



Letter of Comment No: 19
File Reference: FSPFAS133A

November 21, 2005

Mr. Lawrence W. Smith
Director, TA&I - FSP
Financial Accounting Standards Board
401 Merritt 7
P. O. Box 5116
Norwalk, CT 06856-5116

Re: Proposed FASB Staff Position No. FAS 133-a, "Accounting for Unrealized Gains (Losses) Relating to Derivative Instruments Measured at Fair Value Under Statement 133"

Dear Mr. Smith:

Deloitte & Touche LLP is pleased to comment on the Proposed FASB Staff Position No. FAS 133-a, "Accounting for Unrealized Gains (Losses) Relating to Derivative Instruments Measured at Fair Value Under Statement 133" (the "proposed FSP").

We support the staff's effort to provide guidance that will result in more consistent treatment of unrealized gains (losses) at inception of a derivative instrument (so-called "dealer profit") under FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and the subsequent accounting for such dealer profit. Our recommendations to improve the clarity of the proposed FSP are described below.

Paragraph 3(b) — dealer market

The guidance in the proposed FSP is based on whether the market in which the derivative was entered into was a "reference market." The term reference market is defined in the working draft of the proposed FASB Statement No. 15X, *Fair Value Measurements* (the "working draft"). We have reviewed the working draft and believe that the discussion of the reference market needs to be substantially clarified to ensure consistent application by constituents. The consistent application of the guidance in this proposed FSP is dependent on the clarity of the working draft.

Paragraph 8 — Amendment to Statement 133 Implementation Issue No. B6, "Embedded Derivatives: Allocating the Basis of a Hybrid Instrument to the Host Contract and the Embedded Derivative"

As indicated in the amendment to Issue B6, if the transaction occurs in a market that is not the reference market for the hybrid instrument or the embedded derivative, and the minimum reliability threshold is not met (as prescribed in the proposed FSP), any unrealized gain or loss at inception of the instrument should be recognized as a deferred credit. The initial carrying value assigned to the host contract is determined as the difference between the basis of the hybrid instrument and the fair value of the embedded derivative less the unrealized gain (loss) component.

The result of this calculation is that any unrealized gain or loss (whether deferred or recognized in income) may consist of both (1) unrealized gain or loss related to the embedded derivative and (2) unrealized gain or loss related to the host contract. The final FSP should clarify that none of the originally deferred amounts, whether they relate to the host or the derivative, would be recognized until the minimum reliability threshold is met for the entire hybrid instrument, not just for the embedded derivative

The FASB should also clarify the rationale for the proposed application of B6 when the transaction occurs in a market that is neither the reference market for the hybrid instrument nor the embedded derivative. By way of illustration, assume that the host instrument is an issued debt instrument and there is an unrealized gain associated with the debt host as well as an unrealized gain associated with the embedded derivative. Also assume that the unrealized gain is recognized soon after the transaction because the hybrid instrument meets the minimum reliability threshold. The issue is the recognition of any unrealized gain associated with the debt host. Generally, debt is carried at proceeds and hence does not have an unrealized amount associated with it. Is it the intention of the FASB to permit recognition of any unrealized amount associated with a debt host when there would be no similar accounting consequence as a result of issuing straight debt?

Other recommendations to clarify the amendment to Issue B6 include the following:

- Numerical examples illustrating the different scenarios explained in Issue B6 would benefit users.
- Each of the first three paragraphs in the response begins with the phrase: “If the reference market in which the transaction occurs is...” We believe the first use of the term “reference” as noted above should be deleted from each of these phrases, because these transactions may occur in markets other than the “reference market” as defined in the working draft.

Other

Paragraph 16 of Statement 133 states that if an entity cannot reliably measure the embedded derivative that paragraph 12 requires to be separated from the host contract, the entire contract shall be measured at fair value with gain or loss recognized in earnings. The working draft, as noted in the proposed FSP, establishes a fair value hierarchy (all estimates of fair value fall within such hierarchy, with Level 1 being the most reliable and Level 5 being the least) and indicates a minimum reliability threshold (Levels 1–4) necessary to recognize an unrealized gain or loss at inception of a derivative. It is implied in the amendment to Issue B6 that an embedded derivative in a hybrid instrument may not meet the minimum reliability threshold, but may still be considered reliably measurable such that bifurcation of the embedded derivative is required. In the basis for conclusion, the FASB should highlight this point and provide an indication of how the working draft, this proposed FSP, and paragraph 16 of Statement 133 interact.

We appreciate the opportunity to comment on the proposed FSP. If you have any questions concerning our comments, please contact Bob Uhl at (203) 761-3705.

Yours truly,

Deloitte & Touche LLP

cc: Jim Johnson