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1550-100

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LETTER OF COMMENT NO. 58

Mr. Russell G. Golden
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Financial Accounting Standards Board
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File Reference: 1550-100, *Preliminary Views – Financial Instruments with Characteristics of Equity*

Dear Mr. Golden:

Credit Suisse Group ("Credit Suisse") welcomes the opportunity to share our views on the Financial Accounting Standards Board's ("FASB" or "Board") *Preliminary Views – Financial Instruments with Characteristics of Equity* (the "Preliminary Views"). Credit Suisse is registered as a foreign private issuer with the Securities and Exchange Commission and its consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States ("US GAAP").

We applaud the joint efforts of the FASB and the International Accounting Standards Board ("IASB") to improve financial reporting for financial instruments with characteristics of equity. US GAAP has over sixty pieces of guidance on this topic, most of which was issued to address specific accounting questions related to new financial instruments in capital markets. In contrast, IFRS has only a handful of guidance on this topic. Having too many instrument and issue specific rules on this topic creates many application issues and potentially results in numerous restatements. These incidents underscore the need for a principles-based approach to accounting for financial instruments with characteristics of equity.

It is our understanding that the Basic Ownership approach is the FASB's preferred approach primarily because of its simplicity. However, the overemphasis on simplicity seemingly ignores the principles and qualitative characteristics as set forth in FASB Concepts Statement No. 2, *Qualitative Characteristics of Accounting Information* ("Concepts Statement No. 2"). For example, in Concepts Statement No. 2, one of the key user-specific qualities is understandability; however, simplicity does not necessarily equate to understandability, particularly for the complex financial instruments with

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characteristics of both liabilities and equity. While the Basic Ownership approach simplifies the balance sheet classification of an instrument within the scope of the Preliminary Views, it creates presentation and measurement issues on the income statement. The Basic Ownership approach represents a major change to current US GAAP by requiring financial instruments, such as preferred stock and certain indirect instruments indexed to the entity's own stocks that are currently classified as equity, to be reclassified as either assets or liabilities and measured at fair value with changes recognized in earnings. We believe that many perpetual instruments and equity derivatives with ownership-like characteristics and payoffs (e.g. written call options, physically or net share settled forward sale contracts, etc.) have loss absorbing characteristics similar to an entity's residual equity claim. Therefore, we believe that the Basic Ownership approach compromises on certain accounting qualities such as relevance and representational faithfulness and does not properly reflect the underlying economics of many financial instruments within the scope of the Preliminary Views.

We support the development of an approach for classifying financial instruments with characteristics of equity that properly reflects their economic substance. In addition, we support convergence and simplification of the requirements that are set forth in US GAAP and IAS 32, *Financial Instruments: Presentation* and IAS 39, *Financial Instruments: Recognition and Measurements*. We strongly believe that the Ownership-Settlement approach, coupled with certain modifications, will best achieve these goals. The attached Appendix includes our reasons for this belief and our responses to certain aspects of the three approaches included in the Preliminary Views. Finally, we recommend that the FASB further develop the Ownership-Settlement approach in conjunction with the Financial Statement Presentation project and Earnings per Share project.

If you have any questions or would like any additional information on the comments we have provided, please do not hesitate to contact Eric Smith in New York on (212) 538-5984, or Todd Runyan in Zurich on +41 44 334 8063.

Sincerely,

Rudolf Bless
Managing Director
Chief Accounting Officer

Norman Leung
Director
Accounting Policy and Assurance Group

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Appendix

I. The Basic Ownership Approach

Credit Suisse does not support the FASB's preliminary view that the Basic Ownership approach is the most appropriate method for determining which instruments should be classified as equity instruments. In our view, this approach runs contrary to the decisions made by the FASB and IASB on the qualitative characteristics of decision-useful financial reporting information. The fundamental user-specific quality of understandability has been unnecessarily sacrificed for simplicity, an enhancing qualitative characteristic.

We support the view that instruments that absorb an entity's losses or have payoff profiles consistent with an entity's equity residual interests should be considered equity. This view argues for a principles-based approach to accounting for financial instruments with characteristics of equity. We believe that financial instruments should be classified based on their economic substance, which is not permitted by the overly prescriptive nature of the Basic Ownership approach. This misalignment between the accounting treatment and economic substance of financial transactions will need to be addressed by the FASB in the income statement, if relevance and representational faithfulness are to be maintained, by differentiating gains or losses attributed to indirect instruments classified in liabilities and earnings attributable to an entity's operations and financial performance. In addition, many of the instruments classified as liabilities under the Basic Ownership approach will be treated as equity for tax and/or regulatory purposes. As a result, the Basic Ownership approach will increase the disparity between the definition of equity for accounting purpose and for other purposes.

We provide responses to your specific questions on the Basic Ownership approach in the paragraphs that follow.

Perpetual Instruments

We believe that perpetual instruments should be classified as equity. In our view, these instruments more closely resemble ownership claims because they typically are not settled through the transfer of assets or services by an entity in the normal course of business. In this regard, they are more conceptually and economically aligned to basic ownership instruments in that they settle upon dissolution of an entity through liquidation and distribution of its net assets.

Changes in the value of an entity's own stock should not be recognized in earnings. Any changes in value of an entity's own stock that are reported in earnings would seriously distort an entity's financial performance by mixing market appreciation of the entity's own stock with its operating results. We request that the FASB address the accounting for changes in value of perpetual instruments, should the Board decide to classify these items as liabilities in its Exposure Draft.

The proposed measurement requirements in paragraph 34 would seemingly lead the companies to use unobservable inputs to remeasure the instruments on a recurring basis. These requirements will invariably increase complexity in financial reporting and introduce more instruments subject to Level 3 fair value measurements.

Redeemable Basic Ownership Instruments

A Redeemable Basic Ownership Instrument can be classified as equity if it meets the criteria in paragraph 20. One of the requirements in paragraph 20 is that "the redemption amount is the same as the shares of the issuer's net assets to which the holder would be entitled if it were to liquidate on the classification date". The liquidation value of net assets is not readily verifiable. At best, we could derive the liquidation value by using many unobservable inputs. The operational burden of such an undertaking is immense, with the outcome of questionable veracity.

In addition, we do not understand the rationale of allowing certain redeemable basic ownership instruments but not certain perpetual instruments to be classified as equity. In our view, many of the redeemable basic ownership instruments and perpetual instruments share the same economic payoff profile and have the same liquidation rights.

Separation

We agree with the Board's interpretation of the facts provided the dividend payment is an obligation that an entity has little or no discretion to avoid. However, the determination of "little or no discretion to avoid" should take into consideration the differences between statutory and contractual requirements.

Substance

We support that the classification of an instrument be based on its substance as this is consistent with the concept of a principles-based approach. This means that the issuer should consider both stated and unstated terms when determining the classification of an instrument under the Basic Ownership approach. However, many equity-like instruments will be classified as liabilities inconsistent with their economic substance. We believe substance should play a significant role in determining the classification of an instrument and this leads us to select the Ownership-Settlement approach as our preferred approach.

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Measurement

We disagree with the classification of all derivatives as assets or liabilities with changes in value reported in earnings. Derivative instruments that either absorb the entity's losses or have payoff profiles consistent with an entity's equity residual interests should not automatically be excluded from equity. In our view, because these instruments have loss absorbing traits similar to an entity's residual equity interests, classification in equity would more accurately reflect their economic substance.

The change in value of these instruments should not be recognized in earnings as the changes do not faithfully reflect the entity's operating performance. For instances, the issuer may purchase a call option indexed to its own stock to replicate a treasury stock transaction. In another case, the issuer may issue a written call option, which is akin to a warrant, to the potential investors. We do not believe that these types of transactions should result in any gains or losses being recognized in the income statement of the issuer. If the Board decides otherwise, we recommend that strong consideration be given to reporting separately changes in income due to changes related to an entity's own stock. In our experience, financial statement users are more interested in earnings from financial and operating performance, which is not exaggerated by including changes in value resulting from an entity's own stock and similar instruments.

Presentation Issues

We disagree with the classification of perpetual instruments and equity derivatives as assets and liabilities on the balance sheet. For reasons discussed above, we believe this classification is inconsistent with the economic substance of these instruments. Should the Board proceed with this classification, however, we recommend that the balance sheet separately display non-basic ownership instruments that settle in cash versus those that settle in shares to assist financial readers in assessing liquidity.

We do not support the reporting of changes in the value of perpetual instruments and derivative instruments with characteristics of equity in the income statement. If the Board should require liability treatment for these items, we recommend that the income statement segregate these items from earnings related to operations and financing.

We recommend that the FASB examine these issues in conjunction with its Financial Statement Presentation project. In addition, we ask the Board to consider whether this proposed guidance would change the accounting for noncontrolling interest as defined in SFAS 160.

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Earnings per Share (EPS)

The FASB has not discussed the implication of financial instruments treated as non-equity for the EPS calculation within the scope of Preliminary Views. Therefore, it is difficult for us to provide any specific comment. With that in mind, we recommend that the FASB evaluate how to modify or simplify the current EPS standard to be consistent with the principles and effect of the classification and measurement required under the Basic Ownership approach. For example, if the gains or losses of non-equity instruments are reflected in net income, no additional adjustments should be made for computing the basic and diluted earnings per share. In addition, we recommend the FASB to consider whether certain instruments within the scope of this PV can be exempted from applying the if-converted method described in Statement 128.

II. The Ownership-Settlement Approach

We believe that, among all three approaches, the Ownership-Settlement approach is the best approach as it would balance the objectives of providing decision-useful information to the financial statement users and simplifying the accounting requirements for the preparers and the auditors. For example, the Ownership-Settlement approach will allow instruments that share the same or similar economics as basic ownership instruments, such as perpetual preferred stock and certain indirect ownership instrument, to be treated as equity, which we believe to be fundamentally sound. With the Ownership-Settlement approach, there will be only one single and consistent framework rather than the current sixty plus accounting pronouncements to address specific issues on financial instruments with characteristics of equity. In addition, the Ownership-Settlement approach will provide the most consistent outcome as compared to current US GAAP and IFRS. Therefore, this approach will (i) significantly simplify the accounting requirements while providing meaningful information to the users and (ii) facilitate the convergence with IFRS.

Classification

Paragraph A6 states that an indirect ownership instrument would be classified as equity if it can be settled by either "(i) issuing or delivering the basic ownership instrument from which its return is derived or (ii) by delivering another indirect ownership instrument that is part of a chain of indirect ownership instruments, all of which have returns derived from the same basic ownership instrument and the last of which will be settled by delivering that basic ownership instrument". Since the perpetual instruments such as preferred stocks would be classified as equity under the Ownership-Settlement approach, we recommend that the perpetual instrument should be included in the conditions set forth in paragraph A6.

We oppose the requirement of classifying an indirect ownership instrument as a liability if it is required to be net settled for cash or other assets. This requirement implies that the form of settlement could dictate the classification of an instrument. Said differently, instruments with the same payoff profile may result in different classification because of the form of their settlement. We believe that this contradicts the principles-based concept. Therefore, we recommend that the Ownership-Settlement approach allow net share settlement as an alternative outcome as long as the payoff of the instrument is consistent with the basic ownership instrument and the issuer of the instrument controls the form of settlement.

Substance and Linkage

We support that the classification of an instrument be based on its substance as this is consistent with the concept of a principles-based approach. This means that the issuer should consider both stated and unstated terms when determining the classification of an instrument under the Ownership-Settlement approach. We believe substance should play a significant role in determining the classification of an instrument.

In terms of the Linkage principle as described in paragraph 40, we are not sure how this principle would significantly improve a similar linkage criteria introduced in *Statement 133 Implementation Issue No. K1* ("DIG Issue K1"). Therefore, we recommend that the FASB use the DIG Issue K1 model rather than introducing a different linkage principle.

Presentation Issues

We believe that the presentation issues on the instruments within the scope of the Preliminary View are significant to an entity's financial statements. Therefore, these issues would be better addressed under FASB's Financial Statement Presentation project.

Separation

As indicated in paragraph A42 of the Preliminary View document, more instruments will be subject to the separation requirements under the Ownership-Settlement approach. The increased separation, in turn, gives rise to complexity in measurement and reporting requirements. Recently, the FASB issued FSP APB 14-1, which has similar separation requirements. As a consequence, we recommend the FASB consider any issues that arise from FSP APB 14-1 and address these issues in its liabilities and equity project.