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Financial Accounting Standards Board
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LETTER OF COMMENT NO. 76

15 August 2008

File Refernce No. 1590-100, Accounting for Hedging Activities, an amendment of FASB Statement No. 133

Dear Mr. Stoklosa:

UBS appreciates the opportunity to comment on the Exposure Draft of Proposed Statement of Financial Accounting Standards *Accounting for Hedging Activities* (the proposed Statement). UBS is a global financial services firm that employs derivatives in hedging strategies for its own benefit and provides counterparty derivatives as a service to clients as they manage their own risk exposures. In addition to our consolidated financial statements, which are prepared in accordance with International Financial Reporting Standards, we have subsidiaries that prepare financial statements in accordance with US GAAP.

UBS is aware of the significant complexity that exists in the current US GAAP literature related to accounting for hedging activities. We fully support the Financial Accounting Standards Board's efforts to simplify the 800+ pages of US GAAP hedge accounting guidance. The current complexity in US GAAP has lead to numerous restatements by many firms due to widespread misapplications and repeated reinterpretation. However, while we support the proposal to modify the effectiveness threshold from highly effective to reasonably effective, we believe other proposals within the proposed Statement will result in financial statements that are more volatile, and less reliable.

Given the movement toward a single set of global accounting standards and the complexity with which our clients deal in complying with hedge accounting rules, we feel it is necessary that we participate in the discussion about how best to proceed with improvements to hedge accounting. In that capacity, we are writing to express our concerns with the proposed Statement's elimination of the ability of an entity to designate individual risks as the hedged risk in a fair value or cash flow hedge.

If companies are prohibited from designating individual risks as the hedged item, there is a great concern that financial statements will not reflect economic reality. This is because entities may choose not to apply hedge accounting, increasing income statement volatility from the hedging instrument or apply hedge accounting and increase income statement volatility from changes in fair value of the unhedged risk. We do not believe that the benefits of modifying the effectiveness threshold from highly effective to reasonably effective exceed the problems associated with the increased income statement volatility. As a result, unless the bifurcation-by-risk framework is retained we would not support the final issuance of this proposed Statement.

Responses to specific questions raised in the proposed Statement are included in the appendix (Appendix A) to this letter. Please contact us if you would like to discuss any comments that we have made.

Kind regards

UBS AG

Ralph Odermatt	John Gallagher
Managing Director	Managing Director
Head of Accounting Policy and Support	Accounting Policy and Support

Appendix A
Responses to Questions

Issue 1: For the reasons stated in paragraph A16 of this proposed Statement, the Board decided to eliminate (with two exceptions) the ability of an entity to designate individual risks as the hedged risk in a fair value or cash flow hedge. As a result of that change, the financial statements would reflect information about the risks in the hedged item or transaction that an entity both chooses to manage and not to manage as part of a particular hedging relationship.

Do you believe that the proposed Statement would improve or impair the usefulness of financial statements by eliminating the ability of an entity to designate individual risks and requiring the reporting of the risks inherent in the hedged item or transaction?

We strongly believe that eliminating the ability of an entity to designate individual risks as the hedged risk will impair the usefulness of financial statements. We do not agree with the Board's position that 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 result of operations from hedge accounting activities"*. We agree that the effect of the proposed Statement is directionally consistent with the goal of measuring all financial instruments at fair value, but that this approach will only serve to increase income statement volatility, which may not reflect the economics of the transactions. We believe that the current bifurcation-by-risk model accurately reflects an entity's ability to hedge individual risks. Requiring the measurement of the effect of unhedged risks in the hedge accounting model will obfuscate the effectiveness of hedges on the hedged risks.

In addition to applying hedge accounting for its own use, UBS provides derivative products to clients of all sizes though our investment bank operations. UBS is concerned that those clients that enter hedging transactions to manage risks and volatility may be written out of the market due to the inability under the proposed Statement to designate individual risks as the hedged risk. The incorporation of all risks of the hedged item into the assessment of effectiveness may preclude certain smaller companies from achieving hedge accounting due to credit and basis risk effects were they even able to perform the assessment necessary to determine reasonable effectiveness. The examples below illustrate situations in which the proposed Statement could impair risk management practices and financial statement presentation usefulness.

Cash flow hedge – changes in cash flows attributable to changes in the benchmark interest rate on a forecasted debt issuance

Hedging the benchmark interest rate risk associated with a forecasted debt issuance using a treasury-lock or a forward starting swap is a very common risk management strategy that mitigates or eliminates benchmark interest rate risk for the borrower prior to the date of issuance. Under the proposed Statement, this strategy would be required to be designated as a hedge of the total forecasted cash flows and not just cash flows related to changes in the benchmark interest rate. We believe that a majority of such hedges would no longer qualify as effective under the proposed model as there are key factors that impact the ultimate coupon on a debt issuance that are not incorporated in the hedging instrument. Specifically, new issue premiums (driven by supply and demand dynamics on the date of issuance) and changes in the credit spread of the borrower are not and may not be able to be effectively/efficiently hedged. Given new issue premiums are not price or indexed based, changes in cash flows related to them will not be able to be effectively hedged. Additionally, companies typically do not hedge their own credit risk as a matter of concerns around self-dealing and reputational risk as well as enforceability.

Given the issues with hedging certain variables expressed above, we believe that a majority of companies that employ such a prudent risk management strategy will abstain from doing so in the future due to the undesired earnings volatility resulting from purposely unhedged cash flow variability. We also believe that certain highly rated issuers with less volatile credit spreads may still be able to achieve hedge accounting with some amount of ineffectiveness and this raises fairness and comparability concerns. Should a AAA-rated conglomerate be able to hedge forecasted debt issuances and a BB high yield borrower be constrained or restricted from doing so due to the increased earnings volatility? We do not believe this is helpful to users or improves the usefulness of financial statements, yet this will be the result of the proposed Statement.

Fair value hedge – changes in fair value attributable to changes in the benchmark interest rate on a previously issued piece of fixed rate debt

The proposed Statement permits a hedge designation on own debt at inception, but disallows hedge accounting for so-called "late hedges" of own debt. Hedging fixed rate debt (callable and non-callable) for changes in the benchmark interest rate is also a very common risk management strategy employed by companies in various sectors. Companies frequently assess their asset and liability interest rate sensitivities and seek to maintain them at certain reasonable levels without introducing undue risk to debt/equity investors and other parties interested in the well being of the institution. Plain vanilla interest rate swaps are commonly used to alter the asset and liability sensitivities to interest rates. Given the proposed Statement will require companies to hedge the total changes in fair value on a "late hedge" as opposed to purely interest rate risk, this will likely lead to undesired earnings volatility due to ineffectiveness related to purposely unhedged risks (i.e. credit) or the loss of hedge accounting all together. We believe this will lead to inappropriate risk management decisions in an environment where risk management is tantamount to shareholder value.

In summary, we do not support elimination of the bifurcation-by-risk model currently prescribed in SFAS 133 and encourage the Board to reconsider this amendment as it will lead to poor risk management decisions given the counterintuitive earnings volatility related to purposely unhedged risks.

Issue 2: For the reasons stated in paragraphs A18–A20, the Board decided to continue to permit an entity the ability to designate the following individual risks as the hedged risk in a fair value or cash flow hedge: (a) interest rate risk related to its own issued debt (that is, its liability for funds borrowed), if hedged at inception, and (b) foreign currency exchange risk. For those two exceptions, the financial statements would not reflect information about the risks that an entity chooses not to manage as part of a particular hedging relationship.

Do you believe the Board should continue to permit an entity to designate those individual risks as a hedged risk?

Yes, we strongly believe that it is essential to permit entities the ability to hedge individual risks as the hedged risk. As noted in our response to Issue 1, we would not limit this ability to own issued debt, but we recommend that this be permitted for all financial assets and liabilities. The same arguments that are made in paragraph 18 in regard to why entities synthetically create fixed-rate or variable-rate debt can be made for assets. If the Board believes that it is appropriate to consider changes in own credit risk when measuring liabilities at fair value, we do not understand why an exception should be made for hedges of own issued debt but not for assets.

Issue 3: This proposed Statement would eliminate the shortcut method and critical terms matching. Therefore, an entity would no longer have the ability upon compliance with strict criteria to assume a hedging relationship is highly effective and recognize no ineffectiveness in earnings during the term of the hedge. As a result, when accounting for the hedging relationship, an entity would be required, in all cases, to independently determine the changes in fair value of the hedged item for fair value hedges and the present value of the cumulative change in expected future cash flows on the hedged transaction.

Do you foresee any significant operational concerns or constraints in calculating ineffectiveness for fair value hedging relationships and cash flow hedging relationships?

Do you believe that the proposed Statement would improve or impair the usefulness of financial statements by eliminating the shortcut method and critical terms matching, which would eliminate the ability of an entity to assume a hedging relationship is highly effective and to recognize no ineffectiveness in earnings?

No, we do not foresee any significant operational concerns or constraints in calculating ineffectiveness. We believe that eliminating the shortcut method and critical terms matching will improve the usefulness of financial statements. Due to the number of restatements as a result of the complexities associated with hedge accounting, we welcome the efforts of the Board to simplify hedge accounting. We agree that it is inappropriate to assume perfect effectiveness as other attributes may contribute to ineffectiveness. This step, while requiring some additional operational efforts insures that any ineffectiveness is recognized while at the same time reduces the risk of a restatement.

The proposed Statement also raises issues of comparability and consistency due to the fact that it would require hedged items to be measured and presented differently from unhedged items within the same entity. Take for instance an unhedged loan, the loan is carried at its amortized cost with losses recorded under SFAS 5 in the allowance for loan losses and taken through income as a charge for credit losses. The same treatment is required of hedged loans under current guidance. Under the proposed Statement, credit events on a hedged loan would be recognized through the income statement as a gain or loss on the value of the loan, and not as a charge for credit loss.

Issue 4: This proposed Statement would modify the effectiveness threshold necessary for applying hedge accounting from *highly effective* to *reasonably effective* at offsetting changes in fair value or variability in cash flows.

Do you believe that modifying the effectiveness threshold from highly effective to reasonably effective is appropriate? Why or why not?

For situations in which interest rate risk is currently designated as the hedged risk for financial instruments but would no longer be permitted under this proposed Statement except for an entity's own issued debt at inception), do you believe you would continue to qualify for hedge accounting utilizing your current hedging strategy? If not, would you (a) modify your hedging strategy to incorporate other derivative instruments, (b) stop applying hedge accounting, (c) elect the fair value option for those financial instruments, or (d) adopt some other strategy for managing risk?

Given the complexities associated with hedge accounting, we support modifying the effectiveness threshold from highly effective to reasonably effective. As long as an entity independently fair values the hedged item and hedging instrument, we do not believe that there is any need to continuously perform detailed effectiveness testing procedures. The time and effort to maintain these effectiveness tests and the punitive consequences of unintentional non-compliance with the documentation requirements under the current standard is not justified.

UBS does not extensively apply hedge accounting under US GAAP. However, for the hedge accounting we do employ, we will likely adopt a combination of continuing to qualify for hedge accounting under our current hedging strategy, and electing the fair value option. We do not believe that companies will incorporate other derivative instruments into their hedging strategies (such as a credit enhancement to mitigate the credit risk component) or adopt alternative strategies for managing risk, as it would be too expensive or uneconomical. However, we are concerned that other companies may stop hedging as a result of these changes. Although we do not believe that this is the right decision or in the best interest of shareholders, it may in fact be the outcome of not permitting the hedging of individual risks.

Issue 5: This proposed Statement always would require an effectiveness evaluation at inception of the hedging relationship. After inception of the hedging relationship, an effectiveness evaluation would be required if circumstances suggest that the hedging relationship may no longer be reasonably effective.

Do you foresee any significant operational concerns in creating processes that will determine when circumstances suggest that a hedging relationship may no longer be reasonably effective without requiring reassessment of the hedge effectiveness each reporting period?

Do you believe that requiring an effectiveness evaluation after inception only if circumstances suggest that the hedging relationship may no longer be reasonably effective would result in a reduction in the number of times hedging relationships would be discontinued? If so, why?

No, UBS does not see any significant operational concerns in creating a process to determine when a hedging relationship may no longer be reasonably effective. As companies will be required to independently value the hedge and the hedging instrument, we believe that ineffectiveness will be apparent at each measurement date. There will be some adjustment in practice required to move away from the currently accepted highly effective threshold to reasonably effective and regulators and auditors will need to become comfortable with accepting the judgment of preparers in this regard.

Yes, we do believe that only requiring effectiveness testing in certain circumstances will in fact lead to a reduction in the number of times hedging relationships will be discontinued. Currently, companies will at an early stage often discontinue hedge accounting in situations where the possibility of falling outside the 80-125% bands may occur, even if only temporary. Under the proposed Statement, those same companies may continue hedge accounting if there is an expectation that the current environment is temporary.

Issue 6: The Board considered but decided against eliminating any assessment of effectiveness after the inception of the hedging relationship. The Board believes that eliminating such an assessment of effectiveness could result in the continuation of hedge accounting even when situations suggest that the hedge relationship may no longer be reasonably effective. Some observe that an implication of the decision to not eliminate any assessment after the inception of the hedging relationship could be that hedge accounting results would be reflected in some reporting periods and not in other reporting periods throughout the life of the relationship. Also, in a hedge accounting model that generally does not permit hedging of individual risks, changes in the relationship between the individual risks being managed and those not being managed could increase the likelihood that the hedging relationship would no longer be reasonably effective. That would result in hedge accounting no longer being permitted for a portion of an expected hedge term. That "in and out" of hedge accounting would make it more difficult for users to interpret financial statements.

Do you agree with the Board's decision to continue to require that hedge accounting be discontinued if a hedge becomes ineffective? Alternatively, should an effectiveness evaluation not be required under any circumstances after inception of a hedging relationship if it was determined at inception that the hedging relationship was expected to be reasonably effective over the expected hedge term?

In practice, UBS believes that companies will re-balance or discontinue hedge accounting if a hedge becomes ineffective. As a result, we do not object to the decision to require hedge accounting to be discontinued if a hedge becomes ineffective.

UBS also supports the proposal to move the designation effectiveness threshold from highly effective to reasonably effective. This move to a principle-based threshold for designation is welcomed and appropriate. We do believe that moving to a principled application will result in challenges by auditors and regulators and will involve additional documentation burden to justify effectiveness and ineffectiveness determinations. However, these additional steps will be offset by cost savings from no longer having to perform extensive effectiveness testing.

Presentation of Hedging Gains and Losses

Issue 7: In the statement of operations, Statement 133 does not prescribe the presentation of gains and losses associated with hedging instruments, including the effective portion, the ineffective portion, and any amounts excluded from the evaluation of effectiveness, such as forward points. Some have suggested that such a prescription would improve financial reporting by creating consistency in the presentation of these amounts across all entities. Others observe that FASB Statement No. 161, *Disclosures about Derivative Instruments and Hedging Activities,* requires disclosure about that information, and they question whether a prescriptive approach is appropriate given the diverse hedge accounting strategies employed by entities.

Do you believe that Statement 133 should be amended to prescribe the presentation of these amounts? For example, the Statement could require that the effective portion of derivatives hedging the interest rate risk in issued debt be classified within interest expense and that the ineffective portion and any amounts excluded from the evaluation of effectiveness be presented within other income or loss.

UBS does not believe that specific guidance related to gains and losses on hedging activities is necessary.

Effective Date and Transition

Issue 8: *The Board's goal is to issue a final Statement by December 31, 2008. The proposed* Statement would require application of the amended hedging requirements for financial statements issued for fiscal years beginning after June 15, 2009, and interim periods within those fiscal years.

Do you believe that the proposed effective date would provide enough time for entities to adopt the proposed Statement? Why or why not?

Yes, UBS believes that the proposed effective date would allow sufficient time to implement the proposed Statement.

Issue 9: The Board did not prescribe any specific transition disclosures upon the adoption of this Statement.

Do you believe that there are specific disclosures that should be required during transition? If so, what? Please be specific as to how any suggested disclosures would be used.

UBS does not believe that specific guidance related to disclosure should be required during transition. UBS believes preparers will make the necessary voluntary disclosures to inform their financial statement users as to the effect of the changes.

Issue 10: The Board decided to permit an entity a one-time fair value option election under FASB Statements No. 156, *Accounting for Servicing of Financial Assets,* and No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities,* for (a) servicing assets and servicing liabilities designated as a hedged item on the date immediately preceding initial application and (b) eligible financial instruments designated as a hedged item on the date immediately preceding initial application of this proposed Statement.

Do you agree with the Board's decision to allow a one-time fair value option at the initial adoption of this proposed Statement? Do you agree with the Board's decision to limit the option to assets and liabilities that are currently designated as hedged items under Statement 133?

If the proposed Statement will force entities that are currently utilizing hedge accounting in hedges of bifurcated risks to measure and recognize all risks of hedged items on a go-forward basis and de-designate and re-designate at adoption, then it is appropriate to provide limited transition relief through the exercise of the fair value option. As the proposed Statement is strictly targeted at hedge accounting relationships, limiting the exercise of the option to those transactions is appropriate.

Benefit-Cost Considerations
Issue 11: The objective of financial reporting is to provide information that is useful to present and potential investors, creditors, donors, and other capital market participants in making rational investment, credit, and similar resource allocation decisions. However, the benefits of providing information for that purpose should justify the related costs. The benefit-cost considerations considered by the Board are provided in paragraphs A43–A50 in Appendix B of this proposed Statement.

Do you believe the Board identified the appropriate benefits and costs related to this proposed Statement? If not, what additional benefits or costs should the Board consider?

Overall, if the final Statement eliminates the ability of an entity to designate individual risks as the hedged item, then we would not agree with the cost/benefit analysis cited in the proposed Statement. As noted earlier, we believe that if companies are prohibited from designating the individual risks as the hedged item, there is a great risk that financial statements will not reflect economic reality. This is because entities may choose not to apply hedge accounting, increasing income statement volatility from the hedging instrument or apply hedge accounting and increase income statement volatility from changes in fair value of the unhedged risk. We do not believe that the benefits of modifying the effectiveness threshold from highly effective to reasonably effective exceed the problems associated with the increased income statement volatility.

Other Comments Related to Intercompany Foreign Currency Hedging Activities

UBS is concerned that amendments to the hedge accounting rules in paragraph 40 of SFAS 133, related to intercompany foreign currency hedging on forecasted transactions, is unclear as to impact. We are concerned that this change may lead to adverse interpretation and affect intercompany hedging transactions currently allowed under SFAS 133. In order to clarify the impact of these changes, we recommend that examples be included to illustrate which intercompany transactions will be affected by the proposed Statement and what the effect will be.