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1510-100

LETTER OF COMMENT NO. 15

Mr. Lawrence Smith
Financial Accounting Standards Board
Technical Director – File Reference No. 1510-100
401 Merritt 7
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Proposed Statement of Financial Accounting Standards – Disclosures about Derivative Instruments and Hedging Activities - an amendment of FASB Statement No. 133

Dear Mr. Smith,

UBS appreciates the opportunity to comment on the Exposure Draft, *Disclosures about Derivative Instruments and Hedging Activities—an amendment of FASB Statement No. 133* (the "Exposure Draft" or "ED"). Understanding the effects of derivative instruments and how they are used in risk management activities is a complex subject. We support the Board's efforts to increase transparency with respect to that subject. However, we are not supportive of the Exposure Draft because we believe that its prescriptive disclosure requirements will significantly increase the financial reporting burden to preparers without necessarily providing better information to financial statement users. Along that line of reasoning, we have several major concerns about the Exposure Draft:

Comprehensive Disclosures Standard for All Financial Instruments
UBS, as a global financial institution, engages in derivative transactions in a sales, trading and hedging capacity. The accounting treatment of hedged transactions varies according to the nature of the instruments hedged and whether the hedge qualifies as such for accounting purposes. Like many financial institutions, UBS enters into derivative transactions to hedge economic exposures, but may not apply hedge accounting due to the complexity of hedge accounting rules. We believe the ED takes a prescriptive, formulaic approach regarding the disclosure of derivatives data. Unfortunately, that data fails to provide a comprehensive assessment of how entities such as UBS use derivatives in conjunction with other financial instruments to achieve their risk management objectives. In fact, by providing only some of that data and strictly limiting the format of how data

is presented, UBS is concerned that such disclosures might result in users making inaccurate assessments about its derivative activities.

Clearly, it is in the interests of all parties to seek out a comprehensive solution. In our view, IFRS 7, *Financial Instruments: Disclosures*, provides a more complete picture of an entity's use of derivatives because that standard encompasses disclosure requirements for all financial instruments and also requires disclosures that enable users to evaluate how risks arising from those instruments are managed. We believe the Board should reconsider its limited scope objective and seek out a comprehensive solution either by issuing IFRS 7 in the US as an invitation to comment or by incorporating the work performed in this project into its joint project on financial instruments.

Design of the Exposure Draft
The ED appears to have been designed for entities that have limited derivative activities. It is an easy task to gather data on five to ten derivative instruments and put it into a table that perhaps adds a page to the financial statements. For such entities, users may find that data to be useful. However, large financial services firms and entities with sophisticated risk management practices deal in significant volumes of derivatives. Using the prescribed tabular format for such volumes provides more data rather than more useful information. In fact, the considered opinion of UBS *equity analysts responsible for assessing financial institutions is that the tabular information* required by the Exposure Draft would be largely disregarded. This is because the prescriptive tabular disclosures provide more data, but that data will not enable users to evaluate the overall risk profile of the entity or provide insight into the timing, amount, and uncertainty of an entity's future cash flows. As discussed above, we believe that a more comprehensive approach to financial instrument disclosures is warranted. However, at a minimum, we encourage the Board to consider whether the scope should be modified with separate requirements for entities with significant derivative activities and those with insignificant derivative activities.

Proposed Effective Date
The proposed effective date is not realistic given the system and process enhancements that will be necessary based on the ED's proposed requirements. Again, it seems more suited to an entity that has a handful of derivative instruments for which data needs to be gathered. To adopt the provisions of the ED by the effective date (December 31, 2007 for UBS), we would have had to have the systems in place to capture the required data by January 1, 2007. In addition, UBS will be adopting Statements 157 and 159 in 2008. Given the work required for those standards as well, we believe that any final standard should be effective for fiscal years ending in 2009.

Recommendation for Roundtable Meetings on Derivative Disclosures
Derivative disclosures is a subject that requires careful consideration with considerable user and preparer input. For this reason, we respectfully request that the Board hold roundtable meetings with users, preparers, and other interested parties to discuss the informational needs of users, the operational concerns of preparers, and the adequacy of the Exposure Draft in addressing those needs and concerns. While the project is intended to increase disclosures in the short term, we think that roundtable meetings may bring about a mutual understanding among FASB constituents of what is needed to improve transparency in the area of derivatives.

In addition to the general recommendations and concerns noted above, we have responded to the detailed questions put to the constituents in the ED. Our responses follow in the appendix to this

letter. If you would like to discuss any comments that we have made, please do not hesitate to contact John Gallagher at 203-719-4212 or Will Widdowson at +41 44-234-5565.
Regards,

UBS AG

John Gallagher Managing Director Accounting Policies and Support	Will Widdowson Managing Director Head of Group Accounting Policies

APPENDIX

Scope

Issue 1
The Board concluded that prescriptive guidance about how derivative instruments should be presented and classified in the financial statements should be excluded from the project's scope. Including presentation and classification guidance could potentially delay issuing a standard that would significantly improve the transparency about derivative instruments and hedged items. In addition, various presentation and classification issues related to derivatives and hedged items have an impact on the Board's current project on financial statement presentation and also would need to be addressed in the context of that project.

Do you agree with the Board's decision to exclude from the scope of this proposed Statement prescriptive guidance about how derivative instruments should be presented and classified in the financial statements? Why or why not? (See paragraphs B5–B11 for the basis for the Board's conclusions).

No. We have discussed the requirement of the ED with UBS equity analysts that cover large financial institutions. Their position is that a comprehensive solution is needed that deals with all financial instruments with the objective of providing an understanding of risk exposures, how they are managed and the potential affect those exposures have on the amounts and timing of future cash flows. We agree with their views. We understand that the Board wants more information on derivatives to be in the financial statements; however, more data is not the equivalent of more or better information. We speculate that users may be requesting additional information because of the number of restatements related to hedge accounting. However, it is not clear that any of the restatements related to hedging would have been prevented by additional disclosures. Furthermore, we are concerned that providing the prescriptive, formulaic style of disclosures about derivatives does not provide users with a complete understanding of a large financial institution's risk management activities and financial performance.

We understand that the Board has discussed the scope limitation with various financial statement users and that the Board has reached the conclusion that users generally would accept the scope reduction from all financial instruments in return for more information regarding derivatives and related qualifying hedged items under Statement 133 in the short run. However, we note that the July 6, 2006 Board meeting minutes reflect that user groups did not reach a consensus view on any of the provided scope alternatives. Based on the FASB staff's research, it is clear that users surveyed "believe that the **disclosures should provide insight into an entity's risks and how they are managed to assist the user in assessing an entity's financial position and performance, as well as provide insight into the timing, amount, and uncertainty of an entity's future cash flows."** (emphasis added)

We see an inconsistency between the information that users generally want; insight into the timing, amount and uncertainty of an entity's future cash flows and the information that will be provided to them based on the scope and the requirements of the Exposure Draft. Please consider the following excerpt from the CFA Institute's 2004 comment letter on IFRS 7:

> *Sensitivity analysis is fundamental to the understanding of the potential effects on a company's cash flows of its use of financial instruments.* ***Sensitivity analysis permits users of the statements to understand the risk exposures of the company to possible changes in the underlying value drivers of the instruments, and the potential effects of the exposures on future cash flows. Disclosures of the fair values of instruments at the balance sheet date alone do not provide sufficient information, particularly in the case for non-linear instruments such as options, collars and the like.*** (emphasis added) *Since organizations can hold very large positions in financial instruments, both on the asset side and the liability side, these disclosures are of central importance in analyzing financial statements. We believe that this is the most important consideration concerning ED 7.*

We believe that the Board could better address user's needs by starting with an IFRS 7 approach and providing additional disclosures where IFRS 7's focus is considered to be too broad. We understand the Board's concerns regarding the time and resources necessary to complete such a project. However, we believe that it is in the interest of all parties involved to consider a more comprehensive approach rather than attempting to address financial instrument disclosures in stages, which will undoubtedly increase the disclosure burden and financial reporting risk for preparers, and will not fully address user needs.

We would like to reemphasize that a comprehensive solution is needed similar to the approach taken in IFRS 7 and that the Board should address such disclosures in the financial statement presentation and the financial instruments projects. However, another alternative would be to modify the scope of the ED to include only entities with limited derivatives activities and design a comprehensive solution for entities with significant derivatives activities.

Issue 2

Statement 133 applies to both public and private entities. The requirements in this proposed Statement also would apply to both public and private entities.

Do you agree that this proposed Statement should apply to both public and private entities? Why or why not?

Yes. We do not see any particular reason why entities should be differentiated by public or private status.

Issue 3
This proposed Statement would require an entity to provide information on derivative instruments (including, but not limited to, notional amounts and fair value amounts), hedged items, and related gains and losses, by primary underlying risk, accounting designation, and purpose in the tabular format shown in Appendix A.

Do you foresee any significant operational concerns or constraints in compiling the information in the format required by this proposed Statement? Are there any alternative formats of presentation that would provide the data more concisely? (See paragraphs B18–B20 for the basis for the Board's conclusions.)

Significant systems enhancements will be necessary to capture the data required for the disclosures, which are based on a lower level of aggregation than our financial reporting systems currently support. Consequently, the proposed effective date is not operational and should be deferred by at least one year, if not two (given the other standards recently issued that have a significant impact on financial institutions).

We do not believe that it is necessary for the FASB to prescribe the presentation format. The ED's objective should be to present information so that it may be readily understood; the ED could provide an example of a tabular presentation, which complies with that objective. However, given the detailed requirements of the ED, a tabular presentation is likely to be the only format that would comply with that objective. Not withstanding, as financial reporting evolves through means such as XBRL, it is not possible to foresee if alternative formats would provide a more concise display. Given that future possibility, we recommend that the Board follow a principles-based objective that permits evolution in financial reporting to occur.

In addition, we are concerned about the relationship between the ED's requirements and the disclosures provided in the sample table included in the application guidance. The table is confusing in that it appears to require further disaggregation of derivative notionals and gains and losses by derivatives in asset positions separately from those in liability positions as of the balance sheet date. However, we note that this is not required by paragraph 44C. Since many derivative gains and losses are recognized in the same income statement line item, it is extremely difficult to disaggregate such gains and losses and present them with their associated derivative assets and liabilities at the reporting date. Additionally, because derivative fair values can flip back and forth between assets and liabilities, we question the benefit of providing such information. Therefore we request that the sample table reflect the actual requirements of paragraph 44C.

We believe that the ED should provide more guidance related to the disclosure of the estimated magnitude that leverage factors have on derivative instrument notional amounts by primary underlying risk. For firms with significant volumes of derivative instruments with various leverage factors, we do not understand how this information, when aggregated by primary underlying risk, will provide users with constructive information. However, the system effort needed to capture and aggregate this information would be significant.

We understand that the Board believes that presenting gains and losses on derivatives and related hedged items that exist at the end of the reporting period separately from gains and losses on positions no longer existing at the end of the period "would enable users of financial statements to analyze separately the effect of derivative activities for the entire reporting period from the effect of derivatives open at period end. This would provide useful information on the effectiveness of hedging strategies in place for the entire period as well as at period end."[1] However, it is not clear why this information would be useful for trading derivatives or derivatives that were never designated in qualifying hedge relationships under Statement 133 (i.e., economic hedges).

Issue 4
This proposed Statement would require disclosure of (a) the existence and nature of contingent features in derivative instruments (for example, payment acceleration clauses), (b) the aggregate fair value amount of derivative instruments that contain those features, and (c) the aggregate fair value amount of assets that would be required to be posted as collateral or transferred in accordance with the provisions associated with the triggering of the contingent features.

Do you foresee any significant operational concerns or constraints in compiling that information for this disclosure? (See paragraphs B39–B42 for the basis for the Board's conclusions.)

We strongly suggest that the Board clarify the meaning of the term *contingent features*. We have actively followed this project, and it is our understanding that the term was intended to capture contingent features such as default events or changes in credit standing that would require the immediate transfers of assets. However, footnote 12a4 excludes some of those items. Additionally, any derivative with optionality could be characterized as having a contingent feature. Hence, as we are unclear as to the Board's intent, we do not feel that we have a sufficient understanding to respond to the question. Nevertheless, we do know that system and process enhancements would be needed to capture and aggregate this information. In addition, because of the volume of derivative instruments that we anticipate have contingent credit features, we do not believe that the aggregation of that information will provide users with any meaningful information.

Disclosure of Notional Amounts

Issue 5
This proposed Statement would require disclosure of notional amounts in tables that also will include fair values of derivative instruments by primary underlying risk, accounting designation, and purpose.

Do you agree that this proposed Statement should require the disclosure of notional amounts? Why or why not? (See paragraphs B21–B25 for the basis for the Board's conclusions.)

No. We do not agree with the ED's requirement to present derivative notional amounts because we do not agree with the Board's conclusion that the disclosure of notional amounts will provide insight into the overall volume of derivative use and into the magnitude of risks being managed. In fact, we believe that the disclosure of notional amounts can mislead financial statement users about the risks an entity is exposed to. For example, the disclosure of notional amounts related to

[1] Paragraph B38 of the Basis for Conclusions.

a hedging strategy using a series of forward interest rate contracts when compared with an interest rate swap would misrepresent the magnitude of the risk being managed. Also, because the ED precludes the disclosure of financial instruments in economic hedge relationships within the tables an entity may have completely offsetting exposures that will not be reflected, resulting in an incomplete presentation of the true risk profile of the entity related to its use of derivative instruments.

Issue 6

This proposed Statement would require disclosure of gains and losses on all derivative instruments that existed during the reporting period regardless of whether those derivatives exist at the end of the reporting period. This proposed Statement would not require disclosure of the aggregate notional amounts related to those derivatives that existed during the reporting period but no longer exist at the end of the reporting period.

Do you agree that this proposed Statement should not require the disclosure of the aggregate notional amounts related to derivatives that no longer exist at the end of the reporting period? Why or why not?

We agree. As noted in our response to Issue 5, we believe that the disclosure of notional amounts can mislead rather than enlighten financial statement users; therefore, we are not in favor of notional disclosure for any derivatives regardless of whether or not they exist at the end of the reporting period.

Disclosure of Gains and Losses on Hedged Items

Issue 7

This proposed Statement would require disclosure of the gains and losses on hedged items that are in a designated and qualifying hedging relationship under Statement 133. The Board decided that an entity would not be permitted to include information in the tables on "hedged items" that are not in designated and qualifying Statement 133 hedging relationships because "economic hedging" means different things to different people.

Do you agree that information about "hedged items" that are not in designated and qualifying Statement 133 hedging relationships should be excluded from the disclosure tables? Alternatively, should the tables include gains and losses on "hedged items" that are recorded at fair value and are used in hedging relationships not designated and qualifying under Statement 133? Why or why not? Would your answer be affected by the forthcoming FASB Statement on the fair value option for financial assets and financial liabilities, which will provide the option to report certain financial assets and liabilities at fair value? (See paragraphs B33–B35 for the basis for the Board's conclusions.)

In many instances, given the burdensome and detailed hedging requirements of Statement 133, many firms choose to employ economic hedging. Additionally, it can be argued that economic hedges also better reflect the portfolio management of risk exposures. Given the issuance of Statements, 155, 156 and 159 and the Board's consideration of the fair value option for nonfinancial assets and liabilities in phase two of the fair value option project, we expect that economic hedging will become the most prevalent form of hedging. We urge the Board to consider that trend. Economic hedging is an important tool used by many financial services firms. Given its importance, its mandated exclusion misleads users about the nature and volume of an entity's derivatives activity. Again, we strongly urge the Board to adopt a principles-based approach that relies on disclosure objectives that provide entities with the flexibility to include all forms of derivatives activities, including economic hedging.

Disclosure of Overall Risk Profile

Issue 8
Under this proposed Statement, quantitative information about nonderivative instruments used as part of an entity's overall risk management strategy would not be included in the disclosure tables. However, paragraphs 44 and 45 of Statement 133 would permit an entity to provide qualitative and quantitative information about the derivatives included in the disclosure tables as those derivatives (a) relate to the overall context of its risk management activities and (b) are related by activity to other financial instruments.

Do you agree that information that could be provided in the qualitative and quantitative disclosures encouraged by paragraphs 44 and 45 of Statement 133 would be sufficient to appropriately inform users of financial statements about the risk management strategies of an entity? If not, should additional information about an entity's overall risk management strategies be provided as part of the tabular disclosure required by this proposed Statement?

As noted previously, we strongly encourage the Board to adopt a principles-based approach to derivatives disclosures. However, we believe the Board needs to consider that principles-based approach in the context of all financial instruments in its financial statement presentation or financial instruments projects. That consideration should include an assessment of how risk exposures and risk management strategies can be best presented. That issue also should be discussed at the roundtables to better understand the needs of users and preparer concerns and constraints.

Examples Illustrating Application of This Proposed Statement

Issue 9
This proposed Statement includes examples of qualitative disclosures about objectives and strategies for using derivative instruments, contingent features in derivative instruments, and counterparty credit risk. Those examples are intended to illustrate one potential way of communicating information about how and why an entity uses derivatives and the overall effect of derivatives on an entity's financial position, results of operations, and cash flows. The examples are not intended to be construed as the only way to comply with the disclosure requirements.

Are those examples helpful in communicating the objectives of providing information on how and why an entity uses derivatives and on the overall effect of derivatives on an entity's financial position, results of operations, and cash flows? Or, do you believe those examples would be viewed as a prescribed method to comply with the requirements of this proposed Statement?

We are supportive of examples and illustrations being included in standards. However, the example in the ED provides further evidence to indicate that the ED is intended for entities with limited derivatives activities. We would appreciate the inclusion of an example of a large financial institution with significant derivatives activities.

Amendments Considered but Not Made

Issue 10
The Board considered but decided against requiring additional disclosures as described in paragraphs B55–B63. Those disclosures focused on providing information on an entity's overall risk management profile, methods for assessing hedge effectiveness, and situations in which an entity *could have elected the normal purchases and sales exception.*

Do you agree with the Board's decisions not to require disclosures in those areas? Why or why not?

We strongly urge the Board to reconsider disclosures for all financial instruments in a comprehensive project that also covers risk management disclosures. We believe the Board should adopt a comprehensive approach whereby disclosures satisfy broad objectives intended to provide users with information (not just data) pertaining to all financial instruments.

Effective Date

Issue 11
The Board's goal is to issue a final Statement by June 30, 2007. The proposed effective date would be for fiscal years and interim periods ending after December 15, 2007. At initial adoption, comparative disclosures for earlier periods presented would be encouraged, but not required. Beginning in the year after initial adoption, comparative disclosures for earlier periods presented would be required.

Does the effective date provide sufficient time for implementation? (See paragraphs B50–B53 for the basis for the Board's conclusions.)

No. Significant system enhancements will be required to comply with the ED's prescriptive requirements. Those systems would have had to have been in place and functioning all year in order to produce the disclosures required for 2007. Consequently, the proposed effective date is not operational, and the effective date should be deferred by at least one year. Further, given that we will be adopting Statements 157 and 159 in 2008 and those standards require significant resources to implement, we think that it would be appropriate to defer the effective date by two years. The Board also should consider whether entities with significant derivatives activities should be given a delayed effective date.