The Clearing House

September 17, 2010

Mr. Russell G. Golden
Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Re: Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities: Financial Instruments (Topic 825) and Derivatives and Hedging (Topic 815) – File Reference No. 1810-100

Dear Mr. Golden:

The Clearing House Association L.L.C. ("The Clearing House"),[1] an association of major commercial banks, appreciates the opportunity to comment on the Proposed Accounting Standards Update ("Proposed ASU"), Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities.

1 Established in 1853, The Clearing House is the nation's oldest banking association and payments company. It is owned by the world's largest commercial banks, which collectively employ 1.4 million people in the United States and hold more than half of all U.S. deposits. The Clearing House Association is a nonpartisan advocacy organization representing – through regulatory comment letters, amicus briefs and white papers – the interests of its owner banks on a variety of systemically important banking issues. Its affiliate, The Clearing House Payments Company L.L.C., provides payment, clearing and settlement services to its member banks and other financial institutions, clearing almost $2 trillion daily and representing nearly half of the automated-clearing-house, funds-transfer and check-image payments made in the U.S. See The Clearing House's web page at www.theclearinghouse.org.

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Executive Summary

The Clearing House supports the Financial Accounting Standards Board's (the "Board" or the "FASB") overall goal to develop a consistent and comprehensive framework for the accounting for financial instruments in order to simplify and improve the accounting in this area. While we appreciate the Board's efforts to resolve this difficult yet important issue, we have significant concerns with several important aspects of the Proposed ASU. In summary, The Clearing House:

- supports a classification and measurement approach based primarily on the business model, as this best reflects the management strategy for the instruments and thereby presents the best information to financial statement users for prediction of likely future cash flows;

- disagrees that fair value should be the primary measurement attribute, as this is inconsistent with the business model approach, is not supported by many bank analysts and regulators, will introduce less relevant and less meaningful information into the financial statements and may make it more challenging, and costly, for banks to raise Tier 1 capital;

- supports a recognition and measurement framework of amortized cost adjusted for impairment for loans held for the collection of contractual cash flows, as this is the most representationally faithful approach for loans held for investment that are managed for yield, not for capital appreciation or capital returns;

- supports a credit impairment model that allows earlier recognition of expected credit losses;

- believes that the consideration of future conditions or events is a necessary component of the determination of expected credit losses, as considering only past events and existing conditions is not consistent with a market participant's view of credit risk and business strategies and may result in credit loss reserves that lag changes in the credit cycle;

- believes that the proposed impairment model, by commingling interest income and credit loss recognition, is overly complex, does not accurately reflect the way banks evaluate credit risk and manage loan portfolios, and obscures information on important credit metrics that are currently used in analyzing financial statements;

- encourages the Board to consider the alternative credit impairment models currently under consideration by the IASB's Expert Advisory Panel (the "EAP");

- believes that the Board should form a joint FASB/IASB Expert Advisory Panel and perform a joint review of the Proposed ASU with banking and other financial regulators to conduct proper field testing to fully understand the implications of its proposal;

- supports a simplified approach to accounting for derivatives and hedging, but disagrees with the Board's decision to prohibit voluntary dedesignation of hedge accounting relationships;

- believes that the Board has not achieved its overall objective of simplification and that, in its current form, the perceived benefits of the Proposed ASU do not outweigh the significant implementation costs of the Proposed ASU;

- believes that the Board should work with the IASB to produce a single, high quality standard governing the accounting for financial instruments that accomplishes the objectives articulated by the G20, as it will be extremely difficult for large, multinational financial institutions to implement two separate approaches to accounting for essentially the majority of their business.

The Clearing House would be pleased to recommend several of its members to serve on the joint FASB/IASB Expert Advisory Panel described above to review the Proposed ASU with banking and other financial regulators. As we learned in 2008, accounting for financial instruments is a critical consideration in the market's assessment of a financial institution with accounting determinations potentially contributing to systemic risk.

1. Classification and Measurement

The FASB states that the main objective of the Proposed ASU is to "provide financial statement users with a more timely and representative depiction of an entity's involvement in financial instruments, while reducing the complexity".[2] The Clearing House supports changes that improve an entity's representation of its financial position; however, we strongly believe the Proposed ASU does not accomplish that goal with regard to the classification and measurement of financial instruments. The Clearing House agrees with the comments of FASB Board members Ms. Seidman and Mr. Smith, who stated they dissent from several aspects of the proposed guidance, primarily because it would introduce fair value accounting for some nonmarketable, plain-vanilla debt instruments that are held for collection (long-term investment), and most liabilities held for payment, which they believe would not reflect the likely realization of those items in cash and, therefore, would not be the most relevant way to measure those items

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2 Summary, Proposed ASU.

in the statement of financial position and comprehensive income.[3] The Clearing House believes the Proposed ASU would result in financial statements that are less representative of an entity's business model, and therefore in less meaningful financial statements that would be more difficult for users to understand.

A. Requiring fair value as the primary measurement attribute does not reflect an entity's business strategy, creates less relevant and less reliable information, is not supported by many end users and will likely increase the cost of capital.

The Clearing House respectfully submits that the fundamental accounting principle of "going concern" has not been given proper consideration in the development of the Proposed ASU. This accounting principle should always be an integral part of the conceptual basis and rationale for the development and comprehension of accounting standards. Commercial banks hold their long-term financial assets for the collection of cash flows. The Clearing House believes that a fair value/liquidation model is not relevant for assets that an enterprise has no current intention to liquidate. Only if an entity is not considered to be a "going concern" should it be required to measure and present its balance sheet on a liquidation basis as proposed in the FASB's Exposure Draft "Going Concern" dated October 9, 2008.

The Clearing House also believes that there are many financial statement users who do not favor fair value as the primary measurement attribute for all financial instruments. Many of The Clearing House members have spoken to the equity analysts that report on their institutions, as well as their primary regulators, and based on these conversations, believe that these end users do not support fair value accounting. In addition, members of The Clearing House are not supportive of using fair value as the primary measurement and classification model in their capacity as creditors. Further evidence of this lack of support for a fair value accounting approach was provided at a recent investor roundtable hosted by the OCC to discuss the Proposed ASU, which was attended by over 100 bank stock investors, where it was noted that "[i]t was apparent that investors that participated in the roundtable were not in favor of the proposed changes. In fact, there was not one comment from the numerous investors that provided their commentary on the proposal that was in support of the fair value accounting changes – especially as the changes relate to both loans and deposits on balance sheets of the banks."[4] In addition, earlier this year, PricewaterhouseCoopers ("PWC") conducted a study that included 62 end users in the financial services industry.[5] The PWC study concluded that a majority of

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[3] Alternative Views, paragraph BC244

[4] Stifel Nicolaus research report, *OCC's Investor Roundtable on FASB's Exposure Draft*, July 30, 2010

[5] The users surveyed were a mixture of buy and sell side analysts, representing 42 percent each of the total respondents, and included the credit rating segment (representing 16 percent of the total respondents). By industry specialization, 41 percent of the respondents covered insurance, 49 percent covered banking, and 10 percent were generalists. From a geographic diversity standpoint, 51 percent of the respondents were in the United States, 35 percent were located in Europe, and 15 percent were located in the Asia Pacific area. Pricewaterhouse Coopers Survey, *What Investment Professionals Say About Financial Instrument Reporting*, June 2010

respondents favored a mixed measurement model, with fair value reporting for short-term instruments and amortized cost reporting for instruments that the reporting entity intends to hold for long-term cash flows. A similar but less formal survey of institutional investors was conducted by Barclays Capital and yielded similar results, as approximately 90 percent of respondents disagreed with the use of fair value as the primary measurement attribute for all financial instruments as proposed in the Proposed ASU.[6]

Moreover, The Clearing House believes that requiring fair value as the primary measurement attribute for financial instruments could serve to incent a short-term focus on earnings and other performance measures. Such a focus, combined with the volatility it brings, rather than an overall focus on balance sheet strength and long-term earnings growth, reduces confidence in financial statements and was considered by many to be one of the perceived causes of the credit market disruption.

Requiring fair value for financial instruments traditionally measured at amortized cost likely will also result in additional instruments being measured based on Level 3 valuation techniques. Historically, financial statement users have struggled with Level 3 valuations and have indicated that these measurements discourage confidence in the financial statements. If investors believe financial information is unreliable, the cost of capital for financial institutions will likely increase. Such higher capital costs may make it more challenging for banks to raise Tier 1 capital in response to regulatory proposals currently under consideration (e.g., Basel III). The Clearing House believes that decisions on issues surrounding regulatory capital requirements should not be driven by the accounting rules.

The Clearing House strongly believes that financial statements should reflect an entity's business model. Financial institutions have three business models for financial assets: 1) holding financial assets for trading or short-term profit-taking, 2) holding financial assets for long-term cash flows, but making those assets available for sale in the event there is a need for liquidity or for other asset/liability management purposes and 3) holding financial assets for long-term cash flows. Current accounting requirements acknowledge these three business models and, as a result, more accurately and completely reflect the economics of the diverse business strategies of a financial institution, while providing for consistency between and among reporting entities.

B. Amortized cost should be retained as a measurement attribute for financial instruments held for the receipt or payment of cash flows.

The Clearing House supports the current mixed attribute model which includes amortized cost. Amortized cost remains the most relevant measure for portfolios of loans held for investment and managed for yield, not for short-term profit, capital appreciation or capital returns. The model recently issued by the IASB (IFRS 9) recognizes that an enterprise's

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6 Barclays Capital Survey: Bank Brief Newsletter Survey, June 2010

business model is integral to the classification and measurement of financial instruments. The Clearing House believes that the Board should work to converge its proposed guidance in this regard towards the IASB's approach, which we believe would result in a more accurate and complete accounting presentation of financial instruments.

C. The definition of the held for cash flow category should be broadened to explicitly accommodate AFS assets.

The Clearing House is specifically concerned that the Proposed ASU would require a significant portion of investment securities presently accounted for as Available-for-Sale (AFS) with changes in fair value recorded in other comprehensive income ("OCI") to be accounted for instead at fair value through net income. Prudent asset/liability management requires that most of these instruments be held for long-term cash flows, but be available for short-term liquidity purposes or asset/liability duration rebalancing purposes, if needed. The proposed rules will adversely impact the ability of an enterprise to implement effective asset/liability management due to the likely accounting measurement mismatch between debt securities measured under the proposal at fair value with changes in fair value recorded in net income, and many liabilities that will be measured at fair value with changes in fair value recorded in OCI. The Clearing House believes that AFS securities should continue to be carried at fair value with changes in value recorded in OCI, but is concerned that these instruments would not meet the proposed criteria for measurement at fair value through OCI as presented in the Proposed ASU. Members of The Clearing House that report under U.S. GAAP believe that the current accounting rules providing for three classifications of financial assets work well, and do not believe there is a need for a major overhaul. However, if the FASB insists on moving to two classifications, the definition of the held for cash flow category should be broadened to accommodate AFS financial assets.

D. Amortized cost is the most relevant measure for financial liabilities, such as deposits and most forms of own debt.

Many financial liabilities are also held for contractual repayment, are rarely settled early, and are not typically traded. Amortized cost is the more relevant measure for these financial liabilities as this measurement better reflects an entity's business model. The Clearing House agrees with the Alternative Views expressed in paragraph BC245 of the Proposed ASU that "it is inappropriate for subjective, unrealized gains and losses to form the basis for the entity's statement of financial position, including book equity, as well as comprehensive income, when those unrealized gains and losses are expected to reverse." Although The Clearing House acknowledges the Board's attempt to reduce the accounting measurement mismatch for assets and liabilities with a framework that allows measurement of certain liabilities at fair value with changes in value recorded in OCI and certain liabilities at amortized cost, the proposed model is more complex than the existing approach. The current model under U.S. GAAP already achieves the goal of asset/liability accounting without introducing any of the complexities of either the proposed remeasurement model for liabilities, discussed below, or the complications associated with what we believe to be an overly complex rules-based approach for liabilities eligible to be recorded at amortized cost. Therefore, if the FASB moves to two classifications – fair value and amortized cost – we believe the definition of the amortized cost category should accommodate financial liabilities held for long-term cash payments.

The Clearing House also strongly opposes the proposed valuation approach for core deposits. The Clearing House acknowledges the remeasurement approach is not a full assessment of fair value, but it is clear that many of the underlying assumptions in the approach are similar to those considered in the fair valuation of an acquired core deposit intangible. Deposits are not typically traded and should not be recorded at fair value or at a fair value-like measurement, particularly when the account can always be, and most often is, settled at par. The approach also has the effect of embedding elements of an intangible asset, which is not a financial instrument, into a financial liability. Thus, to the extent a purchased core deposit intangible exists, the remeasurement methodology would result in duplicate reporting of the intangible asset. The Clearing House believes that it would be inappropriate to recognize one internally developed intangible asset when other similar internally developed intangible assets, such as credit card customer relationships and customer lists, cannot be recognized.

The Clearing House also believes that it is inappropriate to use an average balance to develop a period-end balance sheet measure. Further, without additional guidance, there will be significant variation in the determination of the average core deposit amount. Entities could effectively consider activity for a month, a quarter or a year (or longer) and derive materially different answers. Moreover, determining both the alternative funds rate and the all-in-cost-to-service rate would require numerous inherently subjective assumptions, which will certainly vary widely across reporting entities. In addition, if the all-in-cost-to-service rate exceeds the alternative funds rate, the remeasured amount of the core deposit liability conceivably could exceed the actual amount required to settle the liability, and this difference in value would never be monetized.

In summary, The Clearing House does not support the introduction of a completely different measurement model that is neither fair value nor amortized cost. In order to achieve symmetry, we believe that core deposits should be accounted for on the same basis as loans. We do not believe the proposed accounting for core deposits will yield useful information to financial statements users. Rather, we believe it will be a difficult measurement model for financial statement users to understand, will significantly increase the complexity of financial reporting and will not result in comparability between and among reporting entities.

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The Clearing House supports changes in accounting when those changes enhance financial statements users' understanding of the business and when those changes are not cost prohibitive as compared to the benefits. However, The Clearing House believes current accounting models yield informative financial statement results that best represent an institution's business model and can be applied and interpreted consistently. Conversely, the

Proposed ASU will not provide enhanced information for financial statement users but will increase the complexity of accounting and require significant cost expenditures by reporting entities.

2. Credit Impairment

The requirement to measure all financial instruments including loans at fair value also underemphasizes and obscures one of the more significant risks to financial instruments, credit risk. The Clearing House believes that transparency to the risks associated with financial instruments, and loans in particular, can be better provided through enhancements to the credit impairment model, rather than by requiring measurement at fair value.

A. The consideration of future conditions or events is a necessary component of the determination of expected credit losses

The Clearing House is a strong proponent of a credit impairment model with a longer emergence period that allows for earlier recognition of expected credit losses. However, we do not agree with the Board's decision to allow only the consideration of past events and existing conditions when determining the amount of expected credit losses. Typically, future expectations are based on historical and current economic trends, published statistical data, borrower specific data, and reasonable forward looking expectations. Prohibiting the consideration of this information from the determination of expected credit losses is not consistent with a market participant's view of credit risk, may mislead investors, and may result in credit loss reserves that lag changes in the credit cycle. Further, this limitation on information that may be used is inconsistent with the G20's previously communicated objectives on accounting standard setting, ie., specifically to strengthen the recognition of loan loss provisions by incorporating a broader range of credit information.

The Proposed ASU's calculation of expected credit losses is a fundamental divergence from the inherent expected cash flows that underpin the intrinsic value of financial instruments, as well as a market participant's overall view of credit risk. We understand that the credit market disruption highlighted the need for more transparency related to an enterprise's exposure to credit risk. The notion of expected credit losses, whether based on expected cash flows, statistical data, or implicit in a quoted price, inherently considers how expectations of future economic conditions affect current and historical conditions. However, determining and reporting credit losses based on a static or historical view of credit exposure is fundamentally flawed, may cause an enterprise to misstate its exposure to credit risk and, in turn, may mislead financial statement users. Because the credit impairment portion excludes the impact of future events, both the credit impairment portion and non-credit impairment portion of the instrument's fair value are meaningless and irrelevant. In addition, if adopted this proposal would be operationally burdensome, because it would require preparers to maintain multiple sets of books to monitor cash flows based on both a static view (for impairment determinations) and a market participant view (for fair value determinations).

B. The Board should consider the comments of the IASB's Expert Advisory Panel when re-evaluating the shortcomings of the FASB's proposed credit impairment model.

The IASB's Expert Advisory Panel (the "EAP") is currently reviewing other credit impairment models. The Clearing House supports the work of the EAP and recommends establishment of a joint FASB/IASB EAP that includes entities that report under U.S. GAAP. The Clearing House is prepared to have several of its members participate in a field test of these proposed alternative credit impairment methodologies.

We recommend that any credit impairment model adopted by the FASB include the following attributes which are included in several of the EAP models:

- Do not require the use of expected cash flows to estimate expected losses;
- Permit the consideration of future events and conditions;
- Create a clear distinction between impaired financial assets and assets without indication of impairment;
- Decouple interest income from the allowance for credit losses and permit the calculation of expected losses to be separate from the calculation of the effective interest rate;
- Allow earlier recognition of expected losses than the existing incurred loss methodology;
- Use open portfolios; and
- Use incurred losses as a built-in floor for the total amount of the allowance.

We encourage the Board to consider the models reviewed by the EAP, given the objective of convergence of accounting standards and the goal of producing a single set of high quality standards.

3. Recognition of Interest Income on Financial Assets

Under the Proposed ASU, the amount of interest income for certain loans recorded at fair value with changes in fair value recognized in OCI would be calculated by applying the loan's effective interest rate to the amortized cost balance, net of any allowance for credit losses. To the extent that cash received exceeds the interest accrued, the reporting entity would credit the allowance for credit losses for the difference. The Clearing House believes this interest recognition model is not representationally faithful, is not operational, is not cost justified, and is incompatible with current regulatory guidance. Additionally, we believe that the income recognition model for all financial assets (loans and securities) is overly complex.

A. The proposed model is not representationally faithful for loan portfolios.

Analysts, investors and other users of financial statements focus on two separate components of loan portfolio income data: a portfolio's contractual interest income and the expected credit losses associated with the portfolio. Analysts are then able to use one component to project interest income based on the increase or decrease in the size, weighted average maturity and weighted average coupon interest rate of the portfolio, and use a separate component to project any improvement or deterioration in the portfolio credit quality based on macroeconomic trends. The proposed approach commingles credit losses and interest income by accruing interest income on the amortized cost balance of the loan portfolio, net of any allowance. This commingling will obscure the gross interest income and contractual yields earned on lending portfolios and the gross credit losses based on credit analysis, which are important and distinct parameters for users of the financial statements.

B. The interest income calculation is not operational and any perceived benefit to financial statement users is outweighed by the costs of system changes that would be required to loan and credit systems to implement the calculation.

Financial service companies typically collect and process contractual data in a loan accounting system and store historical loss data and cash flow projections in separate credit systems. The income recognition model proposed for loans held for a significant portion of their contractual terms, which would require one system to collect both sources of data, is fundamentally incompatible with the loan accounting and risk management methodology for which existing reporting systems were developed.

For example, paragraphs 56-60 of the Proposed ASU permit impairment recognition at the pool level. However, there is no guidance as to whether and how to record interest income at the pool level or individual loan level. Entities would either have to use closed/static pools to track the effective interest rate for each pool or allocate a pool level reserve down to an individual loan data field. Current loan systems (which are based on the borrower's unpaid principal balance and accrued contractual interest income and are oriented towards the production of customer billing statements) cannot accommodate either of these approaches. In order to automate the new model, significant capital investment would be required. The significant costs necessary to enable adoption of the proposed model outweigh the benefit, if any, to financial statement users.

Additionally, if interest income were recognized at a pool level, it is not clear how an entity would determine which individual loans would be classified as nonaccrual for regulatory reporting purposes. We believe it is inappropriate to measure interest income on a pooled basis, as to do so would result in an entity accruing interest on loans that are nonperforming. Alternatively, if interest income were to be recognized at the individual loan level, the Proposed ASU does not describe the methodology to be used to allocate the pool level impairment reserve to individual loans.

C. The model is incompatible with current regulatory guidance.

The Proposed ASU also includes a dramatic change in the present rules for suspending accrual on delinquent loans. The Proposed ASU states, "An entity shall cease accruing interest income on a financial asset only if the entity's expectations about future cash flows expected to be collected indicate that the overall yield on the financial asset will be negative." This is far less conservative than present non-accrual practice required by the regulatory agencies. Our preliminary discussions with the regulatory agencies do not indicate any inclination to modify their long-standing nonaccrual loan policies. The proposed model would therefore result in a RAP/GAAP difference in the reporting of nonaccrual loans and would require financial service companies to maintain two significantly different nonaccrual accounting systems.

D. Further simplification of the interest income model is necessary.

The Proposed ASU has at least three possible methodologies for calculating and displaying interest income on loans and securities. First, it would permit, but not require, separate presentation of interest income for financial assets measured at fair value with all changes in fair value recognized in net income. If interest income is presented separately, the Proposed ASU does not prescribe a particular methodology for calculating the interest income. Second, for loans and securities that are originated and expected to be held for a significant portion of their contractual terms, the Proposed ASU prescribes a specific methodology for calculating interest income. Finally, for financial assets that are acquired at an amount that includes a discount related to credit quality, a third methodology is required based on cash flows expected to be collected at acquisition. It has been our experience that financial statement users have had a limited understanding of the disclosures under U.S. GAAP associated with purchased credit impaired loans (which rely on a similar expected cash flow model) even though disclosures in this area have significantly expanded in recent time periods. Thus, expanding this little understood accounting approach further to securities and even more loans would not achieve the Proposed ASU's objective to increase transparency to financial statement users. While users are familiar with the provision and traditional credit metrics, such as nonaccrual loans and allowance coverage ratios, they do not understand the concepts embodied in an expected cash flow model that aggregates credit losses into the interest income line.

In order to simplify the complex income recognition model in the Proposed ASU, we would propose that all interest income be calculated based on the applicable effective interest rate as defined under existing U.S. GAAP and the existing income recognition model. This methodology is both understood and commonly accepted by financial statement users.

4. Other Conceptual and Operational Shortcomings

A. The implementation costs and control risks do not justify the perceived benefits of the Classification and Measurement and Impairment sections of the Proposed ASU.

The Clearing House believes that the costs of implementing the Proposed ASU significantly outweigh the perceived benefits. The far-reaching changes, which include fair value as the measurement attribute for loans and most liabilities, creating a new measurement approach for core deposit liabilities, replacing the incurred loss impairment model with an expected loss model, and calculating interest income on the amortized cost balance net of any impairment allowance, cannot be accommodated by existing reporting systems. For example, interest income on loans is typically calculated on a loan accounting system while the impairment allowance is calculated on a risk management system, and fair value may be calculated on a third system. Given that there are currently no third-party vendor systems that accommodate the requirements of the Proposed ASU, companies will be required to significantly overhaul or, in certain cases, replace entire core accounting and financial reporting systems. These systems will need to be integrated with an entity's existing internal controls structure and fully tested before implementation is complete in order to permit an entity to make its required internal controls certifications. In the interim, it may ultimately be necessary to supplement existing information technology infrastructure with manually intensive processes, such as database or spreadsheet tools, to generate the information required by the Proposed ASU.

The proposed changes would affect virtually every component of a financial institution's balance sheet other than trading assets and liabilities with the movement of loans and most liabilities to fair value. In addition, the calculation of interest income and the measurement of impairment would change dramatically for both loans and securities that meet the criteria for classification as fair value through OCI. Policies would have to be developed and procedures implemented to calculate the new measurement attribute for core deposit liabilities, and all existing hedging strategies would have to be re-evaluated. In light of the complexities of implementing the requirements of the Proposed ASU, if the Board intends to move forward with the Proposed ASU, the Board must allow for a sufficient amount of time to ensure that entities can implement the new requirements in a manner that will allow them to produce reliable financial information that has been tested within the entities' complex internal control systems.

B. Additional review and field testing are needed to identify any unintended consequences of the Proposed ASU.

Given the widespread significance and complexity of the changes embodied in the Proposed ASU, The Clearing House believes that the FASB should review the input that it receives on the Proposed ASU and propose a revised proposed accounting standards update for comment before updating the accounting for financial instruments. Specifically, the FASB should perform a joint review with banking and other financial regulators to determine whether the proposed guidance increases systemic risk for the banking industry. Understanding the systemic consequences to the banking industry of the proposed guidance is paramount to effective standard setting and high quality financial reporting. Unintended consequences of the proposed guidance may include increased volatility in earnings and capital, particularly in times of economic stress, in turn adversely impacting access to credit or equity markets, cost of capital, availability of consumer and commercial credit, as well as certain business and risk management strategies employed by management.

In addition, the FASB should conduct proper field testing with financial institutions to better understand the potential impact on the control environment and on reporting systems. As discussed above, the proposed guidance would require significant changes to systems and operations which could, in turn, lead to increased control risk. As part of the field testing, the FASB should also consider the IASB's EAP proposals and the IASB's guidance for classification and measurement, its proposal on credit impairment, and the upcoming proposal on hedging, for alternatives approaches.

C. The lack of successful convergence on this project is discouraging.

The Proposed ASU diverges in many significant respects from the IASB's classification and measurement guidance and the credit impairment guidance proposed by the IASB. Although The Clearing House does not support all aspects of the IASB guidance, we strongly support the development of high quality, converged standards. Accounting for financial instruments is a very significant issue for financial institutions throughout the world, and it is imperative that both the regulatory and accounting frameworks provide a level playing field for all market participants.

Given that the FASB and the IASB have to date been unable to converge their respective proposals on financial instruments, The Clearing House is deeply concerned that financial institutions will have to adopt new standards for U.S. GAAP followed in a few years by the adoption of different international standards. The Board cannot reasonably expect preparers to implement a multi-step implementation of the same standard as a bridge to ultimate convergence. Accordingly, The Clearing House strongly urges the FASB to defer issuance of the Proposed ASU in final form until the FASB and IASB have agreed upon a converged standard.

We acknowledge the complexity and disparate views surrounding the development of new standards for financial instruments. However, the process of generating high quality financial reporting standards must afford sufficient time for preparers to evaluate the nature and extent of the proposed changes and rely on the knowledge that such standards will not be subject to change in the foreseeable future.

5. Derivative and Hedge Accounting

A. Dedesignation is a prudent and cost effective risk management strategy.

The Clearing House disagrees with the proposed prohibition on voluntary dedesignation of hedge accounting relationships, which we believe would unnecessarily restrict the use of many valid hedge programs. For example, instead of hedging on a macro basis, which is not allowed under U.S. GAAP, entities frequently designate specific transactions which are representative of a larger group as hedged items. As changes occur in the risk profile of the larger group, an entity will typically adjust its hedging relationships through dedesignation of the existing hedging instruments and immediate redesignation of those hedging instruments as hedges of similar but not identical transactions. Similarly, an entity may hedge instruments, such as mortgage-backed securities, whose fair value is impacted by changes in prepayment assumptions. As these assumptions change the risk profile, the current hedging instrument may no longer function as an effective risk management tool, leading to dedesignation of the current hedging instrument and designation of a new hedging instrument or perhaps redesignation of a portion of the current hedging instrument. These types of hedging programs, which are prudent and cost effective risk management tools, would no longer be permitted under the Proposed ASU.

Even assuming that terminating the hedge position and entering into a new hedge position is possible without counterparty consent and/or a substantial financial penalty, these new hedging instruments would be costly, particularly when considering that the hedged items may change as frequently as daily, requiring continuous rebalancing of the hedging instruments. As we see no economic benefit to this approach, we do not agree that the costs related to this amendment are warranted.

In addition, we are uncertain as to whether the proposed prohibition would apply to certain dynamic hedging strategies, pursuant to which hedging relationships are dedesignated frequently. For example, it is unclear whether the Proposed ASU would affect hedging relationships designated with a shorter hedge period than the life of the hedging instrument (e.g., daily hedging periods), even if the strategy does not require a dedesignation and redesignation at the end of each hedge period. Should the Board retain the proposed prohibition on voluntary dedesignation, we would appreciate clarification that dynamic hedge strategies involving a hedging period that is shorter than the life of the hedging instrument are still acceptable.

The Clearing House recommends that providing enhanced disclosure requirements about why and how companies use hedging strategies that require frequent dedesignation and redesignation would better address the Board's and user concerns, rather than mandating a prohibition on hedge accounting for these strategies.

Conclusion

The Clearing House strongly believes that the Proposed ASU does not represent an improvement in financial reporting and believes that financial statement users broadly do not support its adoption. Accordingly, The Clearing House does not support adoption of the Proposed ASU in its current form.

As discussed above, moreover, we believe that many elements of the Proposed ASU should be modified. Most importantly:

- Amortized cost should be retained as a measurement attribute for financial instruments held for the receipt or payment of cash flows.

- The credit impairment model should incorporate expectations as to future changes in economic conditions and a longer loss emergence period.

- The measurement of interest income should be based on amortized cost, not on amortized cost net of the credit impairment allowance.

Given the magnitude of the proposed changes, The Clearing House strongly recommends that the FASB perform a joint review with banking and other financial regulators to obtain a better understanding of the economic risks, systemic consequences to the banking system and potential, unintended consequences of the Proposed ASU. Following this review, we strongly encourage the FASB to re-expose the proposed guidance for additional comment. Finally, we believe that a final standard should not be issued unless it converges in all material respects with revised international standards.

Thank you for considering the comments provided in this letter. If you have any questions or are in need of any further information, please contact me at (212) 613-9883 (email: david.wagner@theclearinghouse.org) or Gail Haas at (212) 612-9233 (email: gail.haas@theclearinghouse.org).

Sincerely yours,

David Wagner

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Securities and Exchange Commission

Mr. Arthur Lindo
Associate Director and Chief Accountant
of Banking Supervision and Regulation
Federal Reserve Board

Ms. Kathy Murphy
Chief Accountant
Comptroller of the Currency

Mr. Robert Storch
Chief Accountant
FDIC

Ms. Patricia Selveggi
Statistics Officer
Federal Reserve Bank of New York

Mr. James Bean; Wells Fargo Bank, N.A.
Chairman – Financial Reporting Committee
Chairman – IASB Working Group
The Clearing House Association L.L.C.

Mr. Paul Saltzman
Executive Vice President and General Counsel
Head of *The Clearing House Association L.L.C.*

Ms. Gail Haas
Financial Tax Specialist
The Clearing House Association L.L.C.