



LETTER OF COMMENT NO. 13

July 3, 2008

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

File Reference: Proposed FSP FAS 133-b and FIN 45-c

Dear Mr. Golden:

We appreciate the opportunity to comment on proposed FASB Staff Position (FSP) No. FAS 133-b and FIN 45-c, "Disclosures about Credit Derivatives and Certain Guarantees: An Amendment of FASB Statement No. 133 and FASB Interpretation No. 45." We agree that the FASB could improve the information provided to users about the risks to which a writer of a credit derivative or financial guarantee is exposed; however, we do not believe the proposed disclosures represent an improvement over disclosures required currently. Therefore, we believe the Board should not issue a final FSP.

It appears that the Board may be reacting to issues arising out of the credit crisis and is attempting to fill a perceived gap in disclosures of the risks associated with credit derivatives. While we can appreciate that concern, we do not believe that creating incremental disclosures to address perceived inadequacies arising out of this crisis is helpful, particularly without assessing whether prior amendments to disclosures required by FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*. Rather than reacting to crises as they arise and throwing more disclosures into financial statements that are already overly complex, we believe the Board should undertake a project to create a disclosure framework that establishes principles that capture the nature and type of information investors need to make decisions.

We have the following specific concerns about the proposed FSP:

- Certain of the disclosures appear to overlap with disclosures required by other standards.
- The proposed FSP appears to recycle an idea (disclosure of notional amounts) that the Board rejected when it finalized FASB Statement No. 161, *Disclosures about Derivative Instruments and Hedging Activities*.

- The requirement to disclose the potential risks posed by the underlying obligations through disclosure either of current credit ratings or internal risk ratings will not necessarily provide investors with useful information.

Overlapping Disclosure

Certain of the proposed disclosures appear to be the same as, or similar to, disclosures that will be required when Statement 161 becomes effective, while other disclosures appear to overlap with the disclosures required by FASB Statement No. 107, *Disclosures about Fair Value of Financial Instruments*. The proposed FSP would require a seller of credit derivatives to disclose the following:

- Information that would enable users to assess the potential effect of those derivatives on its financial position, financial performance, and cash flows. This disclosure duplicates the information that will be required by paragraph 44 of Statement 133, as amended by Statement 161.
- The nature of the credit derivative and the reason(s) for entering into the credit derivative. Statement 133, as amended by Statement 161, will require a company to disclose, by underlying risk exposure, information about its objectives for holding or issuing derivatives, along with the context needed so the user will understand those objectives, and its strategies for achieving those objectives.
- The fair value of the credit derivative. Statement 133, as amended by Statement 161, will require a company to provide tabular disclosures showing the location and fair value of derivative instruments reported in the statements of financial position and financial performance, segregated by type of derivative contract.

Given the overlap between the proposed FSP and the disclosures required by other guidance, we do not understand the need for the guidance in the proposed FSP. Is the Board looking for information that goes beyond the disclosures that will be required when Statement 161 becomes effective?

Recycling Previously-Rejected Ideas

The proposed FSP would require a seller of credit derivatives to disclose the maximum amount of potential future payments it could be required to make under the terms of the credit derivative, without reduction for collateral it holds or amounts it would be entitled to receive under the terms of recourse or collateralization provisions. In most cases, that amount will equal the notional amount of the derivative contract. We do not believe that disclosure of notional amounts will provide useful information to most investors because the risk to which a seller of credit derivatives is exposed is often significantly different than the notional amount of the contract (for example, because the seller has recourse or the buyer has provided collateral).

We note that the Board, in the Exposure Draft of the proposed standard that became Statement 161, sought to require a company to disclose the notional amounts of its derivatives. Constituents were successful in persuading the Board that disclosure of notional amounts is not an accurate indicator of the magnitude of risks they are managing. In responding to that concern, the Board took a principles-based approach to disclosures, requiring a company to disclose information that would enable users to understand the volume of its derivative activities. We encourage the Board to assess the quality of the disclosures that companies provide once Statement 161 is effective before deciding to impose incremental disclosures, particularly ones the Board previously rejected for good and valid reasons.

Proposed Disclosures Will Not Be Helpful

In addition to our views on disclosures of notional amounts, we do not believe information about the status of the current external credit ratings of the underlying or the current internal categories/groupings based on the manner in which the seller manages its risk will be helpful to investors. Disclosing that a portfolio of loans on which a company has written a credit default swap is current at the date of the statement of financial position when the company knows from experience that a portion of those loans will ultimately default does not seem particularly helpful to us.

Our Recommendations

As noted above, we encourage the Board to defer adding new disclosures of derivative activities until it has a chance to study the disclosures that companies will make once Statement 161 is effective. However, if the Board feels compelled to take some action because of the credit crisis, we offer the following recommendations:

1. If the Board believes users require additional information to assess the risk exposure created by the underlying, we believe information about a company's expectations of loss emergence would be more relevant than disclosures about the status of the underlying. We assume that companies already incorporate information about future expected losses in estimating the fair value of a credit derivative at the date of the statement of financial position. As such, disclosure of that information may not require significant additional effort, but would provide investors with management's views of the risks inherent in the underlying obligations.
2. We believe, given the issues that have recently arisen in the credit default markets, the Board should encourage a seller of credit derivatives to provide qualitative disclosures when it believes the fair value of a credit derivative is not representative of the expected losses. In some cases, changes in the fair value of a credit derivative do not appear to be correlated with any observable changes in the financial strength of the issuer or the collateral. However, because the credit derivative is within the scope



of Statement 133 and not Statement 5, the seller of the credit derivative is obligated to recognize increasing losses, even while its expectations for paying out claims over the life of the derivative remains unchanged. While we understand that a company may be hesitant to disclose information indicating it expects losses to be less than the losses it is recognizing by marking the credit derivative to fair value, we believe that information would be helpful to investors. That disclosure would be particularly helpful when reasons other than changes in expected future losses (such as changes in market liquidity) are the primary causes of a decline in fair value. If the Board decides to require disclosure of the maximum amount of potential future payments a seller of a credit derivative could be required to make, we believe that information would be essential to avoid misleading investors.

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We would be pleased to discuss any of our comments with the Board or the FASB staff. Please direct any questions or comments to Jeff Ellis at 312-880-3019.

Sincerely,

/s/ Jeffrey H. Ellis

Jeffrey H. Ellis
Managing Director