



LETTER OF COMMENT NO. 15

UBS AG
Postfach
8098 Zürich
Tel. +41-44-234 11 11

John Gallagher
677 Washington Blvd
Stamford, CT 06901
Tel. +1203-719-4212
Fax +1203-719-3945
john.gallagher@ubs.com

www.ubs.com

Mr. Russell G. Golden
Director of Technical Application & Implementation
Financial Accounting Standards Board
File Reference: Proposed Issue E23
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856

20 September 2007

File Reference: Proposed Issue E23

Dear Mr. Golden:

UBS appreciates the opportunity to comment on proposed Statement 133 Implementation Issue E23, "Issues Involving the Application of the *Shortcut Method* under paragraph 68". UBS is a global financial services firm that provides various financial products and services to entities looking to manage and hedge risks. As a dealer in interest rate swaps and an advocate of prudent accounting and risk management policies we have a keen interest in the proposed Implementation Issue.

UBS generally agrees with the conclusions in the proposed Implementation Issue. We believe that they clarify application of the shortcut method and are generally consistent with current practice. However, we do not support the conclusion that application of the shortcut method requires the fair value of the hedged item to equal its par value (i.e. late hedges). In contrast, it is our view that Statement 133 currently explicitly permits use of the shortcut method for late hedges. Thus, we believe that the prohibition of this treatment is a departure from current guidance and long standing practice. The Appendix to this letter includes several references which indicate that shortcut method is allowable for late hedges.

Further, we are concerned that this conclusion will have a significant impact on certain entities that utilize the shortcut method. The shortcut method was originally developed to address the cost benefit concerns of companies with little derivative activity. Such entities enter into interest rate swaps on their fixed rate obligations as a prudent risk management strategy and may not have the sophisticated systems required to implement the complex calculations associated with the long-haul method. If the proposed guidance is adopted, the investment required to implement the long-haul method may be too great, especially for small and medium corporate enterprises, forcing them to abandon this highly effective hedging strategy. This will greatly impact how certain entities manage interest rate risk and the duration of their assets and liabilities. The abandonment of prudent risk management strategies because of accounting and operational difficulties is not a good result for preparers or users of financial statements. We therefore encourage the Board to remove this provision from the proposed Implementation Issue.

We understand that some may view the fair value option as an alternative to applying hedge accounting as it eliminates the need for hedge documentation and effectiveness testing. However, the fair value option is not available to a portion of an instrument, thus significant volatility may result from the unhedged

components of the debt (e.g. credit risk). Further, the fair value option does not provide flexibility for late hedges unless the entity designates the hedged item at inception.

If the FASB decides to go forward with this proposal, we recommend that the guidance be effective prospectively to new hedging relationships entered into after the effective date of the Implementation Issue. We understand that entities have entered into certain transactions because the short-cut method was available. As noted above, we believe that this treatment is currently available under Statement 133 and therefore entities applying this method should not be required to abandon currently effective hedging relationships and re-designate under the long-haul approach. Further, for entities that early adopted Statement 159, the fair value option is not a viable alternative for existing hedging relationships.

We very much appreciate the opportunity to comment. If you would like to discuss any comments that we have made please do not hesitate to contact John Gallagher at 203-719-4212 or Ralph Odermatt +41 44 236-8810.

UBS AG

Ralph Odermatt
Managing Director
Accounting Policies and Support

John Gallagher
Managing Director
Accounting Policies and Support

Appendix

1. The footnotes to paragraphs 115 and 134 of SFAS 133 clearly state that the trade date and the borrowing date of the debt "*need not match for the assumption of no ineffectiveness to be appropriate.*" We believe that this explicitly permits an entity to use the shortcut method when the issuance date of the hedged item and the interest rate swap differ.
2. Implementation Issue No. E10 "*Application of the Shortcut Method to Hedge of a Portion of an Interest-Bearing Asset or Liability (or Its Related Interest) or a Portfolio of Similar Interest-Bearing Assets or Liabilities*" refers to either the principal amount or the notional amount of the hedged item, however the fair value of the hedged item is not mentioned.
3. Implementation Issue No. E15 "*Continuing the Shortcut Method after a Purchase Business Combination*" concludes that the shortcut method would generally not be permitted because the fair value of the swap is unlikely to be zero at the date of the acquisition. This guidance does not make reference to the fact that the fair value of the hedged item is not equal to its par value. We believe that if this were a contributing factor in the Board's decision it would have been mentioned in the conclusion.
4. Implementation Issue No. J9, "*Use of the Shortcut Method in the Transition Adjustment and Upon Initial Adoption*" states that an entity could have designated an existing hedged item not previously designated in a hedging relationship in a new shortcut eligible hedging relationship upon its adoption of SFAS 133 as long as the swap had a fair value of zero on that date. Similar to the guidance in Implementation issue E15 the conclusions focus primarily on the fair value of the swap and do not refer to the fair value of the hedged item. If a requirement of the shortcut method were that the fair value of the hedged item equals its par value, we believe that this would have been clearly stated in the Implementation issue. The fact that the guidance is silent on the value of the hedged item implies that this is not a relevant factor in determining whether the shortcut method can be applied.

All of the references above indicate that shortcut method is allowable for late hedges. It is our view that if shortcut method was not intended to be applied in this situation, it would have been explicitly stated in the original drafting of SFAS 133 or the Implementation Issues mentioned above. We therefore, support the views of the dissenting Board members that Statement 133 does not currently prohibit application of the shortcut method to late hedges and we do not believe that it is appropriate to amend the standard to include such a requirement. We recommend that this proposal be eliminated from the final Implementation Issue.