



LETTER OF COMMENT NO. 32

March 2, 2007

Via email: [director@fasb.org](mailto:director@fasb.org)

Mr. Lawrence Smith  
Technical Director  
Financial Accounting Standards Board  
401 Merritt 7  
P.O. Box 5116  
Norwalk, CT 06856-5116

Re: File Reference No. 1510-100, Proposed Statement of Financial Accounting Standards, *Disclosures about Derivative Instruments and Hedging Activities*

Dear Mr. Smith,

U.S. Bancorp, the sixth largest bank in the United States with over \$219 billion in total assets, appreciates the opportunity to comment on the proposed Statement of Financial Accounting Standard, *Disclosures about Derivative Instruments and Hedging Activities* (the "Exposure Draft"). We support the Board's efforts to improve financial reporting related to an entity's use of derivative instruments and the impact of derivatives on an entity's financial statements. However, we have several conceptual and practical concerns with the Exposure Draft, as outlined below,

### Scope

We understand that the purpose of the Exposure Draft is to enhance transparency about how and why an entity uses derivative instruments, how derivatives and related hedged items are accounted for, and how derivatives impact an entity's financial statements. Further, we understand that the Board considered but rejected adding a fourth objective that disclosures should help users of financial statements understand an entity's overall risk exposures and strategy for managing those risks as the Board believed expanding the scope would result in a long term project that would not timely address financial statement users' need for enhanced transparency and understanding of an entity's use of derivatives.

We believe a delay in issuing expanded disclosures on derivatives is merited in order to ensure that any new disclosure requirements do indeed improve transparency to users rather than layering volumes of financial information that only serves to confuse and

mislead users of financial statements. Given the nature of derivative instruments, the fact that disclosure requirements for financial instruments and derivatives are currently spread out through a number of different accounting standards, the recent issuance of SFAS 157, *Fair Value Measurements* and SFAS 159, *The Fair Value Option for Financial Assets and Financial Liabilities* which include expanded disclosure requirements and will likely result in a change in the use of derivatives or non-derivatives to manage risk, and the general movement towards international convergence, we believe further analysis is warranted to ensure the disclosure requirements meet the objective of enhancing transparency and understanding of an entity's use of derivatives.

While the Exposure Draft, as currently written, may provide transparency for an entity that uses only a few derivatives, we believe the objective of transparency of an entity's use of derivatives will not be met when that entity is a financial institution that manages significant portfolios of derivatives for risk management or other purposes. In addition, many financial institutions currently use a wide array of financial instruments other than derivatives to manage the entity's overall risks. Use of financial instruments other than derivative instruments will likely be used increasingly as entities adopt the fair value option permitted under SFAS 159. Given these factors, we believe that financial statement users will not benefit from the proposed expanded disclosures which only focus on derivatives and do not address other financial instruments that may be used in risk management strategies.

We believe that public company preparers sufficiently address user's needs to understand overall entity risks through the disclosures currently required under Regulation S-K Item 305 Quantitative and Qualitative Disclosures about Market Risk, and through other disclosure requirements including those required under SFAS 107, SFAS 133, SFAS 157 and SFAS 159. If users perceive a lack of transparency, we believe this should be addressed through a long term project that works towards consolidating the disclosure requirements under these various standards and moves towards international convergence with IFRS 7, *Financial Instruments Disclosures*.

### **Costs of Implementing the Exposure Draft**

Paragraph B66 of the Exposure Draft indicates that the Board believes that the incremental costs of implementing disclosures required by the Exposure Draft would not be significant because the information needed for the disclosures is already being tracked for hedge accounting and risk management purposes. Most financial institutions do not currently track the information required for these disclosures at the level of disaggregation required for the quantitative tabular disclosures. Significant systems enhancement would be required to provide the level of information for the following requirements:

- Separate display by asset and liability position of derivative notional and fair value amounts as well as gains and losses
- Reporting portions of a derivative to various accounting designation and purpose sections of the tabular presentation when only a portion of a derivative was

designated as a qualifying hedge or when a derivative was designated as qualifying hedge for only a portion of the reporting period

- Separately reporting gains and losses from derivatives that existed during the reporting period but do not exist at the end of the reporting period from the gains and losses reported on derivatives that remain open at the end of the reporting period
- Reconciling notional amounts, fair values and gains/losses of derivatives that change from a gross asset position to a gross liability position (or vice versa) from one reporting period to the next
- Reporting and linking contingent feature disclosures to specific derivatives
- Reporting and linking information on counterparty credit risk to specific derivatives as it pertains to maximum loss exposures, regardless of collateral held, and netting arrangements associated with specific derivatives

### **Contingent Features**

The Exposure Draft requires disclosure of the existence and nature of contingent features in derivative instruments. While the examples provided in Appendix A seem to indicate that the Board's intention is that this requirement would provide information on credit related contingent features that may accelerate payment or require additional posting of collateral, the standard does not clearly define the meaning of contingent features. We believe that a clear definition of contingent features within the scope of these disclosure requirements should be provided in the body of the standard. Further, the scope exception provided in paragraph B42 for certain default provisions for nonperformance (i.e., those that do not have a greater than remote chance of occurring) should be clarified as to its meaning as entities may interpret this scope exception differently, and this clarification should be moved to the body of the standard.

### **Disclosure of Notional Amounts**

In paragraph B24, we note that Board members supported the disclosure of notional amount of derivative instruments because notional amounts provide insight into the overall volume of derivative use and into the magnitude of risks being managed. We believe that notional amount are not always indicative of the true nature, size, and/or risk of derivatives used by an entity and therefore disclosure of notional amounts is not meaningful and may actually be misleading to users. For example, an entity may use either a series of forward contracts or a single interest rate swap to hedge variable cash flows due to interest rates. Both instruments would have the same effect in managing interest rate risk; however, use of the series of forward contracts would result in a much higher notional amount being disclosed in the interest rate risk table as compared to the notional amount that would be disclosed had the entity used a single interest rate swap.

## **Tabular Disclosure**

We believe that tabular disclosure of accounting information on derivatives requirements will not meet the Board's objective for improved transparency as to an entity's use of derivatives for financial institutions that use hundreds or thousands of derivatives in both designated accounting hedges, economic hedges and for trading purposes. For non financial institutions that may have only a handful of derivatives, the tabular disclosure may improve transparency, however, for many financial institutions we believe transparency will not be enhanced due to the volume of the tabular disclosures and additional qualitative information that will be required to explain more fully the use and impacts of derivatives for each underlying risk, further disaggregated by accounting designation and purpose, and further disaggregated by open and closed derivative positions.

It is our understanding that most financial institutions may be required to disclose at least seven separate individual tables to address interest rate, credit risk, foreign currency risk, market price risk and then additional separate tables to address any combinations of those risks. Though we do not object to increased transparency of derivatives in financial reporting, we believe that tracking multiple risks separately adds complexity and cost to tracking and accumulating information without a corresponding benefit to user of financial statements. We believe that decreasing the number of tables and granularity of the overall disclosure requirements in exchange for quantitative and qualitative disclosures that focus on summary level impacts would be more effective in enhancing financial statement users understanding of an entity's derivatives activity.

We believe that users of financial statements will not be able to be effectively utilize the information due to the level of disaggregation required by the standard and the volume of information that will result as entities attempt to comply with the standard's requirements. Furthermore, entities may aggregate derivatives within disclosure tables which may result in offsetting hedge ineffectiveness amounts within specified line items within the table. This could make it difficult for users to understand how well an entity managed a particular risk and its impact to the financial statements for entities that have a high volume of aggregated derivatives in various positions and accounting designations within a single disclosure table.

## **Gains and Losses Recognized in Income on Derivative Instruments and Related Hedge Items No Longer Held or in a Designated Hedging Relationship at the End of the Reporting Period**

The Exposure Draft requires separate disclosure of gains and losses on derivative instruments that existed during the reporting period but did not exist at the end of the reporting period from the gains and losses of derivative instruments that existed at the end of the period. We do not understand why separate disclosure of realized and unrealized gains/losses is more meaningful when such derivatives are already accounted for on a fair value basis of accounting with all changes in fair value reported in earnings.

### **Disclosure of Gains and Losses on Hedged Items Associated with Economic Hedges**

The Exposure Draft requires disclosure of hedged items designated in qualifying hedges, but precludes disclosure of hedged items that are associated with economic hedges. We believe excluding hedged items associated with economic hedges does not provide a complete picture of how and why an entity uses derivatives not designated in SFAS 133 qualifying hedges.

### **Frequency of Disclosure Requirements**

The Exposure Draft requires all of the disclosures to be made both in interim and annual financial statements. It is possible that derivatives could be required to be moved frequently between specified line items within the tabular disclosures due to changes in their accounting designation, purpose, and existence, and still not result in significant changes in the entity's overall risk profile. Given the level of complexity of the disclosure requirements of the Exposure Draft as currently written and the reconciliation procedures that will be required to ensure the accuracy of movements of derivatives from specified line items within the tabular disclosures, we believe that interim reporting of the tabular disclosures would be unduly difficult to preparers and not substantially beneficial to users to outweigh the costs to preparers. In addition, the intent of interim disclosures is generally to provide qualitative and quantitative disclosures for significant changes in the financial position, results of operations or cash flows of the business. Because of these factors, we believe the tabular disclosures should not be required in the interim financial statements if the entity's overall risk profile has not materially changed during the interim reporting period. If standard setters begin to require interim disclosures on every matter regardless of whether or not changes are significant to the Company, quarterly filing with the Securities and Exchange Commission and regulatory agencies should be changed to allow 75 days to complete the filings similar to annual reporting requirements.

### **Effective Date**

We believe the effective date proposed in the Exposure Draft does not provide sufficient time for financial institutions with significant volumes of derivatives to comply with the standard. Financial institutions will need to dedicate a significant amount of time and resources to make system enhancements as well as enhanced internal controls and establish new accounting procedures to ensure the accuracy of information that previously was not tracked at the disaggregated level that the standard requires. These enhancements will not be in place as of the beginning of the first reporting period for which this standard would be effective (i.e., disclosures for the calendar year ended December 31, 2007 will require that information is accumulated beginning on January 1, 2007). Similarly, we believe the requirement to disclose comparative information for earlier periods in fiscal periods after initial adoption, is also impractical. For calendar

year 2008 disclosures, institutions will need to disclose calendar 2007 information yet systems and processes are not yet in place to gather that information.

In addition to the adoption of this standard, financial institutions will be also be expending a significant amount of time and resources to address the disclosures requirements under SFAS 157 and SFAS 159 which also require significant systems, internal controls and procedural enhancements that must be in place for adoption of these standards in 2008. Given all of these factors, financial institutions will not be able to adopt the Derivatives Disclosure standard in the current time frame without incurring substantial implementation costs. We believe the effective date should be no earlier than January 1, 2008 and that comparative disclosures not be required for any periods prior to adoption.

Thank you for your time and consideration with respect to our views on this matter. Please contact me at (612)303-4352 with questions or if you need additional information.

Sincerely,

/s/ Terrance R. Dolan

Terrance R. Dolan  
Executive Vice President and Controller