



LETTER OF COMMENT NO. 6

September 20, 2007 [via EMAIL]

Russell G. Golden  
Director of Technical Application &  
Implementation Activities  
FASB  
401 Merritt 7  
P.O. Box 5116  
Norwalk, CT 06856-5116

**File Reference: Proposed Issue E23**

We appreciate the opportunity to comment on the proposed Statement 133 Implementation Issue E23, "Issues Involving the Application of the Shortcut Method under Paragraph 68" ("Issue E23"). As a manufacturing company with an active risk management program, we are concerned about the operational issues that would result from implementing the proposed changes. We believe the proposal amends SFAS No. 133, rather than provides implementation guidance about the shortcut method, and has the unintended effect of taking away an effective risk management tool from our treasury function. We believe the shortcut method is essential for companies to be able to continue their hedging programs and should be preserved. Consequently, we do not support the issuance of Issue E23.

As a preparer, we are also concerned that there are multiple projects in the works relating to hedging activities, as well as the upcoming effective date for SFAS No. 157, "Fair Value Measurements," and SFAS No. 159, "Fair Value Option for Financial Assets and Financial Liabilities" which can affect how companies account for their hedging programs. An incremental, piece-meal approach is burdensome for companies as changes made now will likely be subject to change again in the near future and only adds to the compliance cost for preparers. In addition, the use of terms such as "typical" in Issue E23 still leave preparers subject to reinterpretation.

Since the effective date of SFAS No. 133 on January 1, 2001, we have conducted our hedging program with the understanding that the shortcut method was developed in response to cost/benefit concerns over the complexities of long-haul methods and to simplify the computations and accounting for common interest rate risk management practices, like interest rate swaps. We believed that the FASB recognized that if the critical terms of the hedged item and hedging instrument matched and did not contain unusual terms, a company was able to successfully change the economic profile of an interest bearing financial instrument from fixed to floating, or vice versa. The underlying economic premise was that both instruments were priced and marked-to-market off the same interest rate curve and therefore, had the same economic profile even though the actual mark-to-market amounts would differ over time, primarily due to coupon differences.

We believe the new concept of "late hedging" (and the proposed prohibition from using the shortcut method for such hedges) is counterintuitive to prudent risk management strategy which inherently expects a company to respond to changes in the market that occur throughout the life

of a debt instrument. We also believe the concept of “late hedging” was within the original intent of the Board to provide an accommodation for companies entering into such hedging relationships. The economic “success” of the hedging relationship occurs whether the hedge is entered into at inception or sometime later after issuance. For example, we have long-term fixed rate debt maturing in 2096 that was issued many years ago. Over the course of the next 89 years, interest rates will change and prudent risk management would undoubtedly result in times when we should hedge our interest rate risk and times when we would be best served by not hedging this interest rate risk. For any new debt issuance, the “set it and forget it” approach that would have to be employed to use the shortcut method under Issue E23 effectively nullifies any real risk management by our treasury function. Any company that hedges exposures dynamically (or any company that desires to change its risk profile by changing its fixed-floating mix) will be subject to a significant administrative burden to maintain a hedging program, increasing the likelihood that companies will be forced to change their risk management strategies.

Employing the long-haul method of effectiveness testing in lieu of the shortcut method is not only more burdensome analytically, it has unintended consequences for our treasury and risk management functions and will change the way capital is deployed if current hedging programs are maintained. In order to minimize the likelihood and magnitude of ineffectiveness from an interest rate swap (a “late hedge”) that would have previously qualified for the shortcut method, we would have to enter into “off-market” swaps that require a significant upfront investment in order to sufficiently match the terms due to the fact that virtually all outstanding debt has coupon payments significantly higher than current swap rates. Thus, the decision to enter into a hedge is also a decision to invest hundreds of millions of dollars. Previously, implementing a swap after the issuance of the debt and using the shortcut method cost the company zero upfront. There is a significant opportunity cost to tying up that capital in a derivative and not having it available for other corporate needs.

As an example, if one were to assume a company’s debt portfolio consisted of \$10 billion of liabilities maturing in ten years with an average coupon of 6%, there would be an SFAS No. 133-induced incentive to invest approximately \$800 million to enter into “off-market” swaps in an attempt to avoid future ineffectiveness. This investment would be required to sufficiently match the terms enough to achieve the same result under the long-haul effectiveness method (no unpredictable ineffectiveness) that achieved under the short cut method and at no cost.

Because proposed Issue E23 makes “late hedging” more burdensome, companies have a significant bias to issue 100% floating-rate debt. Compliance with Issue E23 is easier in such cases because companies would have the opportunity to hedge a liability priced “at par” throughout the life of the underlying debt instrument. Those companies running dynamic hedging programs would be able to initiate hedge relationships at any time during the life of the debt instrument with greater ease and will probably see the risk management advantage to doing so. An unintended effect of Issue E23 that we can envision is to induce a fundamental change in the capital structures of companies in favor of floating-rate debt. Remembering that fixed-rate debt issued by companies is used as investment vehicles for insurance companies and pensions, a net reduction in the issuance of fixed-rate debt would likely introduce unintended ripple effects in a broader sense for the financial markets.

We agree with the alternative views of the three board members that dissented to the issuance of Issue E23. A requirement that the fair value of the hedged item must equal the par value at

inception contradicts the current guidance in SFAS No. 133. Paragraph 68 does not include any specific prohibition for “late hedges”. DIG E4, “Hedging-General: Application of the Shortcut Method,” issued in 1999 and updated in 2003 after the issuance of SFAS No. 149, “Amendment of Statement 133 on Derivative Instruments and Hedging Activities,” already addresses paragraphs 68-70 and 114. In short, it looks like this ground has been plowed twice before and we have difficulty understanding the theoretical basis of why “late hedging” is now an issue in applying the shortcut method.

We believe preparers and investors would be better served by the Board taking the time to formulate and communicate a vision for the future of hedge accounting and then seeking broad-based preparer feedback about how best to achieve that vision. This will help address operationality issues and minimize unintended consequences as the Board moves forward with modifications to hedge accounting.

In the event the Board decides to finalize Issue E23, we believe existing hedging relationships should be grandfathered and the effective date be delayed until 2009 to give companies adequate time to revise risk management policies and build the analytical tools necessary to execute the long-haul method in a reliable manner.

We appreciate the Board’s consideration of our comments and welcome the opportunity to discuss any and all related matters.

Sincerely,

William H. Weideman  
Vice President and Controller  
The Dow Chemical Company