



December 8, 2006

LETTER OF COMMENT NO. 11

Mr. Lawrence Smith
Director of Technical Application & Implementation Activities
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, Connecticut, 06856-5116

Re: File Reference: Proposed Issue B40

Dear Mr. Smith:

Citigroup is pleased to have the opportunity to comment on the proposed FAS 133 Implementation Issue B40, *Embedded Derivatives: Application of Paragraph 13(b) to Securitized Interests in Prepayable Financial Assets* (Proposed Issue B40).

We appreciate the FASB's prompt attention to addressing concerns regarding the application of FASB Statement No. 155, Accounting for Certain Hybrid Instruments, to mortgage-backed securities and asset-backed securities (MBS/ABS) with prepayment features. We fully support the Board in issuing the Proposed Issue B40 as soon as possible to accommodate reporting deadlines for calendar year-end companies. While we acknowledge that Proposed Issue B40 would significantly simplify and ease the application of FAS 155 to certain MBS/ABS with embedded call options that would otherwise be subject to bifurcation, we believe that Proposed Issue B40 does not alleviate any burden for a significant number of securities. We would appreciate the Board's considering a more practical approach in the Proposed Issue B40 to ensure that the benefits outweigh the cost, as the way it is written now it may not be the case.

One of the criteria in Proposed Issue B40 requires that no underlying financial assets may contain an embedded derivative that requires bifurcation other than a prepayment option, leading to the conclusion that investors would need to perform due diligence on

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each underlying financial asset in order to make that determination. For conforming residential mortgage loans, we should be permitted to assume that there are no bifurcatable embedded derivatives other than a prepayment option. However, for nonconforming loans (e.g., jumbo loans) or asset-backed securities, where the underlying assets may have varying terms, that may not be the case. Without some practicability guidance in the Proposed Issue B40, investors in those MBS/ABS would be required to examine each underlying loan/asset document to ensure that it does not contain another embedded derivative that would require bifurcation. Such diligence is simply not practicable for each investor to undertake individually and may not be possible, as there is no information available to investors to perform this analysis. Incorporating that task into the issuance process would require due diligence on each individual asset in a transaction, not simply on a representative sample basis, and would give a rise to a level of scrutiny that has never been applied in practice for most securitizations.

In addition, because Proposed Issue B40 clearly permits freestanding derivatives to be held by the issuing entity, we are not convinced that criterion (b)'s prohibition on embedded derivatives in the assets underlying the MBS/ABS is of any incremental value over criteria (a) and (c) by themselves (Attachment A). Therefore, we encourage the Board to reconsider the cost and burden of criterion (b) and whether it provides any incremental or meaningful improvement in financial reporting for the investor.

We agree that the proposed transition provisions are reasonable and practicable. We encourage the Board to issue the Proposed Issue B40 guidance as soon as possible so that it is effective prior to the reporting deadlines for calendar year-end companies.

If you have any questions, please feel free to contact me at (212) 559-7721.

Very truly yours,

Robert Traficanti
Vice President and Deputy Controller
Corporate Accounting Policy

## Attachment A

Abstract from B40

## **QUESTION**

Are there circumstances in which a securitized interest in prepayable financial assets would not be subject to the conditions in paragraph 13(b) of Statement 133?

## RESPONSE

Yes. A securitized interest in prepayable financial assets would not be subject to the conditions in paragraph 13(b) of Statement 133 if it meets all of the following criteria:

- a. The right to accelerate the settlement of the securitized interest cannot be controlled by the investor
- b. The underlying financial assets do not contain an embedded derivative that requires bifurcation
- c. The securitized interest itself does not contain an embedded derivative (including an interest rate related derivative) for which bifurcation would be required other than an embedded derivative that results solely from the embedded call options in the underlying financial assets.

The objective of this guidance is to provide a narrow scope exception from paragraph 13(b) of Statement 133 for securitized interests that contain **only** an embedded derivative that is tied to the prepayment risk of the underlying prepayable financial assets and that meets the criteria above. If a securitized interest contains any other terms that affect some or all of the cash flows or the value of other exchanges required by the contract in a manner similar to a derivative instrument and those terms create an embedded derivative that requires bifurcation (ignoring the effects of the embedded call options in the underlying financial assets), those securitized interests would be subject to the requirements of paragraph 13(b) of Statement 133 (for example, an inverse floater).