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Financial Accounting Standards Board  
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Letter of Comment No: 26  
File Reference: 1100-163  
Date Received: 7/1/02

**Re: File Reference No. 1100-163, *Amendment of Statement 133***

Dear Ms. Beilstein:

We appreciate the opportunity to provide comments to the Exposure Draft (ED) of the Proposed Statement of Financial Accounting Standards, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities*, and the guidance in tentative Statement 133 Implementation Issues Nos. A20, B12, B36, C17, D2 and E21.

We commend the FASB's efforts to be responsive to current concerns regarding the accounting for derivative instruments and beneficial interests under SFAS 133. However, we find the proposed guidance overly complicated and difficult to apply without providing additional financial transparency to financial statement users. Accordingly, we suggest that the FASB reconsider the complexity of the proposed guidance.

**Definition of a Derivative**

While certain derivatives may contain financing or investing elements that need to be carefully evaluated, the existing guidance on the definition of a derivative is adequate in making this assessment. The new specifications regarding initial net investments could result in the recognition of new hybrid instruments and impose increased process burden and implementation issues on the preparers of financial statements. For instance, in Example No. 3 in DIG Issue A20, the interest rate swap with an embedded option does

not meet the new definition of a derivative because the initial net investment is zero rather than the fair value of the option. Under the tentative guidance, this instrument must now be treated as a hybrid instrument requiring bifurcation of the embedded derivative and the assignment of the option premium to the host contract. This accounting treatment is overly complex and does not improve financial transparency. We suggest the Board avoid the proposed bright line thresholds, and instead continue to utilize the principle-based accounting that exists in the current definition of a derivative.

### **Applying Statement 133 to Beneficial Interests in Securitized Financial Assets**

The tentative guidance requires beneficial interest holders to perform an evaluation of the holdings of the special purpose entity (SPE) rather than looking only at the terms of the beneficial interest itself. This proposed model for evaluation of beneficial interests under SFAS 133 will not only be difficult to implement but could result in inconsistent accounting treatment for beneficial interests with the same economic characteristics. This evaluation also places a significant burden on the holders of the beneficial interests without providing any meaningful benefit. The accounting for beneficial interests is already adequately addressed by SFAS 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, SFAS 115, *Accounting for Certain Debt and Equity Securities*, and EITF Issue 99-20, *Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interest in Securitized Financial Assets*.

### **Beneficial Interest Issued by Qualifying Special Purpose Entities**

Under the tentative guidance, any securitization of equity instruments by a qualifying special purpose entity (QSPE) will require the bifurcation of the beneficial interest into a debt host contract and an embedded equity derivative. We believe that all beneficial interests issued by QSPEs should not be presumed to have a debt host contract and instead should be evaluated based on their characteristics using existing guidance.

In addition, by applying DIG Issue B12 only to beneficial interests issued by QSPEs, it is possible that the same beneficial interest would have different accounting treatment and balance sheet classification depending upon whether the beneficial interest was issued by a qualifying or non-qualifying SPE.

Lastly, the response for Example No. 3 in DIG Issue B12 makes reference to the embedded feature incorporating a floor that effectively limits loss. We are confused by this reference, as all equity contains a theoretical floor (of zero) that limits the potential loss to the investors but is not bifurcated and accounted for separately.

### **Effect on Qualifying Special Purpose Entities**

We are concerned that the application of the proposed guidance to beneficial interests resulting in the recognition of embedded derivatives may prevent SPEs from being QSPEs pursuant to SFAS 140. We suggest FASB evaluate the potential impact of the proposed guidance on QSPEs and consider amending certain provisions of SFAS 140 to ensure that there are no unintentional consequences.

### **Conclusion**

Again, we appreciate the FASB's effort to provide additional guidance on accounting for derivatives, however, we believe that further simplification is needed concerning the accounting for beneficial interests. Further, we maintain that the process burden associated with the accounting for the additional hybrid instruments created by the change in the definition of a derivative will not enhance financial transparency.

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We hope that these comments are useful for your deliberations. If you have any questions regarding this letter, please call me (212-602-1776) or Melanie Pinto (212-602-1783) or send an electronic message to: [corporate.accounting.policy@db.com](mailto:corporate.accounting.policy@db.com).

Very truly yours,

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