

19001 South Western Avenue Mail Code NF 22 Torrance CA 90501

August 15, 2008

Mr. Russell G. Golden
Director of Technical Application and Implementation Activities
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, Connecticut 06856-5116



LETTER OF COMMENT NO. 100

Re: File Reference No. 1590-100, Accounting for Hedging Activities—an amendment of FASB Statement No. 133

Dear Mr. Golden:

Toyota Motor Credit Corporation ("TMCC" or the "Company"), provides retail and wholesale financing, retail leasing, and certain other financial services to authorized Toyota and Lexus vehicle dealers, and their customers. We routinely enter into derivative transactions and hedging activities for interest rate and foreign currency risk management purposes.

We appreciate the opportunity to comment on the Exposure Draft, Accounting for Hedging Activities, an amendment of FASB Statement No. 133 (the "Exposure Draft" or the "proposed Statement"). We commend the Board's overall objective of simplifying hedge accounting to improve current practices, promote consistency in the application of hedge accounting and better reflect the economics of hedging transactions. We are concerned with certain provisions within the Exposure Draft that 1) may increase complexity in applying the proposed Statement and 2) the divergence from IAS 39, Financial Instruments: Recognition and Measurement.

We support the Board's efforts to simplify the current hedge accounting model. It is voluminous, complex and has become an accounting challenge for practitioners and accounting advisers alike. The inconsistent application of FASB Statement No. 133, Accounting for Derivatives and Hedge Accounting ("SFAS 133") has led to numerous financial restatements so we appreciate why hedge simplification is the desired state. Our understanding is that the Board intends to accomplish this simplification via elimination of the bifurcation-by-risks approach to hedging. We believe the impact of this amendment could result in companies with risk management strategies hedging specific risks being unable to qualify for hedge accounting, or companies choosing to not use hedge accounting so as to



avoid income statement results not representative of their hedging activities, or that might be difficult to adequately explain to investors.

The methodology promulgated within the Exposure Draft will not simplify the hedge accounting model, application and process. The limited flexibility of the proposed hedge accounting model will force companies to amend their risk strategies in order to achieve the desired accounting result rather than prudently managing the economic realities of the hedging transaction. We believe the Board should consider retaining the bifurcation-by-risk approach and we further discuss our concerns regarding the elimination of the bifurcation-by-risk approach in Appendix A.

We are disappointed the Board did not seize the opportunity to work with the International Accounting Standards Board ("IASB") to achieve convergence on hedge accounting. The IASB issued a Discussion Paper, *Reducing Complexity in Reporting Financial Instruments*, which addresses the simplification of the IAS 39 hedge accounting model. If the Board truly supports the move towards a single set of global accounting standards and desires convergence with IFRS, then the Board should strongly consider a cessation of this project and jointly develop a proposed standard with the IASB. The Board and the IASB are currently using a joint approach for other complex accounting standards such as income taxes and leases. Under the current US GAAP convergence to IFRS scenario for hedge accounting, companies must implement derivative accounting and hedging activities in phases as follows:

- 1) Exposure Draft (SFAS 133R)
- 2) IAS 39 (IAS 39R)
- 3) SFAS 133F/IAS 39R Hybrid (The Convergence Model)

The costs simply outweigh the benefits for the current and proposed hedge accounting model. The major accounting proposals significantly impact the following areas:

- 1) **People:** Train personnel, research and interpret accounting standards, engage external consultants, and work with auditors.
- 2) Systems: Implement new applications and/or revise existing applications.
- Processes: Business process reengineering, SOX control revisions and revised or new policies and procedures.

We believe the widespread changes within the Exposure Draft will result in a movement towards FASB Statement No. 159, The Fair Value Option for Financial Assets and Liabilities, including an amendment of FASB Statement No. 115 ("SFAS 159") as there is little distinction between the Exposure Draft and SFAS 159. Since the Board's aim is to utilize the amendment to the hedge accounting model as a means to further its objective to report all financial instruments at fair value, we believe the Board must seriously consider offering companies the opportunity to elect the fair value option for all eligible items on the effective date of the proposed Statement.



Our responses to selected questions are included in Exposure Draft's Notice for Recipients (Appendix A). Thank you for the opportunity to express our views. If there are any questions, clarifications or concerns, please contact the undersigned at (310) 468-7269.

Thomas A. Kiel

Sincerely yours,

Chief Accounting Officer



Appendix A: Responses to Selected Questions in Notice for Recipients on Exposure Draft's Provisions

Hedged Risk

Issue 1: 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 risks inherent in the hedged item or transaction?

We do not agree with the Board's basis, as discussed in paragraph A16 of the Exposure Draft, for eliminating the ability to designate individual risks for hedge accounting. In TMCC's view, eliminating the bifurcation-by-risk approach would diminish the application of hedge accounting to many common interest rate risk management transactions. Since we select derivatives that best reflect the risks we wish to economically hedged, the proposal to eliminate the bifurcation-by-risk could force us away from hedge accounting if we determine that our hedging instruments are not reasonably effective at offsetting all the risks inherent in the hedged item.

As a consumer finance company our risk management strategy is to hedge interest rate risk for our interest earning assets. The elimination of the bifurcation-by-risk approach to hedging interest earning assets would add unnecessary complexity to the accounting for our hedging relationships. Consider the fair value hedge of an existing portfolio of interest earning assets using interest rate derivatives; the fair value of interest rate derivatives are based on the LIBOR curve adjusted for the credit risk of the counterparty. The fair value of the loan portfolio must also include the credit risk component of the borrowers. Under the proposed Statement we would have to identify an appropriate credit spread for our borrowers whom do not have publicly traded debt or market observable credit spreads. We believe that many companies will struggle with this requirement, just as they have struggled with the requirement to include credit risk in the valuation of derivatives under FASB Statement No. 157, Fair Value Measurements.

Additionally, given the current credit environment, we may be unable to conclude that an interest rate derivative would be reasonably effective in offsetting changes in the fair value of the loan.

Issue 2: Do you believe the Board should continue to permit an entity to designate those individual risks as a hedged risk?

We believe the Board should continue to permit an entity to designate individual risks as a hedged risk as discussed in our response to Issue 1 above. Additionally, we disagree with the Board's determination that hedging interest rate risk as a risk management tool should not qualify for hedge accounting. The discussion in paragraph A19 of the Exposure Draft seems to suggest that the Board supports hedge accounting for risk management strategies only in cases where that strategy results in the synthetic alteration of the debt instrument over its entire



term. Our overall risk management strategy is conducted at the entity level. Actual hedging activity is executed at the instrument level based upon the agreed asset liability risk management strategy as well as in response to income statement volatility resulting from movements in interest rate. We believe that most companies manage interest rate risk in a similar manner—by monitoring and adapting to changes in certain economic factors, and not through an approach that seeks to synthetically alter a financial instrument.

Should the Board proceed with the elimination of the bifurcation-by-risk approach, we would support the exception to allow designation of only interest rate risk for an entity's own debt. However, we encourage the Board to make this exception available throughout the life of the debt for the compelling reasons cited by the dissenting Board members in paragraph A57 of the Exposure Draft.

The proposed Statement leads to different accounting results for risk management strategies that focus on reducing interest expense volatility, based only on the timing of the execution of those strategies. The determination of when we enter into a derivative contract to hedge interest rate risk for issued debt is primarily based on the Company's overall asset liability risk management strategy as well as forecasted interest rates over a selected time horizon. Should our asset liability risk management strategy suggest that we execute an interest rate swap at inception of the debt, we would be able to hedge the benchmark interest rate risk; however, should that same strategy suggest we execute the swap after the inception of the debt; we would have to apply overall fair value hedge accounting. As a company that hedges to reduce interest rate volatility, there is the possibility that we introduce credit volatility as a result of the timing of the execution of our risk management strategies. We believe that different accounting results based on the timing of the execution of an asset liability risk management strategy is contrary to the simplification process that the Board is trying to achieve.

Issue 4a: Do you believe that modifying the effectiveness threshold from highly effective to reasonably effective is appropriate? Why or why not?

The Exposure Draft introduces the qualitative assessment, an undefined principles-based component proposed by the Board, to the current accounting standard. The new concept lowers the threshold for effective hedge determination and effectiveness testing for hedging relationships. Under the proposed Statement, companies must demonstrate that a) an economic relationship exists between the hedging instrument and hedged item or forecasted transaction and b) the derivative should be expected to reasonably offset changes in fair value or the variability in the hedged cash flows attributable to the hedged risks.

The Board failed to define the meaning of "reasonably effective" and when a quantitative assessment would be required. A definitional debate for "reasonably effective", as well as "what is a qualitative assessment" will probably occur. Defining and testing hedge effectiveness presents a challenging aspect to the proposed hedge accounting model.

Example: The Board did not define the meaning of "highly effective" in the original pronouncement, and various groups created whitepapers, analyses and quantitative methods to



prove that a hedging relationship was "highly effective." For example, the 80-125% effectiveness band is an unwritten rule under both SFAS 133 and IAS 39 for highly effective hedges.

We believe, and this has been demonstrated in the past, that eventually the new hedge effectiveness testing standard will evolve by way of SEC speeches and communication with auditing firms and external auditors' opinions, definitions and guidelines. Initially, we believe hedge accounting complexity will continue prior to reaching consensus regarding the definition of "reasonably effective". We believe that in certain situations, a quantitative assessment may be more effective in demonstrating the relationship between the derivative instrument and hedged risk due to the requirement to consider variability in all risks, not just the risk hedged economically.

Issue 4c: Would you a) modify your hedging strategy to incorporate other derivative instruments, b) stop applying hedge accounting, c) elect the fair value option, or d) adopt some other strategy for managing risk?

Should the Board adopt the proposed Statement as currently drafted, we would modify our hedging strategies to best reflect the economics of the hedging transactions while simultaneously minimizing hedge ineffectiveness and the corresponding earnings volatility. If the credit spread of the hedged item resulted in significant earnings volatility, we would not apply SFAS 133 hedge accounting. We will strongly consider electing the fair value option since there appears to be minimal differences between the proposed Statement and SFAS 159.

Issue 7: 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 the ineffective portion and any amounts excluded from the evaluation be presented within other income or loss.

The comprehensive disclosure requirements set forth in FASB Statement No. 161, Disclosures about Derivative Instruments and Hedging Activities, provide sufficient information regarding the location of gains and losses recognized on derivatives and related hedged items in the financial statements; therefore, we do not believe that the issuance of further guidance regarding the presentation of gains and losses is necessary.

Issue 10: 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?

While TMCC supports the Board's decision to allow a one-time fair value option at the initial adoption of the proposed Statement, we believe the Board should expand the items that are



eligible under this election. Similar to many smaller corporate entities, we did not elect the fair value option upon adoption of SFAS 159 as our risk management strategies, processes and systems are geared towards the bifurcation-by-risk approach currently allowed under SFAS 133. The issues we identified concerning the elimination of the bifurcation-by-risk approach to hedging risks are similar to the issues we would face in electing the fair value option. As noted in our response to Issue 4c above, we see minimal differences between the proposed Statement and SFAS 159. Owing to the proposed changes to SFAS 133 in addition to the potential changes in our risk management strategies, we will consider electing the fair value option under SFAS 159. Should the Board adopt the proposed Statement as drafted, we strongly encourage the Board to expand the one-time fair value option election to all eligible financial instruments.