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Mr. Russell G. Golden
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LETTER OF COMMENT NO. 119

Re: File Reference No. 1590-100

Merrill Lynch appreciates the opportunity to comment on the Financial Accounting Standards Board's ("FASB") proposed Statement of Financial Accounting Standards Accounting for Hedging Activities an amendment of FASB Statement No. 133 (the "proposed Statement"). As a firm that utilizes hedge accounting under SFAS 133, Accounting for Derivative Instruments and Hedging Activities ("FAS 133"), we remain very interested in the final outcome of this project. In addition, as a market maker in derivatives, we enter into derivative instruments with a significant number of clients who utilize derivatives for risk management purposes. We further support our clients' efforts to apply hedge accounting where possible, and therefore have insight into the use of hedge accounting by a broad spectrum of clients, as well as the limitations they face in utilizing hedge accounting under FAS 133.

We commend the FASB's efforts to move FAS 133 to a more principles-based standard, but have serious concerns about the operability of the proposed Statement and the resulting move to full fair value accounting, as opposed to the existing bifurcation by risk model, for many financial instruments. In addition, we do not support large-scale accounting changes, such as those incorporated in the proposed Statement, that are not done through a joint project with the International Accounting Standards Board (IASB). Please find below our specific comments to the issues raised in the proposed Statement.

Hedged Risk

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 recognize that the FASB has had a stated objective of moving closer to full fair value accounting for all financial instruments and that this project is seen as an opportunity to fulfill this objective. However, we feel that such a move should happen with greater transparency. We believe the impact of this proposed statement results in a move towards full fair value accounting more significantly than would be suggested by a project that amends hedge accounting guidance. This is especially important as many users and preparers of financial statements may not have the same objective to move to greater use of fair value for financial instruments. The limited adoption of SFAS 159, *The Fair Value Option for Financial Assets and Financial Liabilities* ("FAS 159"), for both assets and liabilities by companies other than large financial institutions, the lack of a call from users for preparers to adopt FAS 159, and the demonization of fair value accounting in recent months, even if inappropriate, demonstrates the reluctance to move to fair value accounting for all financial instruments at this time.

In particular, we believe that the impact upon adoption of this proposed Statement will be a greater use of full fair value accounting for loans and issued debt, if companies continue to utilize hedge accounting for these financial instruments. In the case of loans, we do not believe that users of financial statements, let alone preparers, are comfortable with the fair value of unobservable credit risk flowing through earnings. In our experiences with fair valuing our own debt due to the adoption of FAS 159 have demonstrated that the marketplace perceives the impact of changes in our own credit spread affecting earnings as misleading, despite the impact to our earnings being transparently disclosed in our earnings releases and financial statements. Though we are generally strong proponents of fair value accounting for financial instruments, we too question the use of full fair value accounting by all companies and for our issued debt. The original reasons that full fair value accounting was not determined to be the appropriate path for FAS 133 continue to exist.

We support a bifurcation by risk approach, as it acts as a mechanism to allow users to understand the economic effect of risk management efforts. Financial risk management does, and should, exist regardless as to the accounting implication. The accounting should provide a picture of what management has done and how well it has fulfilled its objective. We believe that the fundamental approach in FAS 133 to recording the effect of risk management remains relevant, in contrast to a full fair value objective.

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?

As discussed in our response to Issue 1, we support the continuation of a bifurcation by risk model. We question the appropriateness of introducing full fair value accounting through a hedge accounting model, particularly when FAS 159 provides entities an opportunity to forgo hedge accounting and utilize fair value accounting.

Hedge Effectiveness

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?

We recognize that there has been pressure to remove the provisions of paragraphs 68 (shortcut) and 65 (critical terms matching) in FAS 133 due to the rules-based nature of their application. However, we believe that the benefits derived from application of these paragraphs far outweigh the interpretation risk and any earnings misrepresentation that results from their application. From the standpoint of assessing effectiveness, we believe that the proposed Standard provides a more principles-based approach that achieves the same results as the application of shortcut and critical terms matching. However, the proposed Statement then leaves the preparer subject to long haul hedge accounting for the purposes of hedge ineffectiveness measurement, which eliminates any benefits derived from a simplified approach to testing effectiveness. The complications of long haul

hedge accounting calculations cannot be underestimated; these calculations require significant technology and personnel infrastructure support. For the majority of hedging relationships, particularly as executed by our clients, the hedges entered into are very closely aligned to the items that are being hedged. There is not an interest to take on ineffectiveness from an economic standpoint, let alone from an accounting standpoint. In these cases, the earnings impact of applying the shortcut or matched terms method is an appropriate representation of the economics. Any ineffectiveness derived from using the long haul method should, by its nature, be immaterial; material ineffectiveness for accounting purposes in these cases is more a flaw of the long haul calculation rather than of the hedge itself. As such, we do not support a change to hedge accounting that does not attempt to alleviate the unnecessary burden placed on preparers by long haul ineffectiveness calculations where the hedge and the hedged item match on all critical terms. This is particularly the case for callable debt, which is a very common form of debt issuance. Shortcut can be obtained for hedges on these instruments, but long haul calculations are extremely difficult¹. We agree that for hedges where the critical terms do not match, it is necessary to measure ineffectiveness using the long haul method, as is done today.

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?

We agree with the reduction of the effectiveness threshold. For hedges where the critical terms do not match, the measurement of ineffectiveness under the long haul method should adequately capture the economic ineffectiveness of the hedge. As this ineffectiveness is taken through earnings, the entity would not be misleading users of its financial statements through the use of hedge accounting.

However, we disagree that the reduced effectiveness threshold would be sufficient for many existing interest rate hedges. In particular, in a hedge of an interest rate bearing instrument where the full fair value changes would be compared to just an interest rate

¹ Measuring the change for interest rate risk only on a callable debt instrument is complicated, as the interest rate risk is influenced by the impact changes in credit risk have on the existence of future cash flows upon which there is interest rate risk. This is not to suggest that full fair value calculations are easier for these instruments, as the credit risk optionality that influences that value of the call option is generally not observable and also difficult to quantify.

swap as the hedging derivative, the credit component of the fair value is a significant component of the fair value. As an example, we ran a regression on the full fair value changes of a 30 year fixed rate debt instrument issued by Merrill Lynch against the fair value changes of an interest rate swap, the terms of which would qualify the fair value hedge for shortcut treatment under paragraph 68 (see results in Appendix A). This example was used notwithstanding the fact that it would be permissible to hedge the interest rate risk only under the proposed Statement.

The debt was issued in April 2004 when Merrill Lynch's credit spread, as measured by the spread on the variable leg of the swap, was 54.5 basis points. The regression results for June 2004 through June 2008 indicated an R-squared of 0.15% and a slope of negative 0.06. These results demonstrate that there is no statistical relevance to the relationship. We also ran the regression from June 2004 to June 2006 to consider the impact that our recent credit volatility may have had on the results. This test yielded an R-squared of 35% and a slope of negative 1.8, which also indicates a lack of statistically relevant correlation of the relationship. An analysis of the change in the full fair value of the bond as compared to the change in the fair value of the swap on a period by period basis indicates that the difference between the fair value changes in the bond and the swap were in the same direction for many periods. As such, this relationship could not be deemed reasonably effective when considering a quantitative analysis, even though a qualitative analysis might suggest that it is reasonable effective as the debt was issued by Merrill Lynch as an investment grade credit and the hedge would have otherwise received shortcut treatment.

As demonstrated by the above example, we believe that the assumption that the hedging of just interest rate risk could result in a reasonably effective hedge is flawed. The credit markets for much of the past decade may have been benign, thus supporting such a conclusion, but this is likely just as much of an anomaly as the volatility the credit markets have been experiencing this past year. This will make hedging in the full fair value model especially difficult for issuers with wider credit spreads. In such cases, as it is not uncommon to have a credit spread larger than the interest rate yield curve (e.g., credit spread of 3% when interest rates are under 3%), whereby a qualitative analysis would challenge the suggestion that only hedging interest rate risk provides a reasonably effective hedge when less than 50% of the coupon is related to that risk.

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?

We believe that an effectiveness evaluation should only be required after inception of the hedge if critical contractual terms of the relationship have changed. If significant market factors change, then the impact should be measured through ineffectiveness which will be reflected in the income statement. Otherwise, there should be no need to reassess the relationship unless terms such as rates or maturity change.

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?

As noted in our comment to Issue 5, we believe that an effectiveness evaluation should only be required after inception of the hedge if critical contractual terms of the relationship have changed. If significant market factors change, then the impact should be measured through ineffectiveness which will be reflected in the income statement.

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.

We do not believe it is necessary nor recommended to prescribe the presentation in the income statement. Income statement presentation is largely left to the preparer of the financial statements, as income statements vary by industry. The disclosure requirements under FAS 133 as amended by FAS 161 should be sufficient to enable users to understand where amounts are reported in the financial statements.

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?

Given our serious concerns as addressed above, we do not support the issuance of the proposed Statement as currently drafted. Rather than revise the proposed Statement, we suggest that the FASB alter the course that this project is taking and start anew with a joint project with the IASB that considers carrying forward the simplification of the effectiveness measurement and lessening of the effectiveness threshold as outlined in the proposed Statement, but that also considers simplified ineffectiveness measurement for certain hedges and the maintenance of a bifurcation-by-risk approach.

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.

Given our serious concerns about this project as a whole, we have no comment on transition disclosures.

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?

We do not agree with the FASB's decision to limit the option election to those instruments that are in eligible hedges at transition. If the goal of the FASB is to move towards more fair value accounting, then it would be appropriate to allow entities another opportunity to elect fair value for eligible instruments, regardless as to whether hedge accounting is applicable or not. As an example, an instrument may have received FAS 133 hedge accounting treatment, but was then dedesignated due to the hedge failing effectiveness testing under the existing rules. The fair value option under FAS 159 would not be permitted, as the dedesignation occurred after the instrument had been initially recognized in the financial statements. At transition of this proposed Statement, the instrument would not be eligible for fair value election, though management may have the desire to apply fair value accounting other than through hedge accounting. We do not see why such an instrument should not be eligible for the fair value option at transition.

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?

We believe that the additional cost associated with implementation of the proposed Statement far exceeds any perceived benefits. As expressed earlier, it is our belief that requiring companies to perform long haul ineffectiveness calculations when the critical terms of the hedged item and hedging derivative match is very onerous and risks providing a more skewed picture of the earnings effect rather than a more accurate one.

We believe that significantly more fieldwork is required to fully appreciate the costs associated with the implementation of this proposed Statement.

Amendment to paragraph 40

In addition to the items for which specific comment was requested, we would also like to express our concern about the proposed amendments to paragraph 40. Our concerns stem primarily from the hedge activity that we witness as a financial intermediary that supports our clients with their efforts to manage their foreign currency risk.

Under current application of FAS 133, entities identify a forecasted intercompany transaction as the hedged item in a cash flow hedge of currency risk. The identification of the intercompany transaction as opposed to a third party transaction is a result of the interplay between the functional currency determination and the requirement to have risk to the currency in the entity electing to hedge.

For example, a USD company may make sales in EUR either directly or through its EUR functional currency subsidiary. In either case, it will have EUR exposure that it may hedge from an economic perspective. If the sale is executed through the subsidiary, the entity will have an intercompany sale in either USD or EUR between the USD parent and EUR subsidiary to make the subsidiary whole. As the third party sale is in EUR in a EUR functional currency entity, the intercompany sale is identified as the hedged item. The proposed revision to paragraph 40 suggests that this hedge on the intercompany sale would not be permitted, as the intercompany sale has no impact on earnings. This hedge strategy is very commonplace and has been utilized as the economic exposure exists whether the sale is made through the USD parent or the EUR subsidiary.

We believe that DIG issue H13, *Foreign Currency Hedges: Reclassifying into Earnings Amounts Accumulated in Other Comprehensive Income Related to a Cash Flow Hedge of a Forecasted Foreign-Currency-Denominated Intercompany Sale*, and paragraph 484 of FAS 133 contemplate such a hedge and thus permit application of hedge accounting in such cases. We believe that a more vetted discussion is required on this topic.

* * * * *

Thank you again for the opportunity to comment on the proposed Statement. We hope the FASB will give consideration to our comments as you continue to deliberate this project. We are available to answer any questions should you require clarification on any of the points above. Please feel free to call me at (212) 449-2048.

Sincerely,

/s/ David Moser
Managing Director, Accounting Policy

Appendix A: Regression results for Merrill Lynch debt

Reference Bond Cusip 59018YTM3
Reference Swap Admin ID 04DL05062

Issuance Date: 04/16/04

Maturity Date: 06/01/34

Debt Coupon: 6.05%, S/A

Swap Coupons:

ML receives: 6.05%, S/A, 30/360

ML pays: 1mL+54.5 bps. M. Act360

Date	Bond Price	Swap MTM	cumulative			rsq	slope
			Diff Bond	Diff Swap			
6/30/2004	88.40	(2.70)					
7/30/2004	89.66	(0.34)					
8/31/2004	92.30	4.38	1.26	2.36	0.63		
9/30/2004	92.32	5.89	3.90	7.07	0.55		
10/29/2004	93.25	8.05	3.92	8.58	0.46		
11/30/2004	90.68	4.57	4.66	10.75	0.45		
12/31/2004	93.23	4.45	2.28	7.27	0.31		
1/31/2005	96.28	8.95	4.82	7.15	0.67		
2/28/2005	94.78	6.60	7.88	11.65	0.68		
3/31/2005	94.21	5.04	6.38	9.30	0.69		
4/29/2005	96.84	9.85	5.81	7.74	0.75		
5/31/2005	99.18	14.26	8.44	12.55	0.67		
6/30/2005	101.03	13.64	10.78	16.96	0.64		
7/29/2005	94.24	8.91	12.63	16.34	0.77		
8/31/2005	97.05	13.76	5.84	11.61	0.50		
9/30/2005	92.18	8.78	8.65	16.46	0.53		
10/31/2005	90.29	5.30	3.78	11.48	0.33		
11/30/2005	91.20	6.39	1.89	8.00	0.24		
12/30/2005	92.47	6.22	2.80	9.09	0.31		
1/31/2006	90.61	5.61	4.07	8.52	0.46		
2/28/2006	91.97	7.18	2.21	8.31	0.27		
3/31/2006	87.23	1.51	3.57	9.88	0.36		
4/28/2006	84.08	(1.25)	(1.17)	4.21	(0.28)		
5/31/2006	83.42	(1.77)	(4.32)	1.45	(2.98)		
6/30/2006	83.41	(4.44)	(4.98)	0.93	(5.35)		
7/31/2006	84.67	(1.90)	(4.99)	(1.74)	2.87		
8/31/2006	86.56	2.08	(3.74)	0.80	(4.67)		
9/29/2006	104.53	4.21	(1.84)	4.78	(0.39)		
10/31/2006	106.27	5.31	16.13	6.91	2.33		
11/30/2006	108.86	8.67	17.87	8.01	2.23		
12/29/2006	104.46	2.38	20.46	11.37	1.80		
1/31/2007	103.03	0.69	16.06	5.08	3.16	36.28%	0.867833
2/28/2007	105.72	4.63	14.63	3.39	4.31		
3/30/2007	104.67	2.81	17.32	7.33	2.36		
4/30/2007	104.69	3.48	16.27	5.51	2.95		
5/31/2007	101.29	0.82	16.29	6.18	2.64		
6/29/2007	99.78	(4.43)	12.89	3.52	3.66		
7/31/2007	99.83	(2.44)	11.38	(1.73)	(6.56)		
8/31/2007	96.15	1.39	11.43	0.26	(3.70)		
9/28/2007	97.63	2.16	9.75	4.09	2.38		
10/31/2007	91.89	4.05	9.23	4.86	1.90		
11/30/2007	89.56	10.72	3.49	6.75	0.52		
12/31/2007	88.50	7.15	1.16	13.42	0.09		
1/31/2008	85.52	11.16	0.10	9.84	0.01		
2/29/2008	87.92	11.12	(2.88)	13.86	(0.21)		
3/31/2008	81.06	15.06	(0.48)	13.81	(0.03)		
4/30/2008	87.05	12.52	(7.34)	17.75	(0.41)		
5/30/2008	86.81	9.05	(1.35)	15.21	(0.09)		
6/30/2008	87.43	8.15	(1.59)	11.75	(0.14)		
			(0.98)	10.85	(0.09)	0.15%	-0.05639