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**Via Electronic Mail and FEDEX**

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**File Reference No. 1100-163: Proposed Statement of Financial Accounting Standards, Amendment of Statement 133 on Derivative Instruments and Hedging Activities.**

Dear Ms. Bielstein:

Credit Suisse Group ("CSG") appreciates the opportunity to comment on the proposed amendment to FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities* ("FAS 133" or the "Standard") as well as provide our perspective on the tentative guidance contained in FAS 133 Implementation Issue A20 and the proposed guidance as it pertains to beneficial interests in securitized financial assets and the related FAS 133 Implementation Issues (collectively "the proposed guidance").

CSG also has been actively participating in a joint industry working group ("JIWG") comprised of the International Swaps and Derivatives Association, the Bond Market Association, and the Securities Industry Association by sharing information and responding to the proposed guidance. We fully support the JIWG's response to the proposed guidance. Our letter serves to emphasize certain areas that are of particular concern to CSG, as both preparers of U.S. GAAP financial statements as well as an intermediary, through its subsidiary Credit Suisse First Boston, in the financial markets.

**Overall Comments**

We believe that certain of the modifications to the proposed guidance increase the complexity of applying the Standard and will require intense implementation efforts. It is not evident to us that the impact to the financial statements justifies the costs and efforts required to implement this change. We have particular concerns with the broad impact of

the change in paragraph 6 (b), and related guidance under Implementation Issue A20, as well as the potential impact of the D2 model on the status of qualifying SPEs (“QSPEs”) under Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (“FAS 140”).

Our comments are intended to simplify the guidance, reduce the operational burden for constituents, but yet still provide users of our financial statements with meaningful information.

Our concerns and comments are detailed as follows:

- Definition of a Derivative (par. 6 (b), Implementation Issue A20)
- Fair Value Alternative for Hybrids
- Impact of Investors’ Accounting on QSPE Status
- Implementation Issue D2
- Disclosures
- Transitions Provisions
- Effective Date

### **Definition of a Derivative (par. 6(b), Implementation Issue A20)**

We are concerned with the broad implications of the proposed guidance to revise the definition of a derivative. We recognize that the aim of the Board is to rectify perceived conflicts between FAS 133 and FAS 140 related to transferors who retain beneficial interests in a securitization. However, by revising the definition of a derivative to address those conflicts, the Board has significantly broadened the scope of contracts that are impacted by this change. This change to the definition will require companies, including CSG, to incur significant costs to modify systems and processes in order to conform to the proposed guidance, without a corresponding benefit.

#### ***Option Based Contracts***

We do not believe that the guidance contained in example 3 of Implementation Issue A20 (interest rate swap with an embedded option) benefits readers of financial statements. In our opinion, the separation of the premium related to the embedded option would not provide an accurate representation of the market risk. This is because the related cash flow stream of the interest rate swap would not be reflected at fair value. Added complexity will also result in practice since derivative contracts are often priced as a unit (recognizing the correlation of the underlying components), which does not allow identification of the option premium (e.g., a callable capped floating swap).

In order to comply with the proposed guidance under Implementation Issue A20, companies will need to analyze derivatives on a contract-by-contract basis. This creates an excessive operational burden, which will result in a relatively insignificant bifurcated premium balance. Also, significant system changes will be needed to comply with this guidance.

CSG regularly enters into swap contracts with embedded optionality as part of its normal market making activity. Most of these contracts include a pricing adjustment to reflect the value of the optionality embedded therein. Such contracts are desired by our clients to mirror optionality contained in their assets or liabilities (e.g., bonds or debt issued), and not as a means to obtain financing.

If the Board decides to proceed with the proposed changes, we recommend that the Board permit entities to elect to continue mark to market accounting for these contracts in their entirety. We also refer to our comments below with respect to hybrids.

#### ***Non-Option Based Contracts***

We agree with the Board's view that a contract that includes a substantial financing component embedded within its terms is a hybrid and should be treated according to its substance as both a financing and a derivative contract. However, we believe that to introduce a 5% "bright line" will cause significant implementation issues. For example, in a basis swap questions arise with respect to the determination of the denominator when calculating whether an upfront payment is greater than 5% of the fully prepaid amount of a non-option based contract.

The initial net investment analysis will involve numerous calculations that are not currently considered in systems supporting FAS 133 reporting. Furthermore, as stated above, since these contracts are part of our regular derivative market making activity, compliance with the new rules would require a contract-by-contract analysis.

#### ***Overall Recommendation for Implementation Issue A20***

We believe that judgment should be applied when assessing which contracts truly contain elements of financing (e.g., significantly off-market swaps or deferred payment of a premium on a stand alone option).

By way of analogy, applying judgment has merit if we look to the Board's guidance contained in Implementation Issue B19, which requires the use of judgment when determining the characteristics of a bifurcated debt host contract. Implementation Issue B19 states, in part, *"That determination requires the application of judgment, which is appropriate because the circumstances surrounding each hybrid instrument containing an embedded derivative may be different. That is, in the absence of stated or implied terms, it is appropriate to consider the features of the hybrid instrument, the issuer, and*

*the market in which the instrument is issued, as well as other factors, in order to determine the characteristics of the debt host contract.”*

In summary, we strongly believe that paragraph 6(b) should not be modified and the Board should clarify that the application of judgment is appropriate and acceptable as part of the overall analysis of whether a derivative contract truly contains elements of financing.

## **Fair Value Alternative for Hybrids**

We believe an appropriate solution for many of the issues highlighted above is to provide parties to a hybrid instrument the choice to either bifurcate the hybrid instrument or account for the hybrid instrument at fair value in its entirety. Such a provision would greatly reduce operational burdens on derivative dealers that regularly enter into derivatives contracts that would be considered hybrids under the proposed guidance. Further, such a provision would allow companies to continue to apply fair value accounting to the entire contract, which we believe is consistent with the Board’s intention to move towards fair value accounting for all financial instruments.

Additionally, we note that a similar alternative is present in the *Proposed Amendment to IAS 39, Financial Instruments: Recognition and Measurement*. In this amendment, the International Accounting Standards Board supports an optional mark to market in its proposed model, in part, as a means to “simplify the application of IAS 39 (for example, for hybrid instruments and for entities with matched asset/liability positions) and to enable consistent measurement of financial asset and financial liabilities”.

## **Impact of Investors’ Accounting on QSPE Status**

In FAS 140, the Board introduced limitations on derivatives entered into by QSPEs to address the Board’s perception that entities would use QSPEs to circumvent the requirements of FAS 133. As noted in paragraph A51 of the proposed guidance, the proposed changes relating to the accounting for holders of beneficial interests are intended to address these concerns. However, based on our observation of the Board meetings and the discussion in paragraph A51, it appears that these concerns remain. As a result, the Board has decided not to remove the phrase “... other than a another derivative financial instrument ...” in paragraphs 35(c)(2) and 40 of FAS 140. We believe that the proposed guidance will address the Board’s original concern about potential hidden derivatives in QSPEs. Therefore, we do not believe it is necessary to retain language in a standard that is based on the perception of potential abuses.

One group of SPE transactions that could be significantly impacted by the proposed guidance are risk transformation (also known as ‘repackaging’) SPE transactions. These transactions utilize derivative instruments to transform an asset’s cash flows to meet specific investor needs. The investor would follow the prescribed accounting, which, if required, would entail bifurcation of any embedded derivative. Barring any of the derivative limitations, these SPEs would often be QSPEs as they are passive and act in accordance with predetermined terms. Under the proposed rules, these entities may lose their QSPE status merely because of a change in the investor’s accounting, rather than any change in control by the transferor. We think this is an inappropriate result. We strongly believe that investor’s accounting for the embedded derivative should not drive the consolidation decision.

We are also very concerned about the possible consequences from interaction of paragraphs 40b and 40c of FAS 140 and the D2 model. We believe the potential impact on QSPEs could be broader than anticipated. We refer to the JIWG letter on the proposed guidance for a discussion of certain situations that have already been identified as problematic.

In summary, we recommend that the phrase “... other than another derivative financial instrument ...” be deleted from FAS140. Additionally, we believe that paragraphs 40b and 40c of FAS 140 are unnecessary and should be deleted.

## **Implementation Issue D2**

We understand that the Board’s goal is to increase transparency in financial statements. However, we feel that the proposed model in Implementation Issue D2 creates “accounting derivatives” that do not accurately reflect the economics of a transaction, and thereby do not provide meaningful information to the readers of financial statements. We are concerned that readers of financial statements will be unable to distinguish between true derivative contracts and those that have been created as a result of applying this accounting standard.

We recommend that the explicit terms, substance and economic conditions (rather than the detailed holdings of the SPE) be considered when determining whether a beneficial interest contains an embedded derivative. We also refer to the JIWG letter on the proposed guidance for detailed comments on the proposed D2 model.

## **Disclosures**

Provided certain provisions are met, the proposed guidance will permit grandfathering of certain QSPEs that would no longer be QSPEs after application of the D2 model to the transferor and other holders of beneficial interest that invest in a QSPE. The Board has also required disclosure of these “non-Q QSPEs.” We do not support such disclosure because the risks relating to the SPE transactions are already appropriately reflected in the financial statements and related disclosures, i.e., derivative contract unrealized gains and losses. Also, to highlight these transactions in a separate disclosure may give an impression that these are risks not otherwise reflected in the financial statements. As a result, we recommend that the Board eliminate disclosure requirements for grandfathered transactions.

## **Transition Provisions**

These transition provisions related to beneficial interests impose additional burdens on financial statement preparers, as they must perform the labor-intensive process of evaluating beneficial interests, many of which have been held for several years, for bifurcation.

We suggest that the Board exempt all beneficial interests in existence upon adoption of the Standard. This treatment would be similar to the initial adoption of FAS 133 related to embedded derivatives.

## **Effective Date**

Due to the implementation concerns noted above, we do not believe that the proposed effective date allows ample time to interpret and apply the final guidance. Therefore, we request that the Board reconsider the proposed effective date of January 1, 2003 (for calendar year companies) and extend it for one year.

Further, we strongly believe that a significant amount of time will be required to implement the final guidance as it relates to beneficial interests and the impact on QSPEs. Therefore, we believe it is inappropriate to apply the provisions on the issuance date. We recommend the effective date for beneficial interests be consistent with the effective date of the remaining proposed guidance.

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We appreciate the opportunity to provide comments and look forward to working directly with the FASB staff on these issues. Please do not hesitate to contact Ken Evola in NYC at (212) 325-7382 or Todd Runyan in Zurich at 41-1-334-8063 with questions or comments.

Sincerely,

Rudolf A. Bless  
Managing Director, Chief Accounting Officer

Kenneth J. Evola  
Director, Group Accounting Policies

cc: Robert H. Herz, FASB Chairman  
Victoria A. Lusniak, Assistant Project Manager