



April 25, 2011

Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-05116
Via e-mail: director@fasb.org

Re: **File Reference No. 2011-175 Selected Issues about Hedge Accounting (Including IASB Exposure Draft, Hedge Accounting)**

Dear Technical Director:

The Group of North American Insurance Enterprises ("GNAIE")¹ is pleased to provide comments to the Financial Accounting Standards Board ("FASB") in regards to its Discussion Paper: *Selected Issues about Hedge Accounting (Including IASB Exposure Draft, Hedge Accounting)* referred to herein as the "DP".

GNAIE supports the efforts of the International Accounting Standards Board ("IASB") and the FASB to converge their proposed hedge accounting models. We encourage the IASB and the FASB to continue to work together to converge their models as, depending on the extent of any divergence in the two models and potential adoption of International Accounting and Reporting Standards ("IFRS") in the U.S., it could result in significant re-work for U.S. companies. U.S. companies may be required to first adopt a FASB standard and later adopt a different IFRS standard.

Although we support the hedge accounting changes proposed by both Boards (i.e., the IASB proposal issued in December 2010 and the FASB proposal issued in May 2010), we believe the hedge accounting model proposed by the IASB Exposure Draft ("ED") is preferable compared to the more limited proposed changes in the FASB's exposure draft² as the IASB's ED would provide reporting entities the opportunity to more faithfully represent their risk management activities in their financial statements and thus, produce more relevant information for users of financial statements. The IASB ED accomplishes its objectives of aligning hedge accounting more closely with risk management, establishing a more objective-based approach to hedge accounting, and addressing inconsistencies and weaknesses in the existing hedge accounting model.

We agree with the objective of hedge accounting as outlined in the IASB ED, which is to present in the financial statements the effect of an entity's risk management activities that use financial instruments to manage exposures arising from particular risks that could affect profit or loss. We also support the proposed changes in the IASB ED to replace the existing rules-based guidance with a more objective-based or principles-based approach for determining when an entity should be allowed to apply hedge accounting (hedge effectiveness assessment) and for determining what risks are eligible hedged items. While we support these aspects, there is no evidence (field

¹ GNAIE is a trade organization comprised of leading insurance companies including life insurers, property and casualty insurers, and reinsurers in Bermuda, Canada and the United States. GNAIE members include companies who are the largest global providers of insurance and substantial multi-national corporations, and all are major participants in the US and emerging markets.

² Proposed Accounting for Financial Instruments Update released May 2010.

Jerry M. de St. Paer
Executive Chair

Douglas Wm. Barnert
Executive Director

Group of North American Insurance Enterprises
40 Exchange Place, Suite 1707
New York, NY 10005
UNITED STATES

++1-212-480-0808
info@gnaie.net
www.gnaie.net



testing) that the proposed guidance will achieve the desired benefits; will be applied in a manner consistent with the IASB's objectives; or will be operational. We have interpreted certain aspects of the FASB DP as an effort to obtain additional feedback to assess some of the same concerns we have expressed with the IASB ED as related to verifying that the application of the proposals meets the objectives. As a result, we suggest the IASB and FASB consider testing the application of this model for both financial and non-financial entities where some of the more complex aspects of the guidance will be applied to ensure the outcome of the testing is consistent with the IASB's and FASB's expectations.

Specific Comments on the FASB DP

While we generally support the hedging model described in the IASB ED, we have specific concerns related to the following aspects of the proposed guidance that are reflected in our responses to the FASB DP and further described below.

Field Testing

As is noted in our responses to several questions raised in the FASB DP, we believe the principles proposed in the IASB ED can be practically applied, implemented and will be auditable. However, given they provide flexibility to report hedging activities consistent with risk management activities and thus, are much less limiting than both current IFRS and U.S.GAAP, we believe it would be prudent for the IASB and FASB to perform extensive field testing to validate that companies will apply the principles as expected; that the application of those principles would promote comparability among financial statements; and that the results would be relevant to users of financial statements.

Disclosure Requirements

We interpret the FASB DP to provide disclosure requirements for only those derivatives that receive hedge accounting. We believe disclosures related to derivatives that do not receive hedge accounting (but are economic hedges) would be useful to financial statements users and would provide a more complete picture of the risk management activities for an entity. With the adoption in U.S. GAAP of SFAS 161, *Disclosures about Derivative Instruments and Hedging Activities*, U.S. companies have been required to provide disclosures about all derivatives for a few years and we believe the required disclosures are robust and useful to users of financial statements. Therefore, we encourage the IASB and FASB to consider SFAS 161 as the disclosure requirements are developed for derivatives that do not receive hedge accounting (but are economic hedges) as well as those that receive hedge accounting.

Potential Effect on Risk Management Activities

Given the principles prescribed in the IASB ED, we believe the additional flexibility allowed in the proposal will have a direct impact on various risk management activities employed by companies, such as insurance companies, that hedge certain risks such as interest rate risk, credit risk and foreign currency risk. For example, the quantitative limits (e.g., hedge effectiveness of 80%-125%) are considerations when a reporting entity enters into a hedging relationship. Should a proposed hedging relationship not be expected to meet the quantitative thresholds set forth, an entity may choose to not enter into the hedging relationship due to the potential income statement volatility associated with non-hedge accounting. The proposal in the IASB ED will allow companies more flexibility in designating a hedging relationship that is expected to be an effective hedge (i.e., reduce risk) as a hedging relationship for accounting purposes, but under current U.S. GAAP, may not qualify for hedge accounting. We agree with the proposed approach as it allows companies more flexibility in engaging in certain risk management programs that it may not have considered under the current rules-based guidance when hedge accounting would not be achieved.

When the FASB and IASB address portfolio hedges, we would be supportive of the same principles-based approach proposed in the IASB ED being applied to portfolio hedges. We believe the benefits of providing



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flexibility, as described above, will also be recognized for portfolio hedging if the principles prescribed are similar in nature to the individual hedge principles in the IASB ED.

Key Comments Related to IASB ED

We provided our comments to the IASB regarding their ED for hedge accounting. Such comment letter is attached hereto as Appendix A

The following are our key comments related to the IASB ED, which are discussed in detail in our IASB ED comment letter and in the responses to the questions in the FASB DP:

Hedge Items

We have concerns that credit risk is not considered an eligible hedge risk in the proposed guidance as it contradicts with other areas of the accounting literature (such as embedded derivatives and impairment) where quantification of embedded credit derivatives or credit losses of financial assets are to be recorded in an entity's financial statements. Other guidance implies that credit risk is separately identifiable and reliably measurable. Also, prescribing that credit risk not be allowed as a hedged item is inconsistent with the overall principles based guidance of the IASB ED.

Hedge Effectiveness

We have concerns with the requirement to minimize hedge ineffectiveness as a part of the objective of the hedge effectiveness assessment. Without further clarification, we are concerned that an entity may be required to evaluate every available hedging instrument to determine which instrument most minimizes ineffectiveness and then will be required to use that instrument in order to achieve hedge accounting, rather than allowing risk management activities to provide flexibility on what instruments are utilized.

Rebalancing

While we support the rebalancing concept outlined in the IASB ED, rebalancing could create undue costs on preparers to continuously assess the need for rebalancing and may force entities to rebalance the hedge accounting relationship even when an entity believes no rebalancing is needed based on their risk management review. To alleviate the concerns with required rebalancing, the final guidance should be modified to permit, but not require rebalancing.

Layer Components

The proposed guidance should not prohibit hedge accounting for otherwise eligible hedged risks simply because a prepayment may impact the value of the hedged risk. Current U.S. GAAP allows such a hedged risk to be eligible for hedge accounting as long as the hedging instrument itself has a mirror pre-payment option. We believe this is more aligned with the risk management activities of our member companies.

Voluntary De-designation

We have concerns about the IASB's view with respect to not allowing an entity to voluntarily de-designate a hedging relationship. We note the IASB's basis for conclusion states that voluntary discontinuance of hedge accounting would be arbitrary and unjustifiable. We disagree with the IASB's reasoning. The initial application of hedge accounting is voluntary. Therefore, limiting the reasons for discontinuation of hedge accounting to exclude voluntary discontinuance seems to be inconsistent with the voluntary nature of hedge accounting.

Comprehensive Income Presentation

We believe additional line items in the statement of comprehensive income (as proposed in the IASB ED) would distract from more relevant information and would not provide useful information as separate line items. The



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disclosures required in the IASB ED provide sufficient information related to the amounts presented within the statement of comprehensive income without the need to present this information as separate line items.

In addition to the comments above, we have included our responses to the questions in the FASB DP. If the FASB desires a further discussion of our views please contact Doug Barnert at (212) 480-0808.

Sincerely,

A handwritten signature in black ink that reads "Kevin Spataro". The signature is written in a cursive, slightly slanted style.

Kevin A. Spataro
Chair, GNAIE Accounting Convergence Committee

KAS:JE:LT:cjl

cc: Sir David Tweedie, Chairman, International Accounting Standards Board



RESPONSE TO QUESTIONS:

Question 1: When an entity uses financial instruments to manage risk exposures in economic hedges but those instruments are not designated in hedging relationships for accounting purposes, do you believe that the proposed guidance would provide useful information about all of the effects of an entity's risk management objectives?

For those economic hedges that are designated as hedging relationships for accounting purposes, the IASB ED would provide reporting entities the opportunity to more faithfully represent their risk management activities in their financial statements and thus, produce more relevant information for users of those financial statements. We believe that the proposed accounting guidance coupled with disclosures provides readers with a better perspective of what risks exist, how they are mitigated and how effectively they are mitigated. Our interpretation of the IASB ED provisions for accounting, reporting and disclosure is that they are only applicable to those hedging relationships that are designated as hedging relationships for accounting purposes. We believe disclosures related to derivatives that are not designated as hedging relationships for accounting purposes would be useful to financial statements users and provide a more complete picture of the risk management activities for an entity. Therefore, we encourage the IASB to review the current U.S. GAAP disclosure requirements in SFAS 161 as we believe they provide an appropriate level of disclosure for risk management activities associated with all derivatives.

Question 2: Do you believe that the proposed guidance and illustrative examples included in the IASB's Exposure Draft are sufficient to understand what is meant by risk management, how to apply that notion to determine accounting at a transaction level, and how to determine the appropriate level of documentation required? Why or why not?

Yes. We support the underlying objective of aligning the hedge accounting guidance with its purpose as indicated in an entity's risk management strategies. We understand the concept of risk management strategy to be consistent with its usage in FAS 133, paragraph 20 a. Practically, this means a statement of the type of risk to be mitigated, identification of the hedging instrument, identification of the hedged item, and a description of how the hedging instrument will effectively offset the hedged risk (including a qualitative analysis of the proposed hedging effectiveness criteria in the IASB ED) as part of the hedge accounting documentation. Thus, entities are already subjected to determining the appropriate level of documentation.

Question 3: Do you foresee an entity changing how it determines, documents, and oversees its risk management objectives as a result of this proposed guidance? If yes, what changes do you foresee? Do you foresee any significant difficulties that an entity would likely encounter in establishing the controls related to complying with the proposed guidance?

We believe there is a possibility that the proposed guidance could impact how an entity mitigates risk and thus, would impact its risk management activities. Because current guidance is so limiting with regard to what can qualify for hedge accounting, some entities have likely limited their use of certain derivatives to avoid income statement volatility. The additional flexibility to use hedge accounting, as proposed, may allow entities to qualify for hedge accounting more easily (consistent with their risk management objectives) and thus, may facilitate them using hedging instruments they previously had decided not to use. We recommend robust field testing of all proposals in the IASB ED be done in order to validate that the objectives of the proposal are met and the results are what the Boards expected. With regard to controls related to other aspects of the IASB ED, beyond risk management objectives, see the responses to other questions below.

Question 4: Do you foresee any significant auditing issues arising from the proposed articulation of risk management and its link to hedge accounting? For example, is the information required to be disclosed



regarding an entity's risk management strategies measurable and objective? Could the inclusion of an entity's risk management objectives create an expectation gap that the auditor is implicitly opining on the adequacy of an entity's risk management objectives?

We do not foresee significant auditing issues (but some audit issues are likely to arise when the hedge accounting model is implemented). Current U.S. GAAP disclosure requirements for derivatives (regardless if they receive hedge accounting or not) require information regarding to the intent and objectives for using the derivatives and the auditors must opine on such disclosures. Accordingly, the inclusion of an entity's risk management objectives should not create an expectation gap that the auditor is implicitly opining on the adequacy of such objectives any more than existing requirements under U.S. GAAP.

Question 5: Should cash instruments be eligible to be designated as hedging instruments? Why or why not? If yes, is there sufficient rigor to prevent an entity from circumventing the classification and measurement guidance in other relevant accounting guidance (for example, IFRS 9, *Financial Instruments*, and IAS 21, *The Effects of Changes in Foreign Exchange Rates*)? Are there any operational concerns about designating cash instruments (such as items within a portfolio of receivables) as hedging instruments?

Cash instruments have sometimes been used historically for risk management activities and thus, they should be eligible for designation as hedging instruments. For example, a treasury bond could be used as a hedging instrument for a liability that is linked to treasuries. Further, we believe it is quite clear in the IASB ED that, should a cash instrument be considered a hedging instrument, it should be fair valued through profit and loss in its entirety. As a result, we do not believe there is risk that the instruments used will be improperly classified and measured via IFRS 9. We also do not see any operational concerns about designating cash instruments as hedging instruments.

Question 6: Do you believe that the proposed guidance is sufficient to understand what constraints apply when determining whether an item in its entirety or a component thereof is eligible to be designated as a hedged item (for example, equity instruments measured at fair value through profit or loss, standalone derivatives, hybrid instruments, and components of instruments measured at fair value through profit or loss that are not permitted to be bifurcated)? If not, what additional guidance should be provided?

Yes, but we have concerns that credit risk is not considered an eligible hedge risk in the proposed guidance as it contradicts other areas of accounting literature (such as embedded derivatives and impairment) where quantification of embedded credit derivatives or credit losses of financial assets are to be recorded in an entity's financial statements. By not considering credit risk to have met the separately identifiable and reliably measurable criteria, the IASB would effectively be indicating that the hedge accounting criteria for risk components would represent a higher measurement threshold than impairments and embedded derivatives that are recorded in an entity's financial statements. Therefore, we believe credit risk should be an eligible hedged item in the IASB ED.

Question 7: Do you believe that the proposed criteria are appropriate when designating a component of an item as a hedged item? If not, what criteria do you suggest? Do you believe that the proposed guidance and illustrative examples are sufficient to understand how to determine when the criteria of separately identifiable and reliably measurable have been met? If not, please describe what additional guidance should be provided.

The proposed criteria for designating a component of an item as a hedged item are appropriate. However, we do not believe that the illustrative examples in the proposed guidance should list items believed to not qualify (e.g., inflation and credit risk) as everyone will interpret the guidance as those items never qualifying.



Question 8: Do you believe that “separately identifiable” should be limited to risk components that are contractually specified? Why or why not?

No. We believe it should not be limited to items that are contractually specified. Rather, the separately identifiable and reliably measurable principle should be adequate. We would suggest that the IASB ED not specify certain types of risks that cannot be eligible hedged risks but rather focus on criteria that would determine what qualifies as hedged risks or simply include the principle (separately identifiable & reliably measurable) for determining whether a risk component is an eligible hedged item. The elimination of examples of items that would not be eligible hedged risks would mitigate the potential that certain conditions change that may enable a particular risk to be deemed separately identifiable and reliably measurable in the future and would result in entities being allowed to use their judgment to determine whether certain risks would be eligible hedged items, which is more consistent with the principles-based framework in the IASB ED.

Question 10: Do you believe that the proposed guidance is sufficient to understand what constraints apply to determining a layer component from a defined, but open, population? (For example, do you believe that the sale of the last 10,000 widgets sold during a specified period could be designated a layer component in a cash flow hedge?) If not, what additional guidance should be provided?

Yes, we believe the proposed guidance is sufficient to understand hedging of layer components. However, the IASB ED also references a layer component of a hedged risk impacted by a prepayment option as not being eligible as a hedged item. The proposed guidance should not prohibit hedge accounting for otherwise eligible hedged risks simply because prepayment may impact the value of the hedged risk. By prohibiting this type of hedging relationship, the IASB ED would not align hedging accounting with risk management activities. Our member companies' risk management objectives may contain an objective to hedge, for example, interest rate risk associated with a principal payment on a bond that has a pre-payment option. We believe, as long as the hedging instrument also contains a mirror pre-payment option, an effective hedging relationship can be achieved. Additionally, we note that prohibiting this type of hedging relationship even when the impact of prepayment risk is significant would be inconsistent with the objective of hedge accounting in the IASB ED. Furthermore, there would be no need to prohibit this type of hedging relationship since the ineffective portion of the hedging relationship would be recognized in profit and loss to the extent that a similar prepayment feature was not included in the hedging instrument.

Question 11: Do you foresee any operational concerns applying other guidance in IFRS (for example, guidance on impairment, income recognition, or derecognition) to those aggregated positions being hedged? For example, do you foresee any operational concerns arising when an impairment of individual items within a group being hedged occurs? If yes, what concerns do you foresee and how would you alleviate them? The proposed guidance would define an *aggregated exposure* as a combination of another exposure and a derivative. The proposed guidance would permit an entity to recognize changes in the fair values of derivatives that are part of the aggregated exposure to be reflected in other comprehensive income rather than through profit or loss.

Until certain of the standards are more complete, we cannot determine whether there will be any significant operational issues regarding their application to aggregated positions being hedged.

Question 12: Do you believe that the proposed guidance on aggregated exposures will provide more transparent and consistent information about an entity's use of derivatives? Why or why not?

Yes, because entities do use aggregate exposures as hedged items and as a result, being able to designate them for hedge accounting will provide more transparency regarding their risk management objectives.



Question 13: Do you believe that an entity should be permitted to apply hedge accounting to a group of cash instruments or portions thereof that offset and qualify as a group under the proposed guidance and satisfy the proposed hedge effectiveness criteria? Why or why not?

Yes, as long as the hedging transaction is in accordance with the entity's risk management objective. This is consistent with the overall principles based objectives of the IASB ED. Additionally, it is consistent with being allowed to designate both non-derivatives and derivatives as hedging instruments.

Question 14: Do you foresee any significant operational concerns, including auditing issues, in determining how to assess whether a hedge achieves other-than-accidental offset? If yes, what concerns do you foresee and how would you alleviate them?

No. However, we are concerned with the requirement to minimize hedge ineffectiveness as a part of the objective of the hedge effectiveness assessment. Specifically, we are concerned that without clarification, an entity may be required to evaluate every available hedging instrument to determine which instrument most minimizes ineffectiveness and then will be required to use that instrument in order to achieve hedge accounting, rather than allowing risk management activities to provide flexibility on what instruments are utilized. Overall, we agree with the direction of the more principles-based guidance. However, as large investors in the capital markets, we recommend extensive field testing be done to verify that the results are what the Boards expected and that the results are relevant to a financial statement user.

Question 15: Do you believe that the proposed guidance and illustrative examples are sufficient to understand how to analyze hedge effectiveness (for example, how to measure the change in the value of the hedged item attributable to the related hedged risk for nonfinancial items)? If not, what additional guidance is needed?

Until the scope of the IASB ED proposal becomes final and field testing completed, we cannot determine if the proposed guidance will be sufficient for purposes of analyzing hedge effectiveness.

Question 16: Do you foresee any significant operational concerns or constraints in determining whether (a) a change to a hedging relationship represents a rebalancing versus a discontinuation of the hedging relationship or (b) an entity's risk management objective has changed? If yes, what concerns or constraints do you foresee and how would you alleviate them?

While we support the concept outlined in the IASB ED that would allow rebalancing, we disagree with the proposed guidance that would require rebalancing, rather than allowing entities the option to rebalance. Rebalancing should not be a requirement but rather an option to be consistent with the voluntary nature of hedge accounting. If an entity decides not to re-balance, de-designation should be allowed.

If rebalancing continues to be a requirement in the final guidance, there would be undue operational costs for preparers to assert that rebalancing is not necessary. If there are concerns with changing the rebalancing requirement to be voluntary when no ineffectiveness is being recorded for under-hedges in a cash flow hedge, the final guidance could be changed to require ineffectiveness be recorded for both over and under-hedges for cash flow hedges (similar to the FASB proposal) and remove the requirement to rebalance to minimize ineffectiveness.

While we have concerns with how a change in an entity's risk management objective may be interpreted (whether this is based on individual hedging relationships or overall hedging program) in a way that may not enable an entity to discontinue hedge accounting for various hedging relationships, this concern could easily be alleviated by permitting voluntary de-designation.



Question 17: Do you foresee any significant operational concerns or constraints relating to the potential need to rebalance the hedging relationship to continue to qualify for hedge accounting? If yes, what concerns or constraints do you foresee and how would you alleviate them?

Yes. As stated in our response to Question 16, required rebalancing could create undue costs on preparers to continuously assess the need for rebalancing and may force entities to rebalance the hedge accounting relationship even when an entity believes no rebalancing is needed based on their risk management review. To alleviate the concerns with required rebalancing, the final guidance should be modified to permit, but not require rebalancing.

Question 18: Do you believe that capitalizing the time value of an option as a basis adjustment of nonfinancial items (in other words, marking the asset or liability away from market) will improve the information that is provided in an entity's statement of financial position? Why or why not?

We believe the requirement to determine the aligned time value of an option and only defer that portion in accumulated other comprehensive income creates additional complexity that would result in additional costs to preparers when trying to apply hedge accounting for options. We believe the transfer of the aligned time value of options should not be a requirement but rather an option that an entity could elect this treatment at inception of the hedging relationship. This would allow entities with less sophisticated operations to exclude the time value component from their assessment of ineffectiveness and would not impose the burden of calculating and deferring the aligned time value component. For these entities, the changes in the time value of the option would be recorded in profit and loss each period.

Question 19: Do you believe that the proposed presentation of the gains and losses in other comprehensive income will provide users of financial statements with more useful information? Why or why not?

No. We believe additional line items in the statement of comprehensive income would distract from more relevant information and would not provide decision useful information as separate line items. The disclosures required in the IASB ED provide sufficient information related to the amounts presented within the statement of comprehensive income without the need to present this information as separate line items.

Question 20: Do you believe that the proposed presentation of a separate line item in the statement of financial position would increase the transparency and the usefulness of the information about an entity's hedging activities? Why or why not?

No. We believe the separate balance sheet line item presentation provides limited additional information on an entity's risk management practices or hedge accounting practices because it represents only one side of the hedging activities (i.e., provides information about the hedged item and excludes any information about the related hedge). Additionally, we note this presentation could potentially distract from more meaningful information on an entity's balance sheet. Since these amounts provide limited information without significant commentary and additional information needed to understand the hedging relationship, separate balance sheet presentation may be misleading to investors. Accordingly, we would recommend this information be presented in the notes to the financial statements, which is already a requirement in the IASB ED.

Question 21: Do you believe that there is sufficient guidance to specifically link the hedging adjustments to the hedged assets and liabilities that compose a hedged net position with respect to presenting a separate line item in the statement of financial position?

No. Consistent with our response to Question 20, we note this presentation could potentially distract from more meaningful information on an entity's balance sheet. Since these amounts provide limited information without



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significant commentary and additional information needed to understand the hedging relationship, separate balance sheet presentation may be misleading to investors.

Question 22: Do you foresee any significant auditing issues arising from the inclusion of risk management disclosures in the notes to the financial statements? If yes, what issues do you foresee and how would you alleviate them? Do you believe that it is appropriate to include risk management disclosures in the notes to the financial statements rather than in other information in documents containing financial statements? Why or why not?

We believe it is appropriate to include risk management disclosures in the notes to the financial statements. Given increased transparency in derivative related disclosures under current U.S. GAAP, the disclosure requirement under the proposed guidance would have minimal impacts. However, we recommend that the IASB consider incorporating the disclosures requirements containing in current U.S. GAAP (i.e., SFAS 161) as they are more robust. As stated in our response to Question 1, the disclosures in the IASB ED are not expected to relate to all of an entity's risk management activities (only those that are designated as hedging relationships for accounting purposes). However, we believe the disclosure requirements similar to those in SFAS 161 for all derivatives (both accounting hedges and non-accounting hedges) would be helpful to a user of the financial statements.

Question 23: Do you believe that the changes proposed by the IASB provide a superior starting point for any changes to U.S. GAAP as it relates to derivatives and hedging activities? Why or why not? Should the FASB be making targeted changes to U.S. GAAP or moving toward converging its overall standards on derivatives and hedging activities with the IASB's standards?

We believe the IASB hedge accounting model would be a more superior starting point (with certain changes to the IASB proposal that we disagree with). The FASB should move towards converging its overall standards on derivatives and hedging activities with the IASB's standards. However, as already mentioned, we suggest robust field testing be done on the proposed guidance.