

ISDA

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June 25, 2004

Mr. Lawrence W. Smith
Chairman of Emerging Issues Task Force
Financial Accounting Standards Board
401 Merritt 7
Norwalk, Connecticut 06856-5116

Re: EITF Issue No. 04-7, "Determining Whether an Interest Is a Variable Interest in a Variable Interest Entity"

Dear Mr. Smith:

ISDA would like to take this opportunity to comment on EITF Issue No. 04-7, "Determining Whether an Interest Is a Variable Interest in a Variable Interest Entity." We commend the Task Force for addressing this difficult and important matter.

In response to the issuance of FIN 46R and out of concern that differing approaches to applying FIN 46R would lead to diversity in practice, ISDA's North America Accounting Committee formed a working group to address the issue of accounting for derivatives under FIN 46R. The working group analyzed four approaches. The first two approaches were developed by public accounting firms and are still evolving—a fair value model and a cash flow model (View A and B in the EITF Issue Summary). ISDA's working group analysis indicates that neither the fair value model nor the cash flow model is clearly required under FIN 46R and neither the fair value model nor the cash flow model considers all forms of variability because both models narrowly define variability as changes in fair value or changes in cash flows, respectively. In addition, the fair value and cash flow models do not consider the design of the entity and the economics of the transaction as comprehensively as other models.

The ISDA working group also developed two alternative models supported by major financial institutions. Members believe these models result in a superior application of FIN 46R to derivative instruments as they consider both changes in fair value and changes in cash flows as relevant in identifying variable interests. Both alternative approaches are built on the idea that any analysis should focus on the design of the entity and the economics of the rights and obligations of an entity's assets, liabilities, equity, and other contracts. Therefore, under the

alternative models, certain derivatives that both create and absorb variability, such as at market interest rate swaps and foreign currency swaps, are viewed as merely allocating variability.

In an effort to further explain the working group's analysis and the two alternative approaches, ISDA is submitting its working group analysis to the Task Force (ISDA's working group analysis was previously submitted to the Board). In addition, ISDA members would like to take this opportunity to comment on the Issue Summary prepared by the staff for the Task Force. View C of the Issue Summary includes many of the characteristics included in View C of the ISDA working group analysis; however, there are some important differences between the View C of the ISDA working group analysis and View C of the EITF Issue Summary. Also, View D of the ISDA working group analysis has not been presented to the Task Force in the Issue Summary (unlike other views, View D of the Issue Summary and View D of the ISDA working group analysis are significantly different). We think it is important for the Task Force to review all views currently used in practice.

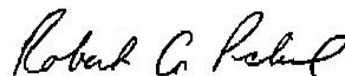
We would also note that it is important for the Task Force to discuss this Issue in the context of common marketplace examples. Since the principle of some of the models is to use qualitative characteristics such as the design of the entity and the intent of the transaction to determine if an interest is a variable interest, marketplace examples are necessary to illustrate the relative importance of qualitative characteristics and provide application guidance.

ISDA is providing this information because we believe the ISDA working group analysis provides valuable insight. In addition, we are available to answer any questions in regards to the information presented in the working group analysis and specifically with regard to the two alternative models presented in the analysis. ISDA members have substantial professional and practical expertise in addressing accounting policy issues with respect to financial instruments. We are hopeful that further discussion of the matter will serve to provide clarity to companies and their auditors as they apply FIN 46R.

Sincerely,



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