Letter of Comment No: 36 File Reference: 1100-163 Date Received: 7/9/02



July 1, 2002

Director of Major Projects and Technical Activities Financial Accounting Standards Board 401 Merritt 7 P.O. Box 5116 Norwalk, CT 06856-5116

RE: File Reference 1100-163 (FASB Proposed Statement of Financial Accounting Standards, Amendment of Statement 133 on Derivative Instruments and Hedging Activities)

## Dear Director:

Wachovia Corporation is pleased to comment on the Exposure Draft - Proposed Statement of Financial Accounting Standards, Amendment of Statement 133 on Derivative Instruments and Hedging Activities ("Proposed Statement"), issued May 1, 2002. We generally support the issuance of the Proposed Statement as a means of codifying and clarifying guidance on the application of Statement No. 133, Accounting for Derivative Instruments and Hedging Activities ("Statement 133"). However, we believe that the Proposed Statement does not adequately address a number of issues related to the proposed accounting model and transition that we encourage the Board to consider prior to issuing a final statement.

## Accounting Model

Overall We are unclear what the overall accounting objective is in the model in the Proposed Statement. Beneficial interests ("BIs") issued from securitizations are recorded on the balance sheet at fair value by holders and classified as either trading or available-for-sale ("AFS") securities. If the BIs are classified as trading, then there will be no change in the accounting treatment under the Proposed Statement. If, however, the BIs are classified as AFS, then the holder will potentially be required to separate a BI into a debt host security, presumably still subject to Statement No. 115, Accounting for Certain Investments in Debt and Equity Securities ("Statement 115") and EITF Issue No. 99-20, Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interests in Securitized Financial Assets ("EITF 99-20"), and a derivative instrument subject to Statement 133. Accounting for the BI under Statement 133 would provide the holder both upside and downside volatility whereas under the current AFS model, the beneficial interest holder ("BIH") recognizes downside volatility but not upside

July 1, 2002 Director of Major Projects and Technical Activities Page 2

volatility, which we believe is conservative and more consistent with the nature of the security. Accordingly, we believe that the Board should address two issues in the final statement: (1) why the Board believes that the current accounting model is inadequate, and (2) how EITF 99-20 will be applied to BIs.

If the Board concludes that the model in the Proposed Statement adequately addresses issues not contemplated in current accounting literature, then we encourage the Board to consider a more concise model. As drafted, constituents need to consider several Statement 133 Implementation Issues, in addition to a number of paragraphs within Statement 133 itself. We recognize that consideration of paragraphs of Statement 133 will be required, as the definition of a derivative, embedded derivatives and scope exceptions all apply to beneficial interests. However, if the Board intends to retain all of the Statement 133 Implementation Issues related to BIs, we suggest that the model be collapsed into one issue and the Board consider inserting a single section into Statement 133 to address the accounting for BIs.

## Transition

AFS Securities Under the current accounting model, a company may classify a BI that arose in a securitization as an AFS security pursuant to Statement 115, and not bifurcate any embedded derivatives pursuant to the tentative guidance in Statement 133 Implementation Issue No. D1, Application of Statement 133 to Beneficial Interests in Securitized Financial Assets. Under the Proposed Statement, an entity may hold a BI that pays a floating rate of interest based on features that would be considered an embedded derivative that must be bifurcated. The company may also have designated an offsetting freestanding derivative (hedging derivative) as a cash flow hedge of the forecasted interest payments. The fair value of the derivative will be bifurcated from its debt host contract pursuant to Statement 133 Implementation Issue No. B6, Allocating the Basis of a Hybrid Instrument to the Host Contract and the Embedded Derivative. Because the fair value of the embedded derivative is already recorded in accumulated other comprehensive income ("AOCI") pursuant to Statement 115 as part of the entire fair value of the security, a reclassification from AOCI for the fair value of the embedded derivative will need to be made and recorded as a cumulative-effect adjustment of net income as a result of adopting the Proposed Statement. It is unclear to us, though, whether any reclassification from AOCI for the fair value of the hedging derivative related to those interest payments is also required as part of the cumulative-effect adjustment. We recommend that the Board provide additional clarification of transition of hedges of such BIs.

Reclassification of Statement 115 Securities The transition provisions in paragraph 55 of Statement 133 permitted a reclassification of any AFS security to trading. Any such reclassification, though, was only permitted on the date that a company originally adopted Statement 133. Accordingly, we believe that companies should again be given the opportunity to reclassify any AFS security to trading under the Proposed Statement. We recommend that the Board clarify whether reclassification to trading is permitted under the Proposed Statement similar to the original transition provisions in paragraph 55 of Statement 133.

Previous Derivatives Paragraph 41 of the Proposed Statement indicates that contracts that were previously accounted for as derivatives, but that would not qualify as derivatives under the Proposed Statement, should continue to be accounted for as derivatives. We believe that this guidance is inconsistent with transition provisions provided by the FASB in Statement 133 Implementation Issue No. K5. Transition Provisions for Applying the Guidance in Statement 133

July 1, 2002 Director of Major Projects and Technical Activities Page 3

Implementation Issues, ("Issue K5"). Specifically, the response to Question 2 in section I in Issue K5 states, in part:

... If an entity had been accounting for a contract as a derivative under Statement 133 but will not do so under the newly issued implementation guidance, the contract's fair value at the effective date shall become its net carrying amount at that date. The entity should apply other generally accepted accounting principles that are applicable to that contract prospectively from the date that the contract ceased to be accounted for under Statement 133. (Prospective application only to future transactions would not be appropriate.) ...[Emphasis added]

Although we recognize that Issue K5 contemplated "new implementation guidance" that resulted as part of the Derivatives Implementation Group process, we believe that an amendment to Statement 133 is equivalent to "new implementation guidance," and accordingly, changes in classification should be treated similarly.

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In summary, although we support the Board's efforts to codify and clarify guidance related to Statement 133, we believe that the Proposed Statement has many significant issues in relation to the proposed accounting model and transition that should be addressed prior to issuance.

We would be pleased to address any questions you may have regarding the comments in this letter or to discuss our position in more detail, at your convenience. I can be reached at 704-383-1293 or by email at lynn.rogers@firstunion.com.

Sincerely,

B. Lynn Rogers Senior Vice President Director of Accounting Policy

cc: David Julian, Senior Vice President and Controller, Wachovia Corporation