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## FASB Proposes Enhancements to Credit Derivative and Financial Guarantee Disclosures

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The FASB recently issued a [proposed FSP](#)<sup>1</sup> to amend disclosure requirements for entities that sell credit derivatives or financial guarantees. The implementation period for the FSP will be short because a final FSP would be effective for financial statements issued for fiscal years and interim periods ending after November 15, 2008, with early application encouraged. Comments on the proposal are due to the FASB by June 30, 2008.

The FSP applies to credit derivatives, which it broadly defines as “contracts in which the underlying is related to the credit risk of a specified entity (or a group of entities) or an index based on a group of entities.” In a typical credit derivative contract, one party makes payments to the seller of the derivative and receives the promise from the seller of a payoff if a specified third party or parties default on a specific obligation. Examples of credit derivatives include credit default swaps, credit index products, and credit spread options.

The popularity of these products, coupled with the recent market downturn and the potential liabilities that could arise from these conditions, prompted the FASB to undertake this project to improve the transparency of disclosures provided by sellers of credit derivatives.<sup>2</sup> Also, since credit derivative contracts are similar in nature to financial guarantee contracts, the FASB proposed certain conforming amendments to the disclosure requirements for all financial guarantees within the scope of FASB Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*.

### Credit Derivative Disclosures

The proposed FSP would amend FASB Statement No. 133, *Accounting for Derivatives and Hedging Activities*, to require a seller of credit derivatives to provide the following additional disclosures, for each credit derivative (or for groups of similar credit derivatives), even if the likelihood of making payments is remote:

- The nature of the credit derivative, including:
  - o The approximate term of the derivative.
  - o The reason(s) for entering into the derivative.
  - o The events or circumstances that would require the seller to perform under the derivative.
  - o The current status of the payment/performance risk of the derivative.

<sup>1</sup> Proposed FASB Staff Position (FSP) No. FAS 133-b and FIN 45-c, “Disclosures About Credit Derivatives and Certain Guarantees: An Amendment of FASB Statement No. 133 and FASB Interpretation No. 45.”

<sup>2</sup> Such disclosures were not included within the scope of the FASB's recently issued Statement No. 161, *Disclosures About Derivative Instruments and Hedging Activities*.

- The maximum potential amount of future payments (undiscounted) the seller could be required to make under the credit derivative (or the fact that there is no limitation to the maximum potential future payments).
- The fair value of the derivative.
- The nature of any recourse provisions and assets held as collateral or by third parties that would allow the seller to recover all or a portion of the amounts paid under the credit derivative.<sup>3</sup>

## **Financial Guarantee Disclosures**

As noted previously, the FASB did not perceive substantive differences between the risks and rewards of sellers of credit derivatives and those of financial guarantees (that are not derivatives within the scope of Statement 133 but are within the scope of Interpretation 45). With one exception, the disclosures in Interpretation 45 are consistent with the disclosures proposed for credit derivatives. Accordingly, the proposed FSP would amend Interpretation 45 to require guarantors to provide similar disclosure “of the current status of the payment/performance risk of the guarantee.”

## **Transition**

The proposed FSP encourages entities, upon initial adoption of the FSP, to provide comparative disclosures for earlier periods presented. Such comparative disclosures are required for periods presented that are after initial adoption.

<sup>3</sup> Text extracted from paragraph 10 of proposed FSP FAS 133-b and FIN 45-c.

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