

MEMO# 5847

May 5, 1994

PROPOSED STATEMENT OF FINANCIAL ACCOUNTING STANDARDS ON DERIVATIVE FINANCIAL INSTRUMENTS

May 5, 1994 TO: ACCOUNTING/TREASURERS COMMITTEE NO. 20-94 INDEPENDENT ACCOUNTANTS ADV. GROUP NO. 2-94 RE: PROPOSED STATEMENT OF FINANCIAL ACCOUNTING STANDARDS ON DERIVATIVE FINANCIAL INSTRUMENTS

Enclosed for your review is an exposure draft relating to derivative financial instruments. The proposed Statement of Financial Accounting Standards (SFAS) Disclosure about Derivative Financial Instruments and Fair Value of Financial Instruments was issued by the FASB for public comment on April 15. The proposed SFAS would require improved disclosures about derivative financial instruments. For purposes of the SFAS, derivative financial instruments are defined to include futures, forwards, swaps, option contracts and other financial instruments with similar characteristics, including interest rate caps and floors. Mortgage-backed securities, interest-only and principal-only obligations, and indexed debt instruments are specifically excluded from the definition of derivative financial instruments. Disclosure regarding the amount, nature and terms of derivative instruments with off-balance-sheet risk of accounting loss is currently required by SFAS 105 Disclosure of Information about Financial Instruments with Off-Balance-Sheet Risks and Financial Instruments with Concentrations of Credit Risk. The proposed SFAS would require comparable disclosures for options held and other derivative instruments that do not involve off-balance-sheet risk. The proposed SFAS would require that a distinction be made between derivative financial instruments held or issued for trading purposes (including dealing) and those held or issued for purposes other than trading, such as hedging. For derivative financial instruments held or issued for trading purposes, the SFAS would require disclosure of a) the average, maximum, and minimum aggregate fair values during the reporting period of each class of derivative financial instruments, and b) the net trading gains or losses arising from derivative financial instrument trading activities during the reporting period. For derivative financial instruments held for purposes other than trading, the proposed SFAS would require a) a description of the entity's objectives for holding the derivative financial instruments and the strategies for achieving those objectives, and b) a description of how the derivative financial instruments are reported in the financial statements. The proposed SFAS would encourage, but not require, entities to disclose quantitative information about interest rate or other market risks of derivative financial instruments that would enable comparison of the results of applying the entity's derivative strategies to its objectives for holding or issuing the derivative financial instruments. Such information may include a) details about current positions or activity during the period, b) the hypothetical effects of changes in market prices, c) the duration of the financial instruments, or d) the entity's value at risk

from derivative financial instruments and the largest value at risk level during the reporting period. The proposed SFAS would be effective for financial statements issued for fiscal years ending after December 15, 1994, except for entities with less than \$150 million in total assets. For those entities, the effective date would be for financial statements issued for fiscal years ending after December 15, 1995. Comments on the proposed SFAS are due to the FASB on July 1, 1994. Please provide the undersigned with any comments you wish to have included in the Institute's response to the FASB on the proposed derivative financial instruments SFAS by June 17. Gregory M. mith Director - Operations/Compliance enclosure

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