



March 6, 2007

LETTER OF COMMENT NO. 38

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

**File Reference No. 1510-100 — Proposed Statement of Financial Accounting Standards,
Disclosures About Derivative Instruments and Hedging Activities — an amendment of FASB
Statement No. 133**

Dear Mr. Smith:

Deloitte & Touche LLP (“Deloitte & Touche”) is pleased to comment on the December 8, 2006, Exposure Draft of the proposed Statement of Financial Accounting Standards, *Disclosures About Derivative Instruments and Hedging Activities* (the “proposed Statement”).

We applaud the Board’s effort to increase transparency about how entities use and account for derivative instruments and their related impact on the financial statements. We generally support the Board moving forward with its current narrow-scope project; however, as discussed in greater detail in Appendix A to this letter, we are concerned about the proposed Statement as it relates to:

- The usefulness and benefit of disclosing notional amounts, and
- The lack of clarity regarding the definition of contingent features and the potential implications of a broad interpretation of that definition.

Longer-term, we encourage the Board to explore a more comprehensive project to address disclosures for all financial assets and liabilities. The goal of this long-term project should be to provide a more complete picture of the risks an entity faces and how those risks are managed, including the financial statement impacts from financial instruments not designated in qualifying hedging relationships under FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*.

Our responses to the specific issues identified in the Notice for Recipients are included in Appendix A. Other comments and suggestions intended to improve the clarity of the proposed Statement are included in Appendix B.

Deloitte & Touche appreciates the opportunity to comment on the proposed Statement. If you have any questions concerning our comments, please contact Bob Uhl at (203) 761-3152.

Yours truly,

Deloitte & Touche LLP

cc: James A. Johnson

APPENDIX A
DELOITTE & TOUCHE LLP COMMENTS
Responses to Notice for Recipients
File Reference No. 1510-100

Scope

Issue 1: *The Board concluded that prescriptive guidance about how derivative instruments should be presented and classified in the financial statements should be excluded from the project's scope. Including presentation and classification guidance could potentially delay issuing a standard that would significantly improve the transparency about derivative instruments and hedged items. In addition, various presentation and classification issues related to derivatives and hedged items have an impact on the Board's current project on financial statement presentation and also would need to be addressed in the context of that project.*

Do you agree with the Board's decision to exclude from the scope of this proposed Statement prescriptive guidance about how derivative instruments should be presented and classified in the financial statements? Why or why not? (See paragraphs B5–B11 for the basis for the Board's conclusions.)

Deloitte & Touche response:

We agree.

Issue 2: *Statement 133 applies to both public and private entities. The requirements in this proposed Statement also would apply to both public and private entities. Do you agree that this proposed Statement should apply to both public and private entities? Why or why not?*

Deloitte & Touche response:

We agree. The relevance of the proposed Statement's disclosures is not dependent on whether the entity is public or private, or the size of the entity (e.g., market capitalization or sales). Rather, the relevance of the disclosures is dependent on the extent of and purpose for using derivatives.

Costs of Implementing the Proposed Statement's Disclosure Requirements

Issue 3: *This proposed Statement would require an entity to provide information on derivative instruments (including, but not limited to, notional amounts and fair value amounts), hedged items, and related gains and losses, by primary underlying risk, accounting designation, and purpose in the tabular format shown in Appendix A.*

Do you foresee any significant operational concerns or constraints in compiling the information in the format required by this proposed Statement? Are there any alternative formats of presentation that would provide the data more concisely? (See paragraphs B18–B20 for the basis for the Board's conclusions.)

Deloitte & Touche response:

The proposed Statement is unclear as to the appropriate level of aggregation by “purpose” within the required tabular disclosure. For example, paragraph B17 states, in part, that “[e]ntities **may** also deem it appropriate to provide information on specific exposures within each underlying risk category (for example, exposures to foreign currencies).” [Emphasis added] This implies that it may be appropriate to aggregate all exposures to foreign currencies from trading derivatives into a single line item (i.e., purpose category) in the table and that entities may provide **optional** qualitative disclosures by specific exposure.

The proposed Statement should clarify the appropriate level of aggregation by exposure required within the “purpose” category of the tabular disclosure. For entities that extensively use derivatives (e.g., derivative dealers), the cost of disclosing within the table each specific exposure (e.g., a separate line for each individual commodity and equity underlying a dealer's derivatives) would likely exceed the benefit because of the amount of information that would be required. Conversely, aggregating different specific exposures (e.g., natural gas, oil, and gold) into a single line item titled, for example, “derivatives used in commodities trading activities,” may produce information that is less relevant because users would not understand the actual risk exposures an entity faces through its derivatives. There is no “one-size-fits-all” approach, and therefore we recommend that the Board develop a principle that provides flexibility and, at the same time, results in the conveyance of sufficient and understandable information. Such an approach might be one that allows aggregation of different exposures, but requires entities to provide supplemental qualitative information sufficient to gain an understanding of the actual risk exposures.

Preparers are best suited to identify specific operational concerns. However, because the Statement's comment deadline coincided with the year-end financial reporting requirements of many entities, certain preparers might not have had the time to rigorously focus on the proposed Statement. Therefore, we encourage the Board to consider field testing, interviews with preparers, or other focused input from preparers to assess the feasibility of developing and maintaining the disclosures required by the proposed Statement.

Issue 4: *This proposed Statement would require disclosure of (a) the existence and nature of contingent features in derivative instruments (for example, payment acceleration clauses), (b) the aggregate fair value amount of derivative instruments that contain those features, and (c) the aggregate fair value amount of assets that would be required to be posted as collateral or transferred in accordance with the provisions associated with the triggering of the contingent features.*

Do you foresee any significant operational concerns or constraints in compiling that information for this disclosure? (See paragraphs B39–B42 for the basis for the Board’s conclusions.)

Deloitte & Touche response:

Yes. We do not believe that the term “contingent feature” is sufficiently defined. We interpret the proposed Statement to require disclosure of a narrow set of contingent features (e.g., a credit downgrade that results in the ability to terminate the agreement or accelerate payment). However, some may interpret the proposed Statement more broadly to require disclosure of all “contingencies” related to derivatives, such as:

- An underlying pertaining to the occurrence or non-occurrence of an event.¹
- Whether an underlying is above or below a strike price in an option.
- A foreign currency or commodity derivative with a “knock-out” feature. For example, a provision in which the derivative terminates or payments cease once the underlying rate or price increases above or below a specified level.

If defined broadly, preparers do not currently have the systems to collect this information and the benefit to users of voluminous information about a broad array of contingent features likely will not be of such a benefit to justify the cost. The Board should consider an approach that limits disclosure of contingent features to those features that accelerate payment or posting of collateral related solely to credit events of the entity.

¹ Paragraph 7 of Statement 133 indicates an underlying can be the occurrence or nonoccurrence of an event.

Disclosure of Notional Amounts

Issue 5: *This proposed Statement would require disclosure of notional amounts in tables that also will include fair values of derivative instruments by primary underlying risk, accounting designation, and purpose.*

Do you agree that this proposed Statement should require the disclosure of notional amounts? Why or why not? (See paragraphs B21–B25 for the basis for the Board’s conclusions.)

Deloitte & Touche response:

We believe that disclosures of notional amounts might not be relevant and have the potential to be misleading. Thus, we recommend that the Board consider eliminating this disclosure requirement in the final Statement.

Designated and Qualifying Accounting Hedges

A derivative’s notional may not always be a reliable indicator of the actual risk being hedged. For example, if an entity is hedging \$10,000,000 in fixed rate debt due in three years with three interest rates swaps (one covering each successive year), the notional amount of the derivatives would be \$30,000,000. In this situation, disclosing the notional amount implies that the entity is exposed to \$30,000,000 of fixed rate debt, when in fact the actual exposure is \$10,000,000. The Board should consider whether, for qualifying hedges, the more relevant disclosure is information about the hedged item (e.g., the principal amount and term of a fair value hedged item, or the amount and expected periods of hedged cash flows).

Trading Activities

For entities that extensively use derivatives in trading operations, the disclosure of notional amounts may not be operationally feasible nor provide useful information. On the basis of the guidance in the proposed Statement, these entities may reasonably conclude that the “purpose” of using derivatives is for “trading,” and therefore may include a single line item in the required tabular disclosure for these derivatives. For example, an energy trader might enter into derivatives with natural gas, oil, and coal underlyings. This entity would be unable to aggregate its trading positions into a single line item because the notional amounts are in disparate units such as BTUs, barrels, and tons. While an entity could potentially determine the USD equivalent for the notionals, the user would be unable to ascertain the magnitude of exposure to each specific underlying. For a dealer that trades in many commodities, equities, credits, foreign currencies, etc., a requirement for separate disclosures for each type of notional associated with trading derivatives has the potential to be so voluminous as to be meaningless.

Deleted:

In addition, disclosing the notional amounts in the situation described above could have the unintended consequence of overstating the overall risk associated with derivatives used. This is because an entity is required to disclose the notional, even though it has entered into nonderivative positions that have essentially mitigated the risk. Also, without knowing the tenor of the derivative, one is not able to properly assess the risk associated with the derivative. For example, an interest rate swap with a notional amount of \$10,000,000 and maturity within three months contains a much different risk profile than an interest rate swap with the same notional amount of \$10,000,000 and a maturity that extends for 10 years.

We understand that the Board considered sensitivity or value at risk as part of this project and determined that requiring such disclosures was beyond its scope. If the Board decides that providing insight into the risks an entity is exposed to from using derivatives should be an objective of the project, then we would support the exploration of an alternative approach that permits sensitivity or value at risk disclosures in place of notional amounts. That said, we are reluctant to propose that the Board permit sensitivity or value-at-risk disclosures in the audited footnotes without some standardization or guidance for those calculations. Accordingly, if the Board does permit sensitivity or value-at-risk disclosures, it should consider carrying forward certain aspects of the SEC's Market Risk Disclosures.²

Other Clarifications

- As noted in Issue 3, the Board should consider whether additional supplemental information is necessary in situations in which an entity has combined derivatives with differing underlyings in the "purpose" category (for example, commodities consisting of coal, natural gas and oil).
- Some derivatives contain a payment provision³ instead of a notional amount. The Board should clarify whether the amount of the payment provision should be treated as the notional amount. Otherwise, the tabular disclosure will not include information about all of an entity's derivative positions.

² SEC requirements in Financial Reporting Release 48, *Disclosure of Accounting Policies for Derivative Financial Instruments and Derivative Commodity Instruments and Disclosure of Quantitative and Qualitative Information About Market Risk Inherent in Derivative Financial Instruments, Other Financial Instruments, and Derivative Commodity Instruments*.

³ Paragraph 6 of Statement 133 indicates in part, "A derivative . . . has one or more notional amounts or payment provisions or both."

Issue 6: *This proposed Statement would require disclosure of gains and losses on all derivative instruments that existed during the reporting period regardless of whether those derivatives exist at the end of the reporting period. This proposed Statement would not require disclosure of the aggregate notional amounts related to those derivatives that existed during the reporting period but no longer exist at the end of the reporting period.*

Do you agree that this proposed Statement should not require the disclosure of the aggregate notional amounts related to derivatives that no longer exist at the end of the reporting period? Why or why not?

Deloitte & Touche response:

We agree. However, the Board should consider whether to require entities to require gross reporting of gains and losses for positions no longer open at period end. This would provide insight into the magnitude of derivative activity during the period without requiring notional amounts to be tracked for positions no longer held. Alternatively, the Board should consider adding a requirement similar to paragraph 35 of IFRS 7,⁴ which states, “If the quantitative data disclosed as at the reporting are unrepresentative of an entity’s exposure to risk during the period, an entity shall provide further information that is representative.”

Disclosure of Gains and Losses on Hedged Items

Issue 7: *This proposed Statement would require disclosure of the gains and losses on hedged items that are in a designated and qualifying hedging relationship under Statement 133. The Board decided that an entity would not be permitted to include information in the tables on “hedged items” that are not in designated and qualifying Statement 133 hedging relationships because “economic hedging” means different things to different people.*

Do you agree that information about “hedged items” that are not in designated and qualifying Statement 133 hedging relationships should be excluded from the disclosure tables? Alternatively, should the tables include gains and losses on “hedged items” that are recorded at fair value and are used in hedging relationships not designated and qualifying under Statement 133? Why or why not? Would your answer be affected by the forthcoming FASB Statement on the fair value option for financial assets and financial liabilities, which will provide the option to report certain financial assets and liabilities at fair value? (See paragraphs B33–B35 for the basis for the Board’s conclusions.)

Deloitte & Touche response:

We agree.

⁴ IFRS 7, *Financial Instruments: Disclosures*.

Disclosure of Overall Risk Profile

Issue 8: *Under this proposed Statement, quantitative information about nonderivative instruments used as part of an entity's overall risk management strategy would not be included in the disclosure tables. However, paragraphs 44 and 45 of Statement 133 would permit an entity to provide qualitative and quantitative information about the derivatives included in the disclosure tables as those derivatives (a) relate to the overall context of its risk management activities and (b) are related by activity to other financial instruments.*

Do you agree that information that could be provided in the qualitative and quantitative disclosures encouraged by paragraphs 44 and 45 of Statement 133 would be sufficient to appropriately inform users of financial statements about the risk management strategies of an entity? If not, should additional information about an entity's overall risk management strategies be provided as part of the tabular disclosure required by this proposed Statement?

Deloitte & Touche response:

We agree.

Examples Illustrating Application of This Proposed Statement

Issue 9: *This proposed Statement includes examples of qualitative disclosures about objectives and strategies for using derivative instruments, contingent features in derivative instruments, and counterparty credit risk. Those examples are intended to illustrate one potential way of communicating information about how and why an entity uses derivatives and the overall effect of derivatives on an entity's financial position, results of operations, and cash flows. The examples are not intended to be construed as the only way to comply with the disclosure requirements.*

Are those examples helpful in communicating the objectives of providing information on how and why an entity uses derivatives and on the overall effect of derivatives on an entity's financial position, results of operations, and cash flows? Or, do you believe those examples would be viewed as a prescribed method to comply with the requirements of this proposed Statement?

Deloitte & Touche response:

Yes, the examples and table are helpful.

Amendments Considered but Not Made

Issue 10: *The Board considered but decided against requiring additional disclosures as described in paragraphs B55–B63. Those disclosures focused on providing information on an entity's overall risk management profile, methods for assessing hedge effectiveness, and situations in which an entity could have elected the normal purchases and sales exception.*

Do you agree with the Board's decisions not to require disclosures in those areas? Why or why not?

Deloitte & Touche response:

We agree.

Effective Date

Issue 11: *The Board's goal is to issue a final Statement by June 30, 2007. The proposed effective date would be for fiscal years and interim periods ending after December 15, 2007. At initial adoption, comparative disclosures for earlier periods presented would be encouraged, but not required. Beginning in the year after initial adoption, comparative disclosures for earlier periods presented would be required.*

Does the effective date provide sufficient time for implementation? (See paragraphs B50–B53 for the basis for the Board's conclusions.)

Deloitte & Touche response:

The Board should carefully evaluate the responses from preparers to gain insight into specific operational concerns and the amount of time necessary to build systems to collect the information needed to comply with the proposed disclosures. Additionally, if the Board decides to field test the proposed statement, it should consider the results of these tests in evaluating whether a sufficient amount of time has been provided before the effective date.

APPENDIX B
DELOITTE & TOUCHE LLP COMMENTS
Comments and Suggestions on the Proposed Statement
File Reference No. 1510-100

Objective

We generally agree with the proposed objectives. However, as currently drafted the proposed Statement is not clear about how the disclosure of notional amounts fits within the objectives, and the explanatory paragraph does not appear to align with the objectives. We propose the following changes (added text is underlined and deleted text is struck through):

1. FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*, establishes, among other things, the disclosure requirements for derivative instruments and for hedging activities. This Statement amends and expands the disclosure requirements in Statement 133 with the intent to provide an enhanced understanding of:

- a. How and why an entity uses derivative instruments
- b. How derivative instruments and related hedged items are accounted for under Statement 133 and its related interpretations
- c. How derivative instruments have affected and may affect an entity's financial position, results of operations, and cash flows.

To meet the first objective, this Statement requires qualitative disclosures about objectives and strategies for using derivatives. To meet the second objective, it requires that entities distinguish between derivatives used in qualifying hedging relationships and those used for other purposes ~~quantitative disclosures about notional and fair value amounts of derivative instruments and about gains and losses on derivative instruments and related hedged items.~~ And, to meet the third objective, it requires quantitative disclosures about fair value amounts of derivative instruments and about gains and losses on derivative instruments and related hedged items, as well as quantitative and ~~this Statement requires~~ qualitative disclosures about counterparty credit risk and contingent features in derivative agreements.

Scope

Since the proposed Statement is an amendment that does not change the scope of Statement 133, we do not believe that it is necessary to have a scope paragraph. Historically, amendments to Standards don't include a scope paragraph. We recommend the Board remove paragraph 2 of the proposed Statement to prevent any potential confusion.

Amendments to Statement 133

Paragraph 44 as Amended

Please refer to our clarifying comments in the Objective section above. Conforming changes should be made to objective (c) within paragraph 44 as amended by the proposed Statement.

Paragraph 44 indicates that entities should make a distinction between derivatives “used for risk management purposes” and all other derivatives. Some might argue that all derivatives are used for risk management purposes (i.e., either to reduce risk or increase risk). To clarify, the Board should consider replacing the phrase “used for risk management purposes” with “used to reduce or mitigate risk.”

Paragraph 44C

It is our understanding that the Board intends that entities make the required disclosures **first** by primary underlying risk, **next** by accounting designation, and **last** by purpose. The Board should consider clarifying paragraph 44C to reflect this requirement.

Leverage Factors

If the Board decides to retain the quantitative disclosures about notional amounts, the final Statement should permit entities to disclose *effective* notional amounts (i.e., the notional amount adjusted for the impact of any leverage factors) instead of separately footnoting the impact of leverage.

Not all constituents may be familiar with leverage factors. It would be useful to provide examples of typical leverage factors, highlighting that a leverage factor can leverage the notional, the underlying, or both. Also, the Board should clarify that leverage factors may be stated as the notional or the underlying multiplied by a fixed leverage factor, in which case the magnitude would likely not be difficult to calculate.

Appendix A — Examples Illustrating Application of This Statement

Paragraph A2

The third paragraph mentions marketable equity securities prices as an exposure the company attempts to reduce through the use of derivatives. The preceding paragraph should also contain a reference to marketable equity security prices as an exposure that may affect operating results.

The Board should verify with preparers whether cross currency interest rate swaps are typically used to manage foreign exchange risk associated with future sales denominated in foreign currencies. In our experience, fixed rate forwards are commonly used.

Paragraphs A13 and A14

The Board should clarify that the investment in the corporate bond (in paragraph A13) is available for sale. Similarly, in paragraph A14 the Board should clarify that the entity has appropriately performed and documented its effectiveness assessment and measured any ineffectiveness.

Paragraph A15 — Table

For the fair value hedges, it would be more realistic for the income statement classification of gains or losses on the designated derivatives and hedged items to be the same line item instead of different line items (or two line items for the derivative where the effective portion is the same line item as the gains or losses on the hedged item).

One of the “purpose” categories within the “Derivatives Not Designated as Hedging Instruments under FASB Statement 133” section of the Table is entitled “Derivatives used to offset: Changes in 30-year treasury rates.” The use of the term “offset” might lead a user to assume that the derivative is 100 percent effective at offsetting changes in 30-year treasury rates. The Board should consider alternative terms, such as “mitigate” or “reduce the impact from.”

Paragraph A17

A more realistic collateral policy would be to use a case-by-case basis for investment grade counterparties and 100 percent collateral for non-investment grade counterparties.
