
**Board of Governors of the Federal Reserve System
Federal Deposit Insurance Corporation
Office of the Comptroller of the Currency
Office of Thrift Supervision**

August 22, 2008

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



LETTER OF COMMENT NO. 125

Re: File Reference No. 1590-100

Dear Mr. Golden:

We are pleased to submit comments on behalf of the staffs of the four federal banking agencies (the staffs) on the Exposure Draft of a proposed Statement of Financial Accounting Standards, *Accounting for Hedging Activities: an amendment of FASB Statement No. 133*. Hedging with derivatives is an important risk mitigation technique employed by many of the institutions we supervise. We support your effort to simplify Statement No. 133 and remove certain provisions that have led to restatements of financial reports in recent years. However, we are concerned that certain aspects of the current proposal will provide a disincentive to prudently managing risk exposures through hedging practices.

For example, we do not support the FASB's proposal to eliminate the ability of an institution to bifurcate-by-risk when qualifying for and applying hedge accounting. In principle, we agree with the points raised by two Board Members in the Alternative Views contained in Appendix A of the Exposure Draft. As stated previously, we are concerned that elimination of the ability to bifurcate-by-risk will provide a disincentive to prudent risk management through hedging. In addition, we do not view elimination of this ability as a change that simplifies Statement No. 133 or as an improvement to financial reporting. With the additional robust disclosures required by Statement No. 161, the existence of more than one measurement basis for certain partially hedged items will be more transparent to the financial statement user. In addition, significant partial hedging strategies employed by public companies will be linked to risk management practices described in Management's Discussion and Analysis.

The examples provided in paragraphs A55 – A58 of the Alternative Views section of the Basis for Conclusions provide strong illustrations of the types of concerns the staffs have with respect to eliminating the ability to bifurcate-by-risk. In particular, we agree with the notion that, for

some assets and liabilities, it is more effective and efficient to hedge discrete risks than to hedge an entire asset or liability. Indeed, because it may not be currently possible to hedge some assets and liabilities in their entirety, meeting the new “reasonably effective” criteria for employing hedge accounting may be difficult to achieve. We would be troubled if institutions avoided prudently managing certain risk exposures where tools are widely available to do so simply because the accounting treatment would be punitive.

Elimination of the ability to bifurcate-by-risk also raises a concern about using fair value to measure certain illiquid financial assets and liabilities. The agencies have expressed such concerns in the past, specifically with respect to Statements No. 157 and 159. As the example in paragraphs A55 – A56 demonstrates, certain risks embedded in a fixed rate loan can be hedged with commonly available derivative instruments even though the loan as a whole may be illiquid and difficult to measure using fair value. The staffs are uncomfortable with the possibility that a change in the current accounting rules would require such illiquid loans to be measured entirely at fair value in order to achieve hedge accounting despite difficulties in determining and understanding fair value measurements for illiquid financial instruments. We do not view this as a change that simplifies the application of Statement No. 133 or the interpretation of results reported under that standard. Similar fact patterns exist for other assets and liabilities that involve multiple embedded risks. The Basel Committee on Banking Supervision has expressed similar concerns about expanding the use of fair value measurements for illiquid financial instruments.

In response to Issue 10 contained within the Notice for Recipients of the Exposure Draft, if a fair value option is provided in the transition provisions for the proposed amendments, we support the proposal to limit it to assets and liabilities that are currently designated as hedged items under Statement No. 133. We are concerned that a broader one-time fair value option may lead to some of the concerns that arose during the initial implementation of Statement No. 159, namely the use of the one-time option in a manner that is contrary to the principles and objectives of the accounting standard.

Contrary to the two Board Members providing the Alternate Views, however, we consider the simplification benefits provided by other provisions contained within this Exposure Draft to be worthy of issuing a final standard amending certain hedge accounting provisions of Statement No. 133. For example, we see merit in the FASB’s proposals that would replace the requirement to quantitatively assess effectiveness at inception with a formal, contemporaneous qualitative assessment and limit the requirement to reassess effectiveness after inception to cases in which circumstances suggest that the hedging relationship may no longer be reasonably effective. Initial and ongoing quantitative assessments of certain hedge positions result in considerable burden on institutions. Benefits offsetting that burden are questionable given that any ineffectiveness involved in designated hedge positions is reflected in current earnings and is fully disclosed in financial statement footnotes. For the same reason, we see merit in changing the threshold for assessing hedge effectiveness from “highly effective” to “reasonably effective.”

We understand that certain provisions contained in this Exposure Draft have the effect of moving U.S. generally accepted accounting principles (GAAP) further away from International Financial Reporting Standards (IFRS). However, we also understand that the International Accounting

Standards Board (IASB) is pursuing a project that may result in changes similar to those proposed by the FASB. Depending on the outcome of the IASB's project, the perceived divergence between U.S. GAAP and IFRS may be temporary in nature.

We would welcome the opportunity to discuss our comments with you further.

Sincerely,

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