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Ms. Suzanne Bielstein
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Financial Accounting Standards Board
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Dear Ms. Bielstein:

FASB Exposure Draft: Proposed Statement of Financial Accounting Standards, Amendment of Statement 133 on Derivative Instruments and Hedging Activities (File Reference 1100-163)

We appreciate the opportunity to comment on the FASB's Proposed Statement of Financial Accounting Standards, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities* (hereinafter referred to as the "Exposure Draft" or "ED"), the related DIG issues and the "Questions and Answers Related to Derivative Financial Instruments Held or Entered into by a Qualifying Special-Purpose Entity (SPE)" (hereinafter referred to as the "Q&A Document") as posted on the FASB Web site in May 2002.

We believe the Board should take the opportunity to reassess whether FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*, (hereinafter referred to as "Statement 133" or the "Standard") should be superseded and replaced with a more principles-based standard for accounting for derivative instruments and hedging activities. We recommend an approach similar to the "top-down" approach that the FASB's Web site describes for the project on revenue recognition. That approach focuses on developing guidance at the concepts level, testing that guidance against specific issues, and further improving the concepts as necessary. We believe the existing standards on derivatives are at odds with the strategy that the Board is pursuing in revenue recognition. What better time to further the Board's efforts to move to concepts-based standards than by superseding the existing standards on derivatives? We are very supportive of the Board undertaking that type of effort. If the Board decides not to supersede the Standard in favor of a more principles-based standard, we have included below and in the attached Appendix comments on the ED, related DIG Issues, and the Q&A Document.

Even though we believe the proposed changes related to beneficial interests and the definition of a derivative represent an improvement in the operability of Statement 133, particularly as it relates to the interaction of Statement 133 and FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (hereinafter referred to as "Statement 140"), we are concerned that they add another layer of complexity to an already complex standard. We appreciate that some of this complexity is due to the subject matter. However, we urge the Board to more fully explain the basis for the changes. Without a well articulated basis for conclusions, the proposed changes seem to add more subjective rules to a standard that is already overly rule-based. The lack of a detailed basis for conclusion also makes consistent application of these changes difficult. Adding to the complexity of the proposed changes is the fact that the guidance for beneficial interests is found throughout the ED and in selected DIG issues, which makes the guidance difficult to follow. One case in point is that when evaluating whether the beneficial interests issued are exempt from the Standard, paragraph 14 states that one of the requirements is that the beneficial interest initially resulted from separating the rights to receive contractual cash flows of a financial instrument that, in and of itself, did not contain an embedded derivative that would otherwise have been accounted for separately. The reader is required to review paragraph 58 (d) to learn that the existence of freestanding derivatives in a structure also disallows the paragraph 14 exemption. We recommend consolidating the guidance about beneficial interests in one section of the Standard for ease of use, application, and analysis.

Additionally, we recommend that the Board review the current structure of the Standard. Since issuance, the Standard has been amended by FASB Statement No. 137, *Accounting for Derivative Instruments and Hedging Activities – Deferral of the Effective Date of FASB Statement No. 133*, FASB Statement No. 138, *Accounting for Certain Derivative Instruments and Certain Hedging Activities – An Amendment of FASB Statement No. 133*, and the current ED. The Standard also has been interpreted by over 150 DIG issues and several examples that are available only on the FASB's Web site. For many preparers of financial statements and auditors, such a dispersion of relevant guidance makes it difficult to arrive at the appropriate accounting for complex, multi-layered transactions. We believe the Board should re-issue the Standard, combining the guidance in Statement Nos. 137, 138, the ED and the examples currently on the FASB Web site, with the DIG issues provided supplementally. Although we acknowledge the existence of the "green book," we believe the codification of the Standard to combine the various amendments would provide the Board the opportunity to overhaul the current, at times conflicting and other times non-existent, bases of conclusions that are found in the separate documents. Without a robust and insightful basis of conclusions, financial statement preparers and auditors are not given the principles underlying the Standard, thereby limiting their ability to apply the Standard to complex transactions and resulting in a standard that is an aggregation of inconsistent, and somewhat incoherent, rules.

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In the attached Appendix, we have identified several additional issues on which we suggest the Board clarify its intent. Where appropriate, we also have included our recommendations. We would be pleased to discuss our comments at your convenience. Please contact John Guinan at (212) 909-5449 or Enrique Tejerina at (212) 909-5530.

Very truly yours,

KPMG LLP

Amendment of Paragraphs 6(b) and 12 (with related amendments of (57(b), 59(c)(3), 59(d))**1. Issue**

The proposed amended paragraph 6(b) language in the ED sets forth the criterion for an option-based contract as a contract that “has an initial net investment equal to the fair value of the option component.” For various reasons, free-standing option contracts sometimes are purchased with inherent intrinsic value, i.e., with terms more or less favorable than market conditions. The fair value paid by the purchaser, and received by the seller, comprises two components: time value, as defined in the Standard, and intrinsic value. When read together with paragraph 8, the proposed amended language in paragraph 6(b) in the ED is unclear about whether the intrinsic value portion of the fair value paid or received would be included in the “fair value of the option component,” thereby resulting in the entire contract meeting the definition of a derivative, or excluded, thereby resulting in the option contract being accounted for as a hybrid instrument with an embedded option.

Recommendation Specific to Issue

We recommend clarifying the definition of an initial net investment for option-based contracts to state that the term “fair value of the option component” includes intrinsic value. We acknowledge that this point is made in DIG Issue No. A20, “Application of Paragraph 6(b) Regarding Initial Net Investment,” but we believe it should be incorporated in the Standard.

2. General Recommendation about Paragraphs 6(b) and 12

For overall consistency with the rest of the Standard, we recommend replacing the wording “is a derivative” in the first and second sentence of amended paragraph 57(b) with “meets the initial net investment criterion.”

Amendment of Paragraph 10**1. Issue**

The Board proposes to amend paragraph 10(i) of the Standard to provide further guidance in determining when loan commitments are subject to the requirements of the Standard. Although we agree with the Board’s proposed amendment, we believe it is unclear whether the scope exception in paragraph 10(i) relates to the seller, who also is the potential originator, of a mortgage loan or other loans. We believe loan sales commitments, from the perspective of the seller, are subject to the requirements

of the Standard and, therefore, do not qualify for the exclusion in paragraph 10(i). In other words, a seller of loans under a loan sales commitment needs to determine whether the commitment meets the characteristics of a derivative. In addition, the ED does not address the accounting for loan commitments by the purchaser of other than mortgage loans.

Recommendation Specific to Issue

We believe the Board should further clarify the scope exception in paragraph 10(i) to state clearly that the exception does not relate to a loan sales commitment held by a seller of either mortgage loans or other than mortgage loans. Also, the Board should state clearly that loan commitments held by the purchaser of other than mortgage loans are not subject to the requirements of the Standard.

2. *General Recommendation about Paragraph 10*

Since the Board is adding additional paragraph 10 exclusions, we believe it is an appropriate time to clarify the interaction of paragraphs 10 and 12 of the Standard. Specifically, we recommend that the Board amend the introductory sentence to paragraph 10 (or elsewhere as deemed appropriate) to add the concept set out in DIG Issue No. B18, “Applicability of Paragraph 12 to Contracts That Meet the Exception in Paragraph 10(b)” (DIG Issue B18). Although DIG Issue B18 applies only to the normal purchases and normal sales exclusion, we believe the Standard should be amended to clarify that all contracts that meet the definition of a derivative in their entirety, but qualify for a scope exception under paragraph 10, should not also be assessed under paragraph 12.

Amendment of Paragraph 19

1. *Issue*

The Board proposes to delete paragraph 19 of the Standard. We believe paragraph 19 is important because it provides guidance about determining the change in fair value of financial assets or liabilities and, therefore, is a vital practice aid. Specifically, financial statement preparers and auditors have relied on that paragraph to determine that interest accruals related to financial assets and liabilities are excluded from the change in fair value utilized in various sections of the Standard.

Recommendation Specific to Issue

Retain paragraph 19.

Amendment of Paragraph 30(d)1. *General Recommendation about Paragraph 30(d)*

We agree with the proposed amendment to paragraph 30(d); however, due to the complexity of accounting for hedges of the variability of the functional-currency-equivalent cash flows for a recognized foreign-currency-denominated asset or liability that is remeasured at spot exchange rates under paragraph 15 of FASB Statement No. 52, *Foreign Currency Translation*, we recommend including an example of that accounting to assist financial statement preparers and auditors in understanding the Board's intent. Such an example could be taken from those currently on the FASB's Web site. Further, in the proposed amended paragraph, the Board provides guidance on the accounting for the option component in an option-based hedging relationship when the assessment of effectiveness and measurement of ineffectiveness is based on total changes in the option's cash flows. That guidance requires an entity to reclassify each period on a rational basis to or from OCI an amount that adjusts earnings for amortization of the cost of the option. To clarify the guidance in paragraph 30(d) related to non-option-based hedging relationships, we believe the Board should state clearly that the accounting treatment described in the amended paragraph that parallels the above guidance for option-based hedging relationships relates to hedging relationships in which the assessment of effectiveness and measurement of ineffectiveness is based on total changes in the non-option-based instrument's cash flows.

Amendment of Paragraph 57(c)(3)1. *Issue*

Originally, paragraph 57(c)(3) provided general guidance on the application of the concept of readily convertible to cash. In the proposed amendment, the Board has added an example of a specific fact pattern involving stock purchase warrants in which a 32-day sale restriction on the sale of the underlying stock affects whether the stock is readily convertible to cash. Further, the amendment states that for any other fact pattern no sale restriction, no matter whether for more or less than 32 days, would affect the determination of whether an underlying in a contract is readily convertible to cash. We understand that the Board does not wish to establish a bright line as to what kind of sale restriction affects the determination of an underlying being readily convertible to cash for all types of contracts. However, we do not understand how no sale restriction can affect that determination. In paragraph 265 of the basis for conclusions in the Standard, the Board explains that if the assets to be exchanged or delivered are themselves readily convertible to cash, the risks of owning and delivering the assets are minimal or nonexistent. The Board also states

that "... the parties generally should be indifferent as to whether they exchange cash or the assets associated with the underlying." We would expect that parties would not be indifferent whether they exchange cash or an asset that cannot be sold for a period of time. In addition, we believe that the Board's view conflicts with FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities* (Statement 115), which defines as "restricted" an equity security that has restrictions as to its sale that are longer than a year. We believe it is counterintuitive to assert that a "restricted" security is readily convertible to cash.

Recommendation Specific to Issue

We believe the Board should remove from the proposed language at the end of paragraph 57(c)(3) the statement that time restrictions imposed by a stock purchase warrant on the sale or transfer of shares of stock that are received from the exercise of that warrant issued by an entity for *other* than its own stock do not impact the determination of whether those shares are readily convertible to cash. If not, the Board should address the apparent inconsistency between this principle and the principle of "indifference" inherent in the concept of readily convertible to cash and the principle of "restricted" in Statement 115 in its basis for conclusions in the Standard.

2. *Issue*

In the proposed amendment to paragraph 57(c)(3) in the ED, the Board provided a specific fact pattern, i.e., a stock purchase warrant for the purchase of the issuer's own equity that has a sale restriction of 32 days. Does the exception provided include stock purchase warrants issued by *consolidated subsidiaries*? Specifically, what is the definition of "issued by an entity for only its own stock?"

Recommendation Specific to Issue

If the Board determines the proposed amendment to paragraph 57(c)(3) is necessary, we believe the exception related to stock purchase warrants issued by an entity for only its own stock should be clarified to state that its own stock includes that of its consolidated subsidiaries.

3. *General Recommendations about Paragraph 57(c)(3)*

In the proposed ED, we believe the parenthetical reference added to 57(c)(3), which states "(The notion of *readily convertible to cash* shall be applied to a contract throughout its life, not only at its inception.)" also should be included in paragraph 57(c)(2). Specifically, paragraph 57(c)(2) should be amended to include the following parenthetical reference after the first sentence: "(The notion of a *market mechanism* shall be applied to a contract throughout its life, not only at its inception.)" Further, it has become clear through the DIG process that the various

assessments required by the Standard at the inception of a contract also should be made throughout its life. Examples include the normal purchase and normal sale exception in paragraph 10(b), the equity exception in paragraph 11(a) and the non-exchange traded exception in paragraph 10(e). When ongoing assessments are not appropriate, the DIG has made it clear, for example, DIG Issue No. A10, “Assets That Are Readily Convertible to Cash,” which specifically states that the assessment of the significance of conversion costs on the readily convertible to cash assertion should be performed only at the inception of the contract. Therefore, we believe that it would be helpful if the Standard were amended to provide a general statement that, unless stated otherwise, all assessments of individual contracts relative to the provisions of the Standard should be applied to a contract throughout its life, not only at its inception.

Since the Board has amended the “initial net investment” criterion of paragraph 6(b), we recommend amending paragraph 57(b) of the Standard to conform the first sentence of the subparagraph with the language in paragraphs 57(a) and 57(c). Specifically, clarify that the purpose of the test and, therefore, the discussion in paragraph 57(b) is to determine whether the contract meets the “initial net investment” criterion.

Amendment of Paragraph 68(b)

1. *Issue*

Based on our reading, the proposed amendment to paragraph 68(b) appears to preclude from qualifying for the short-cut method of accounting (i.e., assumption of no ineffectiveness) interest rate swaps containing embedded mirror-image call or put options as discussed in paragraph 68(d) that have a fair value of zero at inception. It is our understanding that this change was necessitated by the proposed amendment to paragraph 6(b) related to option-based contracts. Specifically, the proposed amendment to paragraph 6(b) would require that a zero-value interest rate swap containing embedded mirror-image call or put options be bifurcated into a debt host instrument, with a fair value equal to the fair value of the swap instrument excluding any call or put options, and a compound derivative instrument that comprises an at-market swap with embedded call or put options, with a fair value equal to the fair value of the embedded options. Subsequent to bifurcation of the zero value swap (the hybrid), we believe the bifurcated compound derivative would qualify for the short-cut method of accounting prescribed in paragraph 68, assuming all of the other conditions related to the derivative instrument and the hedging instrument are met.

Recommendation Specific to Issue

The proposed amendment should be revised to clarify that an entity should bifurcate into a host contract and a compound derivative pursuant to paragraphs 6(b) and 12 through 16 interest rate swaps that contain embedded mirror-image call or put options as discussed in paragraph 68(d) that have a fair value of zero at inception. Further, the Board should clarify that once bifurcated, the compound derivative could qualify for the short-cut method of accounting for interest rate swaps if the fair value of the compound derivative is equal to the fair value of the option component of the swap and all of the other conditions related to the derivative instrument and the hedging instrument are met.

Application of Statement 133 to Beneficial Interests That Arise in a Securitization

Amendment of Paragraphs 58(d) and 59(f)

1. *Issue*

The proposed amendment to paragraph 58(d) states, “Beneficial interests arising from securitization transactions that distribute noncontractual cash flows to beneficial interest holders do not satisfy the [scope exception] criterion of paragraph 14(a). Paragraph 14(b) [scope exception criterion] is satisfied if the beneficial interests in the securitized assets receive cash flows that arise solely from the particular assets that were securitized.” Since beneficial interests receive their cash flows from the cash flows of the securitized assets, we do not understand how any beneficial interest would fail paragraph 14(b).

Additionally, an understanding of the definition of the phrases “noncontractual cash flows” and “arise solely from the particular assets” is critical in determining whether the requirements of paragraph 14(a) and 14(b) have been met.

- Would an equity security be considered to have noncontractual cash flows because equity instruments generate cash flows only upon sale of the security or receipt of dividends that are declared and paid at the issuer’s discretion?
- Would interest received on a fixed-rate security issued by an SPE that holds only fixed-rate debt securities, be considered noncontractual if the fixed-rate of interest paid by the SPE is less than the fixed-rate received by the SPE on its debt securities, because the financial instrument has a contractual cash flow that is different from the actual cash received?
- Would a fixed-rate beneficial interest be considered to have received cash flows that arise solely from the particular assets securitized if the assets in the trust were variable rate, but the fixed-rate beneficial interest holder has a priority distribution on the cash received by the SPE?

We acknowledge that answers to these questions are in, or can be derived from DIG Issue No. C17, “Application of the Exception in Paragraph 14 to Beneficial Interests that Arise in a Securitization.” However, we believe the articulation of these concepts should be part of the Standard.

Recommendation Specific to Issue

We recommend clarifying the discussion in paragraph 58(d) to ensure that the distinction between noncontractual cash flows and cash flows not arising solely from the assets held by the securitization vehicle is evident. Further, since the excerpt of paragraph 58(d) related to paragraph 14(a) appears to provide an example of beneficial interests that would not satisfy the criterion of paragraph 14(a), we recommend that paragraph 58(d) also should provide an example of disqualifying characteristics related to paragraph 14(b).

2. *Issue*

Paragraph 59(f) was added to provide guidance on applying paragraph 14. We believe that paragraph 59(f) calls for a three-step analysis. First, a beneficial interest should be analyzed relative to paragraph 14 to determine whether the interest qualifies for the scope exception in that paragraph. If the instrument qualifies, no further analysis is required. Second, if the beneficial interest does not qualify, based on the terms of the beneficial interest, the beneficial interest should be analyzed relative to paragraph 6 of the Standard to determine whether the instrument, in its entirety, is a derivative. If the instrument qualifies as a derivative in its entirety, no further analysis is required and the instrument should be accounted for as a derivative pursuant to the Standard. If the instrument does not qualify in its entirety as a derivative instrument, the beneficial instrument should be analyzed relative to paragraphs 12-16 of the Standard to determine whether it contains any embedded derivatives. We believe this three-step analysis has not been clearly communicated in paragraph 59(f).

Recommendation Specific to Issue

The Board should revise the proposed wording to clarify the analysis process required by paragraph 59(f). Further, the Board should make an affirmative statement in paragraph 14 that instruments that meet the scope exception in paragraph 14 do not require further analysis under paragraph 6 and paragraphs 12 through 16.

Bifurcation Of Credit Derivatives Embedded In Beneficial Interests In Securitized Assets – Issuer Accounting

1. *Issue*

DIG Issue No. B36, “Bifurcation of Embedded Credit Derivatives,” (DIG Issue B36) and DIG Issue No. D2, “Applying Statement 133 to Beneficial Interests in Securitized Financial Assets (a Resolution of the Issues Raised in Implementation Issue D1),” (DIG Issue D2) discuss accounting for credit derivatives embedded in debt host contracts. DIG Issue B36 principally deals with whether an embedded credit derivative should be considered clearly and closely related to its host contract. Example 3 of DIG Issue B36 concerns a credit derivative embedded in a debt host contract issued by an SPE and the response concludes that “there is no embedded credit derivative to be bifurcated because the credit risk of the actual securitized assets is passed directly to the beneficial interest holders.” DIG Issue D2 states that “if either prepayment or credit risks are embedded in a subordinated beneficial interest and those risks relate only to the securitized assets, then those implicit prepayment or credit derivatives should not be bifurcated from the host contract.” This conclusion implies that the embedded derivatives are “clearly and closely related” to the host contract.

In many cases, we believe that a credit-related feature embedded in a beneficial interest issued by a securitization vehicle and related to the assets of the securitization vehicle may qualify as a credit guarantee contract. However, this possibility is not explored in relation to the discussion of the above issues regarding bifurcation of embedded derivatives.

Also, we note that (as discussed in Example 1 of DIG Issue B36) a credit-sensitive payment embedded in a debt instrument issued by a substantive operating entity but referenced to an instrument issued by a third party, would require bifurcation as a separate derivative (assuming that the embedded feature was not exempt as a financial guarantee contract) and could not be considered clearly and closely related to the debt host, even if the issuer of the debt instrument held the referenced third-party instrument. This is a different result from that apparently reached in relation to an instrument issued by an SPE.

Recommendation Specific to Issue

The final guidance should include discussion of the application of the scope exemption for financial guarantee contracts to beneficial interests in securitized assets. In addition, the Board should review the inconsistency between the treatments described above for other credit-sensitive payment features embedded in debt host contracts issued by SPEs versus those issued by non-SPEs. If the Board concludes that different treatment should apply to the two types of issuers, the guidance should clarify whether the treatment specified for SPE-issued instruments also should apply in the consolidated financial statements of the parent, which include an SPE.

Impact on Qualifying Special Purpose Entities

1. *Issue*

Statement 140 permits a QSPE to hold only passive derivative instruments that pertain to beneficial interests (other than another derivative financial instrument) issued or sold to parties other than the transferor, its affiliates, or its agents. The guidance for determining whether a freestanding derivative or an embedded derivative pertains to a beneficial interest is intended to be contained in the Q&A Document. It is not clear from the examples provided in the Q&A Document what principle the Staff is applying to determine whether an embedded derivative pertains to a derivative financial instrument or a beneficial interest issued to a third party. For example, a QSPE holds prime-based floating-rate loans, issues LIBOR-based beneficial interests held by third parties, and the transferor holds the residual interests. This residual interest held by the transferor essentially has a basis swap embedded in it. Pursuant to DIG Issue D2, since the basis swap feature is not clearly and closely related to the debt host it should be bifurcated. This feature is considered an embedded derivative instrument issued by the QSPE to which the transferor is the counter party.

If the QSPE were to enter into a freestanding basis swap, the terms of which were consistent with the requirements of paragraphs 35(c)(2), 39, 40, and 41 of Statement 140, the derivative instrument would not taint the QSPE. If this same derivative feature were embedded in the retained interest, as in the above example, the Q&A Document does not provide guidance on how to determine to what beneficial interest this embedded derivative pertains. Based on the guidance in Question 3, Example 2, of the Q&A Document related to a freestanding derivative, we believe this embedded derivative would pertain to the beneficial interests held by the third parties.

Recommendation Specific to Issue

Expand the guidance in the Q&A Document to include additional examples of embedded derivatives, including a situation in which an embedded derivative would taint the qualifying status of the QSPE. Additionally, the guidance should include how to apply the requirements of paragraphs 35(c)(2), 39, and 40 of Statement 140 to an embedded derivative including the principle for determining to what the embedded derivative pertains. For instance, a basis for making this determination could be analyzing which risk is being counteracted by the embedded derivative. The examples should include a derivative embedded in the transferor's residual interest (like those outlined in Attachment 2 to DIG Issue D2). Another example should include an embedded derivative in a senior tranche issued by the QSPE, such as an interest only tranche that is senior to the residual held by the transferor but subordinate to other senior tranches issued by the QSPE. In particular, there should

be further elaboration as to whether and how the criteria in paragraphs 40 (b) and 40 (c) of Statement 140 are satisfied.

2. *Issue*

We understand that the Board's decision to significantly restrict the QSPE's ability to hold derivative financial instruments was intended to prevent entities from circumventing the accounting requirements of the Standard. When accounting for transactions within the framework established by the proposed amendment to the Standard, a number of QSPE structures that are currently in use will no longer be considered qualifying. For example:

- An SPE that holds equity securities as part of its assets may not be a qualifying SPE. As noted in DIG Issue No. B12, "Beneficial Interests Issued by Qualifying Special-Purpose Entities," all beneficial interests issued by a QSPE would be considered debt hosts. Since these beneficial interests classified as debt hosts would have payment streams based on equity securities, an embedded derivative feature exists that would require bifurcation. Statement 140 would then require an analysis to determine to what the embedded derivatives pertain.
- Net Interest Margin Securities (a securitization of retained interests from other securitizations), likely will have embedded derivative instruments that will require bifurcation from both the assets within the QSPE and the beneficial interest issued by the QSPE, which would likely disqualify the QSPE.

Recommendation Specific to Issue

To assist in interpreting the application of the Q&A Document to many of the complex structures existing today, the Board should provide examples detailing whether these types of structures will result in derivatives required to be accounted for separately pursuant to the Standard and the impact such derivatives will have on the qualifying status of the SPE.

3. *Issue*

Certain revolving securitization structures that have freestanding or embedded derivatives that require derivative accounting under the ED, may no longer be qualifying SPEs under Statement 140. Some of these revolving structures may be unable to resolve problematic derivatives without tainting the qualifying status within the timeframe provided under the ED.

Recommendation Specific to Issue

Consideration should be given to the ED's effect on certain revolving structures, such as Master Trusts, and the timeframe for addressing the effects of the accounting set forth in the ED.

Derivative Instruments That Are Liabilities

1. Issue

The response to Question 2 in the Q&A Document states "... a qualifying SPE can enter into derivative financial instruments that are liabilities (for example, written options) but only if they conform to the applicable provisions of paragraph 35(d) (3) if held by the transferor, its affiliates, or its agent or paragraphs 35(d)(2) and 44 if held by another party." The response, as worded, suggests the only requirements a qualifying SPE must meet to hold a derivative financial instrument that is a liability are the permissible asset disposition conditions of a qualifying SPE under Statement 140. Accordingly, under this interpretation a qualifying SPE would be permitted to hold a written option that indexes the payout of a beneficial interest to something unrelated to either the underlying assets or beneficial interests, provided the written option meets permissible asset disposition conditions of a qualifying SPE in paragraphs 35 (d) and 44 in Statement 140.

Recommendation Specific to Issue

If the limitation discussed above reflects the intention of the FASB Staff, the response to Question 2 in the Q&A Document should state explicitly that derivative financial instruments that are liabilities held by a qualifying SPE are not subject to the limitations imposed by paragraphs 35 (c) 2, 39, and 40 of Statement 140. Alternatively, clarify which provisions of Statement 140 limit the type of derivative financial instruments that are liabilities that a qualifying SPE may hold.
