

August 13, 2008



LETTER OF COMMENT NO. 19

Technical Director – File Reference No. 1590-100
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, Connecticut 06856-5116

**Re: File Reference No. 1590-100,
Proposed Statement of Financial Accounting Standards,
*Accounting for Hedging Activities – an amendment of FASB Statement No. 133***

Dear Sir:

TD Bank Financial Group (“TDBFG”) appreciates the opportunity to comment on the Exposure Draft (the “ED”) referred to above.

In the ED the Financial Accounting Standard Board (the “Board”) sets out its intention to achieve the following objectives:

- a. Simplify accounting for hedging activities;
- b. Improve the financial reporting of hedging activities to make the accounting model and associated disclosures more useful and easier to understand for users of financial statements;
- c. Resolve major practice issues related to hedge accounting that have arisen under Statement 133; and
- d. Address differences resulting from recognition and measurement anomalies between accounting for derivative instruments and the accounting for hedged items or transactions.

TDBFG supports the Board’s efforts to achieve the aforementioned objectives. However, we have broad conceptual and practical concerns with the ED in its current format.

We believe that the ED contradicts the stated objectives by introducing additional accounting complexity and barriers to fundamental risk management practices. Furthermore, we believe that the proposed amendments will only serve to exacerbate the mixed-measurement anomalies, lead to increased and unjustifiable income statement volatility, and as a result, will not improve the financial reporting for hedged items or transactions.



We have highlighted in the following section the overall concerns we have that are being caused by key concepts introduced through the ED. We have also included as an appendix to this letter our assessment of the ED against the Board's four stated objectives.

1. Changes to potential hedged risks

We regret the Board's decision to eliminate the prospect of applying hedge accounting on a bifurcated risk basis for many hedging strategies. Most entities, including the most sophisticated users of hedge accounting, routinely hedge their interest rate exposures using interest rate derivatives and designate changes in fair values/cash flows due to changes in the benchmark interest rate as the hedged risk. As a result of this change, many, if not most of these entities would be precluded from applying hedge accounting. This would lead to increased income statement volatility which is not truly reflective of the economic impact. Entities would therefore be forced to alter their current risk management paradigms in order to achieve a suitable accounting result.

We do not understand the reason for revisiting this issue as the Board already considered a prohibition on allowing hedge accounting on a bifurcated risk basis as part of the original Exposure Draft preceding the issuance of FAS 133. It appears that the provisions of this ED effectively dismiss previous comments made by respondents to the original FAS 133 Exposure Draft, and is retracting the well thought out rationale encompassed in the Basis for Conclusions to FAS 133. The following extract bears relevance to this point (from paragraphs 364-366):

"... The Exposure Draft proposed that the gain or loss on the hedged item that would be recognized under fair value hedge accounting incorporate all risk factors and, therefore, reflect the full change in fair value of the hedged item to the extent of an offsetting gain or loss on the hedging instrument. That focus was intended to prevent a hedged asset or liability from being adjusted farther away from its fair value than it was at inception of the hedge. For example, if the fair value of a hedged asset increased due to a change in interest rates but simultaneously decreased due to a change in credit quality, the Exposure Draft would have prevented an entity that was hedging only interest rate risk from accelerating recognition of the interest rate gain without also effectively accelerating the credit quality loss. Accelerating only the interest rate gain would adjust the hedged asset away from its fair value.

Respondents to the Exposure Draft opposed the proposed approach for the very reason that the Board originally favored it – the approach would not have segregated the sources of the change in a hedged item's fair value. Respondents focused on the earnings impact and expressed concern about recognizing in earnings the fair value changes on the hedged item related to an unhedged risk. They said that recognizing the changes in fair value of the hedged item attributable to all risks would cause unrepresentative earnings volatility and would be misleading in reflecting the results of the entity's hedging activities.

The Board believes that the earnings effect of the proposed approach in the Exposure Draft would have reflected an exacerbation of the mixed-attribute measurement model, rather than “unrepresentative earnings volatility.” However, because of the concerns expressed by respondents, the Board reconsidered the proposed requirements. The Board generally focused on the appropriate recognition and measurement of assets and liabilities in developing accounting standards. However, the principal purpose of providing special accounting for hedging activities is to mitigate the effects on earnings of different existing recognition and measurement attributes. Consequently, in this instance, the Board found the focus of respondents on the earnings impact of the approach to hedge accounting to be persuasive and decided to modify the Exposure Draft to focus on the risk being hedged... ”

We believe that the concerns expressed by the respondents above are equally valid today. We urge the Board to reconsider its decision to disallow hedge accounting on a bifurcated risk basis, based on the previous concerns expressed by respondents, as well as its own previous conclusions on the persuasiveness of this argument. We also believe that the Board should provide further clarity around its basis for conclusion around its current decision for disallowing hedge accounting on a bifurcated risk basis, in the context of this explicit departure from its previous decision.

We are also surprised by the rationale offered in the Basis for Conclusions of the current ED, to justify the prohibition of applying hedge accounting on a bifurcated risk basis. It states that the Board believes (paragraph A16): “... *it is just as important to reflect in the financial statements the economics of unhedged risks in order to provide users with a more complete picture of an entity’s financial position and results of operations from hedge accounting activities....*”

Conventional accounting standards do not require presentation in the financial statements of the economics of unhedged risks. We believe that requiring this under a hedge accounting paradigm creates a considerable inconsistency. To illustrate, in the absence of hedge accounting, entities are not required to reflect the economic impact of unhedged risks, such as credit risk. Organizations that are risk averse and introduce hedging measures, for instance, to offset the impact of changes in fair values due to changes in the benchmark interest rate risk, will be required to reflect the economic impact of unhedged risks, if they choose to apply hedge accounting. Introducing hedge accounting is not a reason to require immediate recognition for the impact of unhedged risks. This inconsistency leads to the penalization of organizations with prudent risk management strategies, and the reward of organizations that:

- do not enter into derivatives to manage its key risk exposures;
- hedge exposures beyond their key risks and thus compress their product margins (e.g. by hedging credit risk – an inherent risk when the key objective is to earn a margin of interest on assets over interest on liabilities); or
- choose to absorb earnings volatility by not applying hedge accounting – thereby potentially eroding shareholder value.

The current mixed-measurement model does not require similar measurement of unhedged risks, such as the measurement of unhedged risks proposed by the Board in the ED. We believe the Board has fundamentally changed the objective of hedge accounting, instead of keeping the focus on the achievement of an offsetting impact in earnings against changes in fair values of the hedging instrument, the Board has decided to rather prescribe an accounting treatment for the hedged item that is in contrast to the measurement required by the mixed-measurement model. Instead of facilitating the achievement of an offsetting impact, the ED is introducing unique non-offsetting earnings exposure through these proposed fair value measurement requirements on hedged items. We therefore encourage the Board to allow hedge accounting on a bifurcated risk basis in conjunction with a mixed-measurement model to avoid this gross inconsistency.

The decision to retain the ability of an entity to designate only foreign currency risk as the hedged risk also raises reason for concern. It creates a bias in the accounting model towards allowing special accounting treatment for only certain types of hedged exposures, but not for others. The Board's rationale for this decision that it would not be feasible within the scope of this project to reconsider FASB Statement No. 52, Foreign Currency Translation, does not in our view, provide a strong argument to support bifurcation by risk for only foreign currency risk (excluding hedge accounting for an entities own debt). Instead, with analogy to this statement, one may argue that by not allowing hedge accounting on a bifurcated risk basis, the mixed-measurement model may need to be revisited to prevent inconsistencies between the ED and conventional accounting standards - certainly an undertaking that would not be feasible within the scope of the current project.

We recommend that the Board provides further explanation on this proposed treatment for hedge accounting relationships involving foreign exchange risk. We do not believe leaving the provisions regarding hedge accounting involving foreign exchange risk unchanged, based on the rationale presented, is any more significant than the argument to keep the existing provisions regarding a general bifurcated hedged risk approach intact, when considered in the light of the potential inconsistencies that may arise.

The Board's decision to oblige entities to designate overall changes in fair value of the hedged item, instead of only changes on a bifurcated risk basis, would also force entities into the scope of FASB Statement No. 157, Fair Value Measurements ("FAS 157"). We are not certain whether this is an unintended consequence of the ED. Disregarding the Board's intention, this will result in additional complexities when the fair value of hedged items need to be calculated and disclosed in accordance with the aforementioned Statement's provisions. For instance, in determining the fair value of a portfolio of mortgages an entity would have to consider changes in fair value of each individual mortgage due to changes in credit spreads for each individual mortgagor in the portfolio, as well as the changes in the related liquidity premium that forms part of the cost of funds. The introduction of these additional complexities is contrary to achieving the Board's first stated objective of simplifying the accounting treatment for hedging relationships.

In light of the fundamental issues we have raised above the Board may wish to consider the concept of adjusting the fair value changes on the hedged item, attributable to changes in the unhedged risk, as an adjustment to other comprehensive income, as opposed to income. Under this approach, users of financial statements would receive the information that the Board believes they need. At the same time, the impact of unhedged risks that are present in the underlying hedged item would not be recorded in the income statement, whether these risks were designated as part of a hedging relationship or not. Even though this approach would not dispose of the additional complexities that would be encountered when recognizing the impact of unhedged risks, we feel that a more representative and comparable income statement would result.

We believe that the Board's decision to eliminate hedge accounting on a bifurcated risk basis leads to failure of achieving the project objectives:

- Complexities would be introduced by the fact that valuation techniques would need to be developed in accordance with FAS 157 to include the impact of unhedged risks. These risks may not typically be valued, as the mixed-measurement model does not require the impact of these risks to be recorded currently.
- The usefulness of financial reporting would be impaired by the exacerbation of inconsistencies between derivative accounting and accounting under the mixed-measurement model where common hedging strategies would now fail.
- The quality of financial reporting would further deteriorate where the impact of unhedged risks is not consistently recorded - only by certain entities and for certain hedged risks only – rendering financial statements to be incomparable.
- Major practical constraints would arise where current risk management measures would have to be revised – under the mixed-measurement model many organizations would be left without an effective means to offset income statement volatility caused by changes in fair values of derivative instruments. This issue also adversely impacts the Board's objective of addressing recognition and measurement anomalies.

2. Irrevocable hedge designation

We do not support the Board's decision to propose the irrevocable designation of hedging relationships. We feel that any attempt to simplify an accounting standard should be principle based and not introduce additional rules. Furthermore, based on practical experience, this issue has not presented itself as a particularly complex element of FAS 133, nor has it been the centre of any controversies or restatements.

Current accounting standards do not always allow for entities to reflect the true economic substance of their hedging activities. Macro hedging, for example, is not supported by FAS 133, and as a compromise entities are currently allowed to hedge risks on a portfolio basis where the portfolio is comprised of a pool of homogenous assets (or liabilities). These pools may constantly change due to the prepayment characteristics of products within the pools. As such, the ideal mix of derivatives designated as hedges against these

pools may also change over time, for instance to better hedge duration and/or convexity of a portfolio. Under these circumstances, the economic reality of the transaction has changed, but through an irrevocable hedge designation rule entities will be required to continue to account for the effect of a historical hedging relationship that is no longer representing the business purpose for which the hedging relationship was established at inception. The result is that even though an organization may be hedged on a macro-level, using this portfolio-based approach imposes the need to de-designate (and re-designate) hedging derivatives constantly. Under the ED, this would not be allowed and entities may be required to enter into additional transactions to give effect to the same intent, but by incurring additional costs in the process. Therefore, we do not believe that the introduction of an irrevocable hedge designation rule would ensure that the economic reality of portfolio hedging relationships is reflected. The prohibition on de-designating hedging relationships will not only severely affect the successful hedging of portfolios of homogeneous assets/liabilities, but will also lead to further divergence between the economic substance of an organization's risk management measures and its reported results. We propose that the Board amends the ED to allow for the de-designation of hedging relationships where these hedging strategies are being used.

We believe that the distinguishing characteristic between economic hedging and hedge accounting is the concept of choice in which hedging relationships, and when, to designate qualifying hedge accounting relationships. Where entities exercise the option of applying hedge accounting, they will be forced to continue to reflect the hedge accounting impact of a transaction even though their intent may have changed. In contrast, entities with the same economic hedging strategies, that choose not to apply hedge accounting, will not have to continue the same basis of accounting they have committed to at inception of the economic hedging strategy. In fact, such entities would have more freedom to manage earnings volatility. During periods in which favorable results are being obtained, they would not have to apply hedge accounting. Where results may be unfavorable, they may have the opportunity to designate a qualifying hedging relationship in order to prevent any further income statement volatility. We believe this *inconsistency could be eliminated by reinstating the ability to designate hedging relationships on a revocable basis*. This will ensure that organizations with prudent risk management practices are not treated unfairly by limiting their need for and use of risk management instruments.

We do not feel the Board's proposal that hedge accounting relationships can effectively be de-designated by entering into an offsetting trade to offset the impact of the original derivative is practically suitable. Furthermore, we believe that this proposal would significantly increase the need for customization of hedging derivatives (e.g. transacting an amortizing and/or cancellable swap to hedge prepayable instruments) and therefore increase the complexity and costs associated with hedging activities.

In practice, under the proposed amendment an entity would be forced to enter into two transactions to give effect to hedge de-designation: (i) to offset the original hedging derivative, and, (ii) to offset the impact of the first transaction. Such a series of transactions would require the incurrence of a real economic cost, to give effect to

management's intent: transferring a derivative from a hedging portfolio to a trading portfolio. In addition, in a substance-over-form paradigm, such a series of transactions should not be allowed, or encouraged, as a mechanism to de-designate hedging relationships.

Current GAAP allows management to change its intent with respect to the use of certain financial instruments by permitting management to concurrently change its accounting treatment to reflect this new intent. For instance, an entity may commence net settlement under certain own-use contracts and obtain derivative accounting treatment. A held-to-maturity portfolio of debt securities may be accounted for at fair value if management taints its portfolio, or by actively engaging in trading activities management may even display a held-for-trading intent. Through these illustrations it is clear that management's intent may change, and that accounting standards envisage this change in intent. However, the proposed ED no longer facilitates the use of a different accounting model where management's intent has changed with respect to hedge accounting. As a result, transactions would no longer be accounted for in accordance with an organization's intent.

We believe that the Board should prevent this inconsistency from arising, in line with the project's objectives, by not requiring irrevocable hedge designation. We believe that this amendment is necessary to continue the fundamental premise that hedge accounting is an optional accounting model and a model to be used to address recognition and measurement anomalies present under the mixed-measurement model.

In summary, the Board's decision to require entities to irrevocably designate hedging relationships is contrary to achieving its objectives:

- We fail to see how the introduction of a rule that requires irrevocable hedge designation achieves simplification of hedge accounting. In addition, a proposal to enter into a series of offsetting trades to de-designate a hedging relationship would result in operational complexities and an unnecessary use of scarce resources.
- Financial reporting will not be improved if entities can no longer reflect the economic reality of hedging on a portfolio basis using portfolio or dynamic hedging strategies which may require de-designation of certain hedging derivatives.
- The usefulness of financial statements will be impeded where the accounting results no longer aligns to management's intent or the economic reality of a hedging relationship. In contrast, there is no requirement to consistently account for economic hedges - this inconsistency will impede users' ease of understanding the financial results. We also do not believe that financial reporting is improved by requiring entities to enter into offsetting transactions to account for the true substance of a transaction.
- A major practical concern will arise where an entity can not rebalance its portfolio hedges due to the prohibition on de-designated hedging relationships. In turn this

may lead to ineffective hedging relationships and an exacerbation of measurement anomalies present in the mixed-measurement model.

3. Assessment of hedge effectiveness

We do not believe that a simplification project should introduce additional areas of interpretation for concepts where widely accepted market practices have already been established. In specific, we believe the move of the hedge effectiveness hurdle from “highly effective” to a “reasonable” expectation of effectiveness is merely academic in nature. We do not foresee that this proposed change would provide any significant benefit to preparers of financial statements, and in particular to financial institutions. The reason for this is that even the simplest form of hedging relationships typically established by these organizations will fundamentally be flawed, for instance where changes in the fair value of the hedging instrument do not contain similar credit risk exposure as a hedged item. Entities that frequently apply hedge accounting under advanced hedging strategies design hedging relationships to be highly effective over the term of the hedging relationship. A lower threshold would not generally be beneficial to such entities – in fact strategies using such lower threshold would result in an increase in reported hedge ineffectiveness, which is generally undesirable. This would further deteriorate users’ ease of understanding financial statements.

We are also concerned that the Board decisions regarding the simplification of effectiveness assessments may be inconsistent. We understand the rationale for removing the literature on use of the so-called “Short-cut method” and “Critical terms match” approach when assessing hedge effectiveness. In practice, the use of these methods has been severely restricted and has come under close scrutiny by officials in oversight roles. However, at the same time, the Board proposes to eliminate the need for ongoing effectiveness assessments based on the premise that a qualitative assessment at hedge inception can be performed. This might in practice be done by proving that all key terms of the hedged item and hedging instrument match. The only observable difference is the need to measure and recognize hedge ineffectiveness under this new method, which introduces additional complexity.

We do not believe that the combination of removing simplified hedge effectiveness assessment techniques and replacing it with similar, but more onerous techniques, achieves the Board’s objective of simplifying hedge accounting. A more consistent approach would have been to augment the current requirements for the use of the “Short-cut method” and “Critical terms match” approach to incorporate the need to measure hedge ineffectiveness. We also believe that the DIG Issue G20 approach (as described in Question 2 of the DIG) used to assess and measure ineffectiveness, could similarly be retained to at least conclude on the initial prospective and ongoing effectiveness of hedging relationships. Similarly, we believe that a mere introduction of a measurement-of-ineffectiveness-technique could supplement, rather than replace the G20 approach.

We believe that the current literature around the “short-cut-method”, “critical-terms-match approach” and DIG Issue G20 provides valuable guidance to qualitatively assess

hedge effectiveness. In instances other than where these methods would traditionally have been applied, it is doubtful whether any other form of prospective effectiveness assessment, other than some form of quantitative analysis, would meet the general expectations of regulators and auditors. In fact, for simple hedging relationships where changes in fair values would have to consider all risks, it is likely that a quantitative analysis would be the only reasonable approach to prove prospective hedge effectiveness. This may in practice lead to a more burdensome hedge accounting environment, in contrast to the Board's objective of simplifying hedge accounting. This is also expected to be an area that would cause practical application issues and potentially lead to inconsistencies as to when, and how, a qualitative assessment of effectiveness could and should be performed.

The Board's introduction of the perfect derivative concept to measure hedge ineffectiveness also causes reason for concern. By introducing this concept the Board is doing away with some of the simplifications and general agreement developed around the design and implementation of the hypothetical derivative concept, and raises significant practical questions. For instance, the perfect derivative may not be an actual derivative that is obtainable in the market; hence, an entity may be exposed to income statement volatility based on an exposure it can not hedge. We further believe that the introduction of this concept would create significant complexity in the design and valuation of the derivative, which may lead to different interpretations and inconsistent practices between entities, rendering incomparable financial results. This concept is introduced with very little guidance, difficult to understand, complex to define and to consistently model for valuation purposes and thereby seems to introduce a new practical issue for constituents to address.

We believe that the Board should consider certain simplifications in the design of the perfect derivative, to avoid impractical solutions, or inconsistent simplifications made by preparers themselves. In addition, the Board is encouraged to provide more guidance on the design of the perfect derivatives for common hedging strategies. In its current format we do not believe that the Board achieves its simplification objective by introducing the perfect derivative concept and also introduces an additional practice issue.

4. Hedging of an entity's own debt

The Board's decision to only allow entities to hedge the benchmark interest rate risk on an issuer's own debt when designated at the issuance of the debt prevents entities from taking prudent risk management actions.

Only entities with the most basic types of funding structures and static hedging relationships would be accommodated under these provisions - to effectively transform fixed rate debt into synthetic floating rate debt, and vice versa, as indicated in the Basis for Conclusions in the ED. We believe that the hedge accounting needs of all preparers of financial statements should be considered when developing hedge accounting standards concerning debt issuances and potential debt issuances.

Secondly, the fact that locking in a funding rate prior to funding date would not equally qualify for hedge accounting on a bifurcated risk basis may cause further inconsistency. In effect, an entity would only be allowed to hedge using the benchmark interest rate as a designated hedged risk upon the funding date. Prudent organizations with more sophisticated funding needs may in actual fact attempt to lock in their spread/fixed rate prior to an upcoming funding date. As described further on, such organizations would realistically be precluded from locking in a spread or rate prior to funding date. We do not believe that these provisions encourage prudent risk management behavior by organizations. We do not believe that the Board should make a distinction between situations where an entity locks in its rate at the funding date, or at any date prior to funding, as the only difference is the date on which an entity elects to convert its fixed rate debt into floating rate debt, or vice versa. Based on the ED, an entity would be required to close out its rate-lock-derivative, and enter into a new derivative on the funding date to give effect to the rule of hedging only at inception of the funding event. We do not believe that entities should be required to incur an economic cost to only obtain a specific accounting result.

Thirdly, we noted in the preceding paragraph that certain entities would realistically be precluded from locking in a spread or fixed rate prior to a funding date. Interest rate derivatives that are used for this purpose only hedge interest rate risk with respect to an anticipated debt issuance, and do not have credit risk exposure similar to that of the issuing entity. As such, a potential hedging relationship that involves an interest rate derivative attempting to hedge the all-in risk of an anticipated debt issuance is fundamentally flawed and would not qualify for hedge accounting. This impact can be overcome where an entity has the ability to more accurately project its credit spread and prove that it historically has had small and stable credit spreads. Only under these circumstances would an entity be eligible to potentially qualify for hedge accounting prior to the funding date where changes in fair value are determined based on the all-in risk of the anticipated debt issue.

This creates an inconsistency purely due to the fact that some entities issue debt more frequently than others, or have a more stable and strong credit history, even though the intent was never to offset the issuer's own credit risk exposure economically, or from an accounting perspective. Certain entities would therefore be precluded from applying hedge accounting prior to issuance date, whilst others may be able to overcome this hurdle and apply hedge accounting due to their proven credit quality. This would lead to incomparable accounting results, even in instances where identical economic hedging strategies were used by two competitors.

A disturbing byproduct of the ED would be that entities have to model, and potentially enter into transactions, to hedge their own credit risk. In hedging its own debt, entities will also have to deal with complexities in estimating its own credit spread, and in calculating hedge ineffectiveness based on changes in its own credit spread. This is contrary to the Board's objective of simplifying hedge accounting.

Fourthly, the Board is effectively encouraging entities to issue long term debt. Under current GAAP entities are allowed to designate changes in the benchmark interest rate for future roll-overs of fixed rate instruments, in effect hedging the variable interest pattern created by continuous roll-overs of fixed rate debt. The hedging instrument in a cash flow hedging relationship could typically be a pay-fixed interest rate swap with a potential maturity date up to the maturity the roll-over program. Due to the fact that the current ED would require the designation of a discrete hedging relationship at each potential funding or roll-over date, it would be extremely difficult to obtain the same economic result using a single pay-fixed interest rate swap. As such, entities would be required to mark-to-market the economic hedging derivative, or, augment their economic activities by issuing long term debt instead. We believe that this would introduce, as opposed to eliminate another major practice issue for entities relying on funding through roll-over strategies.

We believe that the ED should be amended to allow hedge accounting based on the benchmark interest rate for an entity's own debt prior to the funding date.

5. Other Concerns

Process of changing accounting for hedging relationships

FAS 133 is arguably the most complex accounting standard to be introduced by the Board as it deals with accounting for derivative instruments, a complex product in itself. The ED attempts to simplify a certain portion of this literature but fails to address some of the most complex areas of the standards, such as the definition of a derivative, identification and accounting for embedded derivatives and the scope of FAS 133. As such, the goal of simplifying the accounting for derivative instruments in general is not achieved by this ED.

The ED eliminates the use of the mixed-measurement model for most hedged items that have been designated in hedging relationships and effectively forces entities to adopt the fair value option - at the same time that constituents are struggling to come to terms with the complexities of applying FAS 157 and FAS 159. We believe that the mixed-measurement model is equally relevant as a foundation for both hedged items and unhedged items and provides useful information to users by distinguishing between financial instruments that are managed on a fair value basis and those that are not. We do not believe that a simplification project on hedge accounting provides a suitable opportunity to alter fundamental accounting principles in such a manner that it leads to the abolishment of the mixed-measurement model.

At the same time that the Board is undertaking this project, we understand that the International Accounting Standards Board ("IASB") is in the process of considering various options to simplify International Accounting Standard 39, Financial Instruments: Recognition and Measurement. The potential changeover from FAS 133's hedge accounting provisions to the ED's may confuse users of financial statements, as once these changes have been absorbed, interpreted and implemented, further changes may well occur within the foreseeable future due to the adoption of International Financial

Reporting Standards (“IFRS”). Convergence efforts between US GAAP and IFRS may result in concepts within International Accounting Standard 39, Financial Instruments: Recognition and Measurement becoming applicable once more under US GAAP. These series of potential changes may severely restrict users’ ease of understanding, and complicate comparisons between financial statements of preparers, which may fall in a different transition schedules for each of these potential changes.

We suggest that the Board undertakes a holistic approach in addressing the accounting for derivatives, other hedging instruments and hedged items, by reviewing FAS 133 in its totality, and work closely with the IASB in developing a comprehensive standard that extends beyond the most basic form of hedge accounting for US entities which may also only have a short tenure. As illustrated above, the ED only addresses a small component of the accounting for derivative instruments, introduces new complexities that are wider in scope than merely hedging relationships, and is potentially causing further divergence from IFRS in the short term.

The ED falls short on addressing the needs of the financial services sector

Given that TDBFG is in the financial services sector we obviously have a specific interest in ensuring that the hedge accounting needs of this sector are considered by the Board. Based on the issues described above it is clear that the ED will have a significant adverse impact on the hedge accounting practices employed within the financial services sector.

Entities with more simplistic hedge accounting practices would not be affected in a similar fashion, as they may not have significant exposures to be hedged on a bifurcated risk basis, such as the hedging needs of a typical Asset-Liability Management function, nor would they routinely use portfolio or dynamic hedging strategies that require constant de-designation and re-designation of hedging relationship to rebalance portfolio exposures.

We believe that the proposed ED accommodates the issues entities with less complex risk management practices may encounter. Hedging relationships typically designated by these entities (e.g. hedging of their own debt and hedging of their foreign exchange exposures) will still be permitted on a bifurcated risk basis. In fact, the ED will allow a more liberal approach to the designation of hedging relationships by these entities through less rigorous hedge effectiveness testing requirements.

We encourage the Board to consider and address the practical constraints the ED would impose on all preparers of financial statements, but also specifically for preparers in the financial services sector. We believe that the scope of an improvement project’s recommendations should be inclusive of hedging practices across all industry participants, and not only of industry participants without complex hedging practices.

Cost and benefits

After careful consideration we believe the number of inconsistencies that arise from the ED and the resultant impact on financial reporting may outweigh any benefits envisaged from simplified hedge accounting practices and may further impede comparability between financial statements of preparers. This lack of clear benefits to the users is also evident when we evaluate the ED against the Board's objectives for each of the major issues we have raised and per objective in the appendix.

From a cost perspective the proposed changes would require a certain level of investment, but more importantly, vast investments previously made by organizations to meet FAS 133's stringent requirements would become largely redundant. Organizations that made these investments would now be subject to severe, unjustifiable income statement volatility, as most simple hedging relationships - for which these systems were developed - would no longer meet the conditions of the proposed simplified version of FAS 133. We do not believe that organizations that developed sophisticated hedge accounting solutions and embraced the current hedge accounting provisions should be penalized for their previous efforts.

As a result of the lack of clear and distinguishable benefits, and the cost involved in adopting the ED, including the potential redundant investment made in systems and processes to meet FAS 133's requirement, we do not believe the implementation of the ED in its current format is justifiable.

Timing

The ED proposes fundamental changes to current hedge accounting practices. We do not believe that a comment period of approximately ten weeks allows for sufficient response to such a complex area. In contrast, the IASB's discussion paper entitled: "Reducing Complexity in Reporting Financial Instruments", allows for an initial comment period of approximately six months, where-after an exposure draft may be issued. We recommend that the Board allows further time for industry groups to consolidate comments and identify any further issues which are not immediately apparent upon first reading the ED.

We also do not believe that a proposed effective date of June 15, 2009 is readily achievable. The fundamental changes proposed in this ED would have an impact on areas such as investor relations activities, regulatory capital requirements and other areas for large organizations. To fully absorb the impact of the proposed changes, educate financial statement stakeholders, redesign hedging strategies - where possible or required, meet the transition requirements, as well as come to agreement with external auditors on any changes in accounting, would require at least an additional six month window. We therefore encourage the Board to delay the effective date of the final Standard by at least six months.

Final Remarks

In conclusion, we believe that the proposed changes would lead to further inconsistencies between a hedge accounting paradigm and conventional accounting standards. We also believe that the approval of this ED would not be of any significant value for the users of financial statements, as the gap between (a) sophisticated risk management techniques and risk management instruments, and (b), accounting standards, would widen. We also believe that the Board only partially achieved the objectives it set out for this project, and then only for certain constituents. We have highlighted some of the areas where we expect the ED would have a profound impact on preparers of financial statements, and in specific financial institutions, and how this impact is contrary to achieving the Board's objectives. We strongly encourage the Board to revisit the affected areas and work closely with the IASB to develop hedge accounting standards that would better suit all users' needs.

We thank the Board for the opportunity to present our views and recommendations and would be pleased to further discuss our comments with you.

Sincerely,



.....
Kelvin Vi Luan Tran
Senior Vice President Finance and Chief Accountant

APPENDIX A

Evaluation of the ED Against the Board's Objectives

a. Simplification:

We believe that the simplification concepts introduced through the ED are only relevant to preparers of financial statements with basic hedge accounting needs, and only in certain limited instances. Preparers with more complex hedging strategies would have to deal with additional complexities, as highlighted below:

- Entities would be required to mark-to-market unhedged risks for hedging relationships where these risks were previously not recorded for at fair value under the mixed-measurement model, thereby introducing valuation complexities.
- Irrevocable hedge designation would oblige entities to continue to apply hedge accounting and meet the hedge accounting requirements, even after management's intent has changed, or where the initial economic exposure has changed.
- The ED envisages that entering into a series of offsetting trades would have the same effect as de-designating a hedging relationship. This may cause additional costs and utilization of operational capacity.
- The amended effectiveness assessment threshold may confuse users as to when an effective hedging relationship exists, and whether the hedging instrument is truly effective in offsetting the identified hedged risk exposure. This would be even more evident where the hedged risk exposure does not align with management's actual risk management practices.
- The ED is removing literature on how to qualitatively assess hedge effectiveness without replacing existing guidance that can be referred to in this regard.
- The ED is removing the current literature on how to quantitatively assess effectiveness and measure ineffectiveness for cash flow hedges and introduces the concept of a perfect derivative. It is expected that this concept will lead to significant complexity as it is introduced with very little guidance, difficult to understand, complex to define and would prove challenging to consistently model for valuation purposes.
- When hedging its own forecasted debt issuances entities will have to deal with complexities in estimating its own credit spread, and in calculating ineffectiveness based on changes in its own credit spread. It may also create incentive to manage its own credit risk in order to obtain hedge accounting which causes conceptual challenges.

b. Improve Financial Reporting, usefulness and ease of understanding:

We believe that this is a valiant objective of the Board, and arguably the most persuasive objective that would warrant changes to FAS 133. The following issues support our view that this objective is not achieved by the ED in its current format:

- The lower effectiveness threshold introduced by the ED would lead to increased income statement volatility that would reduce users' ease of understanding financial statements, especially where volatility is not reflecting the economic nature of an enterprise and its associated risk management techniques. Increased hedge ineffectiveness reported will also call into question management's ability to effectively hedge key exposures.
- In addition, the ED's requirement to include the impact of unhedged risks will not provide useful information to users - the impact of unhedged risks would be recorded only by certain entities and for certain hedged risks only. In contrast, entities that do not apply hedge accounting, or entities that designated only certain hedged risks would not have to account for the impact of unhedged risks. We believe this would cause financial statements to be incomparable and inconsistent.
- Inconsistencies between derivative accounting and accounting under the mixed-measurement model will be further exacerbated in the absence of common hedging strategies which would fail to meet the hedge accounting requirements under the ED. This will impair the usefulness of financial statements.
- Further divergence between the impact of risk management measures organizations undertake and financial reporting would occur, especially for entities that hedge on a bifurcated risk basis or entities that employ portfolio or dynamic hedging strategies – common strategies used by entities with prudent risk management practices. This divergence would be detrimental to users' understanding of the financial results and will not improve financial reporting of hedging activities.
- The usefulness of financial statements will further be impeded by the fact that hedge accounting would not allow for accounting results to align to management's intent, as hedging relationships would have to be designated in an irrevocable manner. A further inconsistency arises when an accounting treatment is locked in for an economic hedge that has been designated in a hedging relationship, but where the accounting treatment for economic hedges for undesignated strategies offers more flexibility. This appears to be the case even where the economic composition of the hedged item has changed – typically experienced in portfolio or dynamic hedging strategies. We believe that users would not be able to understand with ease why this inconsistency is acceptable.
- The Board's proposal to enter into offsetting transactions instead of de-designating hedging relationships is not improving financial reporting and is contrary to accounting based on intent and substance-over-form.
- The usefulness of financial statements will also be questioned when two entities entering into similar economic hedging transactions, e.g. forecasted debt issuances, would not necessarily be in a position to achieve similar accounting results, i.e. hedge accounting. This may occur as a result of the unpredictability of one company's basis risk, or the instability of that company's credit spread. Comparability of these entities' financial statements, involving similar type of

transactions, would be compromised, even though both companies essentially hedged the same economic risk – exposure to changes in the benchmark interest rate.

c. Resolve major practical issues:

We applaud the Board's efforts in attempting to resolve practical issues through the ED, but have concern over its focus on this specific area of FAS 133. Many other practical issues have arisen from FAS 133, which are left untouched by this ED, and will continue to cause concern to the general public. In its current format, FAS 133 has taken many years to be refined to the point of becoming a practical standard addressing accounting for derivatives. We are concerned that the Board's current process on improving hedge accounting did not undergo the same rigor and will invariably lead to significant and substantial practical implications. We have identified certain of these practical concerns identified to date below. We believe that for entities within the financial services sector in particular these practical issues are so persuasive that it would lead to inconsequential hedge accounting standards. For instance:

- Day-to-day risk management measures would become impractical when entities can not engage in hedging specific risks, such as the benchmarked interest rate, or, where entities can not rebalance its portfolio hedges due to the prohibition on de-designating hedging relationships.
- Hedging of common short-term funding through roll-over programs of fixed rate debt, such as commercial paper, would be difficult to achieve when an entity has to designate the overall changes in fair value of the anticipated debt issuance as the hedged risk. Similarly, hedging forecasted debt issuances would also become impractical due to the introduction of the need to include other risks, such as an entity's change in credit spread. The projection of an entities own credit, and the potential requirement to enter into credit derivatives to hedge an entities own credit in order to achieve a reasonable expectation of hedge effectiveness is also impractical.
- The introduction of the perfect derivative concept to assess and measure ineffectiveness appears problematic and vague. It is doing away with some of the simplifications and general agreement developed around the design and implementation of the hypothetical derivative concept, and raises significant practical questions.
- Entities may also struggle to determine the impact of changes in fair value due to changes in unhedged risks - previously not required to be marked-to-market. These risks may not typically be valued, as the mixed-measurement model does not require the impact of these risks to be recorded. At the same time, the mixed measurement model still does not provide the option to offset changes in fair value for all common positions of financial institutions, such as deposit books, even after the introduction of SFAS 159. This may leave many organizations without an effective means to offset income statement volatility caused by changes in fair values of derivative instruments.
- Further practical constraints would be evident where management can not account for their change in intent, as a result of the restrictions on de-designating hedging

relationships, that is, without incurring an economic cost to enter into offsetting transactions.

- The Board proposed the use of a qualitative assessment of effectiveness under certain circumstances. At the same time potential guidance on how to perform such an analysis, for instance by referring to the literature on the “short-cut method” or “critical-terms match” approach has been removed by the ED. It is unclear when a qualitative assessment would suffice in practice, and what factors should be considered when reaching a conclusion.

d. Address recognition and measurement anomalies:

We are cognizant of the fact that resolving anomalies between accounting for derivative instruments and the accounting for hedged items or transactions are particularly challenging under a mixed-measurement model. However, we believe that through the ED the Board amplified these anomalies by:

- Severely restricting the application of hedge accounting for many entities, for example, by prohibiting hedge accounting on a bifurcated risk basis, and by requiring irrevocable hedge designation (which is not practical for portfolio or dynamic hedging strategies). In the absence of hedge accounting available for common economic hedging strategies, the recognition and measurement anomalies that arise between derivatives and legacy hedged items would be exacerbated.
- Requiring accounting for the economic impact of unhedged risks, even though these unhedged risks will not be matched in derivative products. As such, changes in fair values of the derivatives would not offset changes in fair values of hedged items. In contrast, for economically hedged items which have not been designated in qualifying hedging relationships the economic impact of unhedged risks would not be recorded and measured. This creates a significant measurement inconsistency.
- Requiring entities to model its own credit spread when hedging forecasted debt issuances, account for changes in its own credit spread, and potentially entering into derivatives to hedge its own credit spread. The risk of changes in an entity’s own credit spread is normally not hedged - this may create further anomalies between changes in fair value of the hedged item when compared to changes in fair value of the hedging derivative.

Our evaluation of the ED against the Board’s stated objectives leads us to believe that the ED fails to meet the objectives in many instances, and as such, should not be issued in its current format.