consolidation by sponsors in a number of respects. First, we believe that, if liquidity facilities have been incorporated in the original design of the conduit and fundings pursuant to that commitment are made, a reconsideration event has not necessarily taken place. In this case, only the form of variable interests has changed, not the proportion of variability absorbed by the liquidity providers.

Second, we disagree with the suggestion that changes in liquidity spreads for conduit assets are likely to be correlated to inherent losses. The current widening of liquidity spreads on conduit commercial paper may be the result of an irrational response to generalized fears and not a rational response to inherent losses in the conduit assets. An appropriately structured conduit should be able to withstand a certain level of credit losses absent an extraordinary event such as prevalent fraud, large operational deficiencies, significant servicing failures, etc. None of these conditions is correlated to changes in general market liquidity.

Third, we further disagree with the suggestions that: (i) short-term changes in fair value of assets must be factored into a FIN 46(R) analysis of a vehicle that does not absorb those changes or pass them along to its variable interest holders; (ii) the FIN 46(R) analysis must reflect market assumptions of default even if they contradict the best estimates of the conduit sponsor; and (iii) the current market conditions suggest the potential of a repetition other than a low probability. In our view, the sponsor should exercise judgment whether there are factors influencing the fair value of conduits assets or liabilities that need not take into account the present value of expected cash flows because such factors do not create variability based on the design of the conduit. We believe that, outside the subprime market, the widening of spreads reflects factors such as general liquidity in the market that do not create variability within the conduit.

In addition to these concerns, we note that, again, the discussion of fair value measurements appears to be biased towards a more mechanical approach and does not fully address that judgment must be applied in determining appropriate fair values.

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We recognize that you have been required to proceed on an abbreviated schedule and have of necessity provided a very short comment period. Nonetheless, the issues involved are of such importance that they must be resolved thoughtfully. We urge you to consider our comments carefully, and we are prepared to work directly with you to achieve our mutually desired result of sound, accurate and credible accounting.

If you have any questions, please contact me at (212) 612-9205.

Sincerely yours,

A handwritten signature in black ink, reading "Norman R. Nelson". The signature is written in a cursive style with a large, prominent initial 'N'.