



Deloitte & Touche LLP  
Ten Westport Road  
PO Box 820  
Wilton, CT 06897-0820

Tel: +1 203 761 3000  
Fax: +1 203 834 2200  
www.deloitte.com

June 30, 2008

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



LETTER OF COMMENT NO.

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

Dear Mr. Golden:

Deloitte & Touche LLP is pleased to comment on proposed FASB Staff Position 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 support the Board's efforts to increase transparency by requiring disclosure in the financial statements of an entity's exposure to risk from issuing credit derivatives and guarantees. Thus, we generally support issuance of this limited-scope proposal as a final standard but note that consideration should be given to certain aspects of the proposed amendments as discussed below.

However, we believe that the current approach to setting standards for financial instrument disclosures has been piecemeal. Such an approach does not produce a clear and complete set of disclosures and increases the burden on users and preparers of financial statements and auditors. We suggest that the Board explore a more comprehensive project on financial instrument disclosures that addresses (1) the need for new disclosures, such as those that would provide a more complete picture of the risks an entity faces and how those risks are managed and (2) the elimination of currently required disclosures that are not useful to users of the financial statements.

**Scope**

*Definition of a Credit Derivative*

The proposed FSP's definition of "credit derivatives" does not clearly articulate a principle that can be applied uniformly so as to allow a constituent to determine whether a given contract is within the FSP's scope. Paragraph 8 states that "credit derivatives generally are contracts in which the **underlying is related** to the credit risk of a specified entity . . ." (emphasis added). The definition's reference to "the underlying is related to the credit risk" is unclear, because many financial instruments have more than one underlying, not all of which may be tied to credit risk, or they may have an underlying that indirectly encompasses credit risk (i.e., the underlying may relate to more than one risk).

For example, entities may have difficulty determining whether a total return swap in which the underlying is a debt security of a specified entity would fall within the scope of the FSP. For such a contract, the underlying creates exposure to both interest rate risk and credit risk. Under the proposed FSP, this swap could be interpreted by some to be a credit derivative since its underlying is “related” to the credit risk of a specific entity. However others might reach a different conclusion depending on whether the underlying debt security is investment grade (i.e., it has minimal to moderate credit risk and potentially greater interest rate risk) or below investment grade (i.e., it has significant credit risk).

The final FSP and amended FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*, should incorporate a definition of a credit derivative that will enable constituents to easily assess whether a particular contract is within the scope of the FSP. This definition should clearly establish whether the value of a contract having multiple underlyings must be primarily driven by the referenced credit risk in order to be in the scope of the FSP or whether at least one of a contract’s underlyings must be primarily related to credit risk. For example, the following definition may help clarify the scope of the FSP: *Credit derivatives are financial instruments (e.g., futures, options, or swaps) whose price and value are predominantly derived from an event of default on, or the credit quality of, a third party’s obligations or a change in credit spreads.* The FSP also would be clearer if it specifically addressed whether total return swaps and other common credit-linked arrangements are within its scope.

#### *Embedded Derivatives*

It is unclear whether the amended disclosures in Statement 133 will apply to embedded derivatives that are not accounted for separately from their host contracts because the entire instrument is measured at fair value with changes in fair value recognized in earnings. Certain instruments contain embedded derivatives that incorporate credit risk exposures, and the value of the instrument may be affected by an event of default or a change in creditworthiness of a referenced entity. In some cases, these embedded derivatives may be separated, but in other cases an entity may choose to carry the entire cash instrument at fair value with changes in fair value recognized in earnings as permitted by FASB Statement No. 155, *Accounting for Certain Hybrid Financial Instruments*, or FASB Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*. The FSP should clarify whether an embedded credit derivative that is not separated from its host contract falls within the FSP’s scope. This may also require amendments to Statements 155 and 159.

#### **Amendments Proposed in Paragraph 10(a)**

##### *Approximate Term*

The requirement in paragraph 10(a) to disclose the nature of the credit derivative, including the “approximate term,” is confusing. Although this language conforms to the disclosure requirements of FASB Interpretation No. 45, *Guarantor’s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*, it is difficult to understand in the context of derivative instruments that have stated contractual terms. For example, the language does not indicate whether an entity should use discretion in determining whether it discloses the contractual terms or its estimate of when the credit derivative or guarantee may be required to be settled because of a credit event.

The proposed FSP also does not specify how an entity should disclose the approximate term for a group of similar credit derivatives. The FSP should state explicitly whether the intention is to

have entities disclose a range of terms or a weighted average term (whether contractual or estimated).

#### *Current Status of the Payment/Performance Risk of the Credit Derivative*

In describing the requirement to disclose the current status of the payment/performance risk of the credit derivative, the FSP notes that this status “could be indicated by . . . current external credit ratings of the underlying, when available.” Recent experience in the credit markets indicates that an external credit rating alone may not be the best indicator of the current status of the payment/performance risk. If the Board chooses to retain the external credit rating example, it should clarify whether an entity is permitted to disclose payment/performance risk information derived from internal sources in lieu of information that may be available from external sources. In other words, in preparing this disclosure, should entities give greater weight to information obtained externally? Also, if an entity chooses to disclose information derived from internal sources instead of information obtained externally, should that fact and the entity’s rationale also be disclosed?

#### **Amendment Proposed in Paragraph 10(d) — Consideration of Purchased Credit Protection**

The last sentence in paragraph 10(d) of the proposed FSP refers to consideration of purchased credit protection when estimating potential recoveries — a concept that is not included in the existing Interpretation 45 disclosure requirements. Paragraphs 6 and 7 of the proposed FSP state that amended Statement 133 will incorporate existing Interpretation 45 disclosure requirements and add a new requirement to disclose “the current status of the payment/performance risk of the guarantee.” The proposed FSP should also highlight that consideration of the effect of purchased credit protection is an additional new requirement. The Board should also consider whether a similar requirement should be included in the amendments to Interpretation 45.

#### **Amendments to Interpretation 45**

The amendments proposed in paragraphs A2(a) and (b) remove **all** derivatives from the scope of both (1) the initial recognition and initial measurement provisions and (2) the disclosure requirements of Interpretation 45. An effect of this amendment is that an entity will not be required to provide guarantee disclosures for derivatives that are not credit derivatives but nevertheless have characteristics of a guarantee. For example, paragraph A8(b) of Interpretation 45 observes that certain written put options are within the scope of Interpretation 45 and subject to its disclosure requirements. Under the proposed FSP, if a written put option is accounted for as a derivative, it will be outside the scope of Interpretation 45; however, such a derivative may also not be subject to the proposed disclosure requirements for credit derivatives if it does not meet the definition of a credit derivative.

If this is not the Board’s intent, the Board should consider revising the amendments to paragraphs 6 and 7 of Interpretation 45 as follows (suggested amendments to the proposed FSP are underscored):<sup>1</sup>

“Paragraph 6(h) is added as follows:

A guarantee that is accounted for as a credit derivative instrument at fair value under Statement 133, as defined in paragraph 44DD of Statement 133.”

---

<sup>1</sup> These revisions assume that a credit derivative definition will be developed and added to paragraph 44DD of Statement 133.

“Paragraph 7(a) is amended as follows:

A guarantee, other than a credit derivative as defined in paragraph 44DD of Statement 133, that is accounted for as a derivative instrument at fair value under Statement 133.”

The amendment to paragraph 13(a) of Interpretation 45 also should be clarified. The example of what might be disclosed as the current status of the payment/performance risk of the guarantee cites “current external credit ratings,” which is not the best example, particularly because many guarantee-type contracts or instruments related to credit risk will be in the scope of Statement 133. Further, the example could lead constituents to believe that credit risk exposure should be disclosed for all guarantees within the scope of Interpretation 45. The Board should consider providing disclosure examples for other common types of guarantees (e.g., a performance guarantee or tax indemnification).

#### **Addition of Example**

Certain guidance in the proposed FSP could be illustrated more clearly by the addition of a comprehensive example. For example, it is not clear whether the “groups of similar credit derivatives” noted in paragraph 10 of the proposed FSP could be aggregated at a level comparable to that shown in FASB Statement No. 161, *Disclosures About Derivative Instruments and Hedging Activities* (i.e., by type of derivative contract). If the Board intends the disclosure to be more granular than Statement 161’s requirements for credit derivatives (e.g., grouped by type of credit derivative contract, such as credit default swaps or credit spread options), a comprehensive example would clarify this difference. Readers would benefit most from an example that illustrates the disclosures that would be provided by an entity with a large portfolio of credit derivatives.

#### **Other Editorial Comment**

The description of credit derivatives in paragraph 1 of the proposed FSP should be consistent with the description in paragraph 8 to avoid confusion in application.

\*\*\*\*\*

Deloitte & Touche appreciates the opportunity to comment on the proposed FSP. If you have any questions concerning our comments, please contact Mark Bolton at (203) 761-3171.

Yours truly,

Deloitte & Touche LLP

cc: Bob Uhl