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## VIA ELECTRONIC MAIL

June 30, 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:

The Investment Company Institute<sup>1</sup> appreciates the opportunity to respond to the proposed FASB Staff Position, Disclosures about Credit Derivatives and Certain Guarantees: An Amendment of FASB Statement No. 133 and FASB Interpretation No. 45 (Proposal). The Proposal seeks to improve financial reporting by enhancing the transparency of the effect of credit derivatives and guarantees on an issuer's financial position, financial performance and cash flows. The Institute fully supports the Board's efforts to improve disclosure of these arrangements. We encourage the Board to do so in a flexible manner that does not place a disproportionate amount of emphasis on one form of risk (credit) relative to other risks associated with financial instruments (e.g., market risk, interest rate risk, currency risk).

Investment companies may buy or sell credit default swaps (CDS) for a variety of different reasons. For example, a fund may buy CDS to provide a measure of protection against default of an issuer (i.e., to reduce risk where a fund owns or has exposure to the reference obligation). A fund may sell CDS to gain credit exposure to a particular issuer. Under certain market conditions, the sale of a CDS may be a more liquid and lower cost means to gain credit exposure to an issuer than direct purchase of the issuer's debt. In this regard, a fund's investments in CDS should be viewed as providing long or short credit exposure to particular issuers in the context of its overall investment program. The associated financial statement

<sup>&</sup>lt;sup>1</sup> The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors and advisers. Members of ICI manage total assets of \$12.66 trillion and serve almost 90 million shareholders.

disclosures should not unduly emphasize one financial instrument (CDS) or one form of risk (credit) in relation to other instruments and risks associated with the fund's investment portfolio.

SEC registered investment companies that buy or sell CDS currently provide extensive financial statement disclosures regarding these arrangements. Such disclosures typically include both textual note disclosure on the nature and operation of CDS and tabular disclosure describing the terms of outstanding CDS at the report date. Textual note disclosures typically include: objectives, strategies, risks, cash flows, and credit events requiring performance. Tabular disclosures typically include: the reference entity, the counter-party, the pay/receive fixed rate, the expiration date, the notional amount, and the unrealized appreciation/depreciation (i.e., the fair value). Further, funds determine the fair value of their CDS daily for purposes of calculating net asset value per share. Our specific comments below are intended to enable funds and other issuers to provide disclosure that is meaningful to financial statement users given the nature of operations and the volume of CDS activity.

## Paragraph 10.a.

Paragraph 10.a. requires disclosure of the nature of the credit derivative, including the approximate term, reasons for entering into the contract, events or circumstances requiring performance, and the current status of the payment/performance risk. According to the Proposal, the current status of the payment/performance risk could be indicated by external credit ratings of the reference entity or internal categories or groupings based on the manner in which the entity selling the credit derivative manages risk.

We strongly support the ability of issuers to provide the required disclosures based on groups or categories of similar credit derivatives. For example, where the reasons for entering into a CDS, or the credit events requiring performance, are substantially similar for a number of different individual contracts, we believe the ability to provide the required disclosure for the group as a whole will make the process manageable for issuers without compromising the usefulness of the disclosure for investors.

If instead the Board seeks disclosure of the reasons for entering into a particular CDS or the specific events requiring performance for each individual contract, we are concerned these disclosures would overwhelm users and place undue emphasis on this one type of financial instrument. We note that funds currently do not describe the rationale for each individual security holding in their financial statements. As described more fully below, we have operational concerns with capturing this information for financial reporting purposes.

Providing external credit ratings for the reference entity would be one way to inform financial statement users of the payment/performance risk associated with a CDS. We believe, however, there may be other ways to provide users with an understanding of the payment/performance risk associated with the sale of a CDS and encourage the Board to provide flexibility in this regard.

For example, where an issuer provides the terms and current fair value of a CDS, a reader with an understanding of these instruments could readily assess the likelihood that the seller will

be called upon to perform in response to a credit event. An issuer that discloses: a) the "cost" of the position (i.e., the amount paid or received at inception, if any), b) the contracted credit spread (the fixed-rate received), c) the notional value, d) the term, e) the reference entity, and f) the current fair value, provides the reader with the terms necessary to assess the likelihood that the seller would be required to perform. Such assessment, based on the current fair value at the report date, would likely better reflect the payment/performance risk than external credit ratings, which often lag the market.

There may be other reasons why a fund would choose to communicate payment/performance risk in the manner described above, rather than provide external credit ratings. For example, where a reference entity is unrated, the fund may prefer not to disclose its own credit analysis, as this information may be viewed as proprietary. Also, where the reference entity is a basket or index comprised of issuers of differing credit quality, it is unclear what form of disclosure would be required. Finally, we note that funds that invest in fixed-income securities are not required to disclose external credit ratings for each of their individual security holdings. A requirement to disclose external credit ratings for reference entities would place undue emphasis on the credit risk associated with CDS.

## Effective Date

The Proposal would be effective for financial statements issued for fiscal years and interim periods ending after November 15, 2008. The Proposal requests comment on whether the proposed disclosures are operational and whether the proposed effective date will provide adequate time to implement the FSP.

We understand from our member firms that certain of the proposed disclosures may not currently be captured or maintained in fund financial reporting systems. For example, while the fund's portfolio manager would know the reasons for entering into the derivative, such information may not be captured on trade tickets or in the fund's financial reporting system. If a fund is an active participant in the CDS market, manually gathering these disclosures may be time consuming.

We note that FASB Statement No. 161, Disclosures About Derivative Instruments and Hedging Activities (FAS No. 161) is effective for fiscal years and interim periods beginning after November 15, 2008. FAS No. 161 requires disclosure of derivative instruments by type of risk (e.g., interest rate, foreign currency, credit, etc.). In order to provide adequate time to plan for and implement the proposed disclosures, we recommend that the Proposal's effective date be fiscal years and interim periods beginning after November 15, 2008. Concurrent effectiveness with FAS No. 161 would have the added benefit of providing the proposed disclosures for credit derivatives along with the comprehensive disclosures for all derivative instruments.

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We appreciate the opportunity to comment on the Proposal and would be pleased to provide any additional information you may require. Please contact the undersigned at 202/326-5851.

Sincerely,

/s/

Gregory M. Smith
Director – Operations/
Compliance & Fund Accounting