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Russell G. Golden
Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, Connecticut 06856-5116

File Reference: Proposed Issue C22, Exception Related to Embedded Credit Derivatives

Dear Mr. Golden,

PricewaterhouseCoopers LLP appreciates the opportunity to respond to the proposed Derivatives Implementation Group Issue No.C22, *Exception Related to Embedded Credit Derivatives* (the "proposed Issue").

The Board's stated objective in issuing the proposed Issue is to improve financial reporting by resolving some potential ambiguity about the breadth of the embedded credit derivative scope exception in paragraph 14B of Statement of Financial Accounting Standards No.133, *Accounting for Derivative Instruments and Hedging Activities* (FAS 133). We understand that the Board is specifically concerned that this guidance could be interpreted to apply broadly to all embedded credit derivative features in interests in securitized financial assets, including those unrelated to the subordination of one beneficial interest to another. We also understand that there were concerns raised to the International Accounting Standards Board regarding differences between the accounting for some synthetic collateralized debt obligations under U.S. GAAP and International Financial Reporting Standards (IFRS).

The current accounting model for interests in securitized financial assets is complex. Paragraphs 14A and 14B and the related examples in Appendix B of FAS 133 provide a framework for the identification and evaluation of embedded credit derivatives in interests in securitized financial assets. To date, we believe preparers and auditors have exercised their professional judgment in the application of this model to complex financial instruments, and we are not aware that any problems have arisen in practice as a result of an overly broad interpretation of the scope exception.

We continue to support the current accounting model for determining whether an interest in securitized financial assets is a freestanding derivative or contains an embedded derivative requiring bifurcation. We believe this determination should be based on an assessment of whether or not the assets, liabilities and other financial instruments that comprise the securitization transaction support the contractual terms of the beneficial interests. We also agree that the concentration of credit risk in the form only of subordination of one beneficial interest to another should not be considered an embedded derivative that should be subject to bifurcation and separate accounting. Although we do not believe that a change is necessary, we do not object to the Board's proposed amendment to FAS 133. However, it should be noted that the proposed amendment will not result in completely converged accounting for synthetic collateralized debt obligations under U.S. GAAP and IFRS.



If the Board elects to proceed with the proposed Issue, we have outlined in the Appendix to this letter several recommendations to clarify the revised guidance. We believe these recommendations would better illustrate the application of the guidance to single tranche securitizations. They also highlight that the presence of subordination of one financial instrument to another does not exempt a holder of a beneficial interest from the need to evaluate credit risk that is not related only to subordination under paragraphs 12, 13 and 14A. The Appendix also includes our comments relating to disclosures, effective date and transition guidance.

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If you have any questions regarding our comments, please contact John Althoff (973-236-7288) or Francois Grunenwald (973-236-4315).

Sincerely,

Price waterhouse Coopers LLP

**Derivatives Implementation Group
Issue No. C22, Exception Related to Embedded Credit Derivatives**

Examples 38 and 40

Below are our proposed edits to Examples 38 and 40 as included in the proposed Issue. Added text is underlined and deleted text is ~~struck out~~.

Paragraph 200D:

Example 38: A Securitization That Introduces New Credit Risk. An SPE holds a credit derivative referenced to Company A and high-quality bonds, but issues a single tranche of beneficial interests explicitly referenced to Company B (thus, the cash flows relating to changes in the credit risk of Company B are not present in the financial instruments held by the SPE). The beneficial interests would be a hybrid financial instrument with an embedded derivative subject to the application of paragraphs 12, 13, and 14A because the embedded credit derivative feature referenced to Company B is not based only on the concentration of credit risk in the form of subordination of one financial instrument to another and because the financial instruments held by the SPE might not provide the necessary cash flows related to the embedded credit derivative feature referenced to Company B. However, if the beneficial interests were explicitly referenced to Company A, the bifurcation of the embedded credit derivative would not be required under paragraphs 12, 13 and 14A. The economic characteristics and risks of the embedded credit derivative feature would be considered clearly and closely related to the economic characteristics and risks of the host contract because the financial instruments held by the SPE provide the necessary cash flows related to the embedded credit derivative feature referenced to Company A.

Paragraph 200F:

Example 40: Fully Funded Synthetic CDO. An SPE that holds U.S. Treasury securities and that wrote a credit default swap on a referenced credit to a third party, with a smaller notional amount than the U.S. Treasury securities, issues various tranches of credit-linked beneficial interests to investors that differ in terms of priority for the distribution of cash flows from the SPE. The assets in the SPE are sufficient to fund any losses on the credit default swap. Thus, none of the tranches expose the investor to potential future payments related to defaults on the written credit default swap; the investor cannot lose more than its original investment. Rather, the investor is exposed to a potential reduction in its future cash inflows, which is the effect of the credit-related risk. That reduction in future cash flows is allocated among the tranches by the subordination of one tranche to another. Under paragraph 14B (as revised), the investor's embedded credit derivative feature is not an embedded derivative subject to the application of paragraphs 12, 13, and 14A of Statement 133 because it relates only to the concentration of credit risk in the form of subordination of one tranche to another. However, if one of the tranches of beneficial interests explicitly references credit that is not present in the financial instruments held by the SPE, that beneficial interest would be a hybrid financial instrument with an embedded derivative that would require bifurcation as a result of the application of paragraphs 12, 13, and 14A of Statement 133.

Disclosures

The proposed amendment to the second sentence of paragraph 14B of FAS 133 could raise a question as to the applicability of the new credit derivative disclosures under FASB Staff Position FAS 133-1 and FIN 45-4, *Disclosures about Credit Derivatives and Certain Guarantees* (the "FSP"). By limiting the scope exception for concentration of credit risk in the form only of subordination to the application of only paragraphs 12, 13 and 14A, one could conclude that the FSP's new disclosure requirements for credit derivatives should be applied even if no bifurcation of the credit derivative feature is required. We believe that the intent of the FSP is to require disclosure for only (1) freestanding credit derivative instruments, (2) embedded credit derivative features requiring bifurcation, and (3) embedded credit derivative features that would have been bifurcated from a hybrid instrument had the fair value option not been elected. We therefore recommend the Board clarify the application of the credit derivative disclosure requirements for those embedded derivatives that are not required to be bifurcated under paragraphs 12, 13, 14A or 14B.

Transition and effective date

With regard to the effective date of the proposed implementation guidance, we recommend that the Board provide clarification as to how "the first date of [the reporting entity's] first fiscal quarter beginning after December 15, 2008" should be interpreted, for example by private companies. It is unclear whether the first "fiscal quarter" should be interpreted the same as the first "interim period", which is the more commonly used reference by the Board.

We also recommend that the effective date for the proposed Issue be extended. Significant efforts will be required by preparers to appropriately implement the revised guidance and document the new basis for conclusions for all existing interests in securitized financial assets subject to the scope of the proposed Issue.

Lastly, we recommend that the transition guidance be revised. In our view, a hybrid instrument should be assessed under the revised provisions at the date it is acquired, consistent with FAS 133, as opposed to assessment as of the date of adoption of the proposed Issue. Applying the guidance on the date of adoption could result in different conclusions from those that would have been reached if the assessment was at the date of acquisition.