STATE OF NEW YORK
BANKING DEPARTMENT
ONE STATE STREET PLAZA
NEW YORK, NY 10004

April 21, 2011

Ms. Susan M. Cosper
Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Re: File Reference No. 2011-175

By email

Dear Ms. Cosper:

The New York State Banking Department has reviewed the Financial Accounting Standards Board's Discussion Paper, "Selected Issues about Hedge Accounting," and we appreciate the opportunity to provide our thoughts.

We understand that a main objective of the proposal is for hedge accounting to better reflect institutions' risk management. While we acknowledge this effort, we have significant concerns about this approach. There are several reasons why this objective will not produce meaningful results:

- The risk management practices of many institutions, including supposedly sophisticated financial institutions, proved to be of limited value during the recent financial crisis.

- Risk management practices vary in approach and ability, greatly reducing comparability between financial statements.

- Relying substantially on "risk management objectives" as a basis for accounting should recognize that such objectives will usually differ from reality. Likewise, no entity creates a "risk management strategy" to lose money, but this may occur when events contravene.

- Normal human behavior is to present oneself to others in the best light. Business institutions are no different. Consequently, if the IASB proposal is followed we should expect financial results of relevant institutions to offer at best a positive spin and at worst significant misrepresentation. In either case, a risk management approach is

> unlikely to better reflect economic reality, which should be the primary goal of accounting.

The IASB proposal allows institutions great latitude in hedge accounting. Two examples: allowing or requiring the "rebalancing" of hedges, which may make hedge effectiveness a moving target; and meeting hedge effectiveness by what an entity "is expected to achieve" rather than what is actually achieved. For the same reason that accounting standards appropriately do not allow fair value to be determined on an internal basis, hedge accounting should not be left largely to the discretion of management. Keeping open the possible acceptance of macro-hedging raises another red flag.

The alternative view of the IASB's John Smith captures many of our concerns: the proposal "unduly relies on risk management" and its provisions "lack rigour" and "inappropriately expand the use of hedge accounting". Also, "risk management is not defined, it has no boundaries, and is not applied uniformly" while "risk positions are arbitrary". Mr. Smith argues that the proposal could "have the effect of eliminating all volatility in earnings". While stability may be a noble goal, it should not be arbitrarily created to mask problems. We understand the appeal of broad, flexible accounting standards to preparers, and consequently expect this to appear to be a rare popular proposal, but such sentiments do not justify this new approach. Instead, risk management objectives and strategies are better suited to disclosures in the financial statements.

The initial potential danger is in allowing larger institutions most heavily involved in hedge accounting to report financial results in line with their financial objectives. Over time such practices could migrate to smaller institutions which may engage in hedges primarily for financial engineering, so that financial results become increasingly more detached from reality.

A shift which appears to have occurred in the latest proposals is in transforming hedge accounting from an exception to be earned to a right deployed as management wishes. While we appreciate the difficulties of hedge accounting as initially required by Statement 133, we do not consider a much more permissible standard an improvement. We suggest that the FASB not use the IASB's latest proposal as a starting point, but instead work with the IASB to create a converged standard which both reflects reality and requires a rigorous approach (e.g., require at least an annual effectiveness evaluation, preferably a meaningful quantitative test). If both of these goals cannot be accomplished, accounting may be better without hedge accounting rules which can be used to create results that overwhelm the financial statements.

In our September 19, 2008 comment letter to the FASB and IASB on "Reducing Complexity in Reporting Financial Instruments", we addressed these difficulties and made a recommendation: "While hedge accounting represents an attempt to properly record entities' risk management, it has created significant levels of complexity and increased errors and abuse. The discipline needed to enforce hedge accounting also contradicts the principles-based approach. Consequently, the Department would eliminate hedge accounting and take the following steps:

* Allow for the expansion of the fair value option to fair value both sides of transactions where entities seek to obtain 'economic hedging.' With the elimination of hedge accounting, we would facilitate this treatment by considering applicable liabilities to be within the trading account.

* Allow 'synthetic accounting' to replace relevant cash flows in those transactions currently accounted for as cash flow hedges (e.g., by converting a fixed rate security to a security with floating rates)."

If the IASB's latest proposal becomes the framework for a new standard, a separate disclosure containing each entity's fiscal year-end balance sheet and income statement with all financial assets and financial liabilities at fair value may be needed to mitigate the proposal's shortcomings.

If you would like to discuss our letter, please call me at (212) 709-1532 or email me at john.mcenerney@banking.state.ny.us.

Very truly yours,

John McEnerney
Chief of Regulatory Accounting