August 15, 2008

Technical Director—File Reference 1590-100
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, Connecticut 06856-5116

RE: Proposed Statement, Accounting for Hedging Activities, an amendment of FASB Statement No. 133 (File Reference No. 1590-100)

Dear Technical Director:

We appreciate the opportunity to respond to the proposed Statement, Accounting for Hedging Activities, an amendment of FASB Statement No. 133. Even though we agree with the Board's stated objectives of simplifying the accounting for hedging activities, improving the financial reporting of hedging activities to make the accounting model and associated disclosures more useful and easier to understand for users of financial statements, and resolving major practice issues related to hedge accounting, we disagree, for the reasons stated below, with the objective of addressing differences in the accounting for derivative instruments and hedged items or transactions. Also, for the reasons summarized below, we do not support the issuance of the proposed Statement. Instead, we would support more limited changes to the current guidance to simplify hedge accounting and make the guidance more objectives oriented.

Today the accounting for hedging activities under FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities (Statement 133), and International Accounting Standard 39, Financial Instruments: Recognition and Measurement (IAS 39) have many similarities. The proposed Statement represents a significant change to the current accounting for hedging activities. Thus, the proposed changes seem to be a move away from the Board's objective of converging US GAAP and IFRS. If the Board views convergence as the ultimate objective, we do not believe that the perceived benefits provided by the proposed Statement outweigh the additional costs taken on by users and preparers to understand and implement the revised guidance and then potentially adopt a different set of guidelines if the Boards subsequently converge their standards. If significant changes to the accounting for hedging activities are deemed necessary, we would suggest that the Boards work together on a joint project that will result in a converged standard.
In addition, although we agree with three of the Board’s stated objectives, we do not believe that the proposed Statement would meet these three objectives (the simplification of accounting for hedging activities, improvement of the financial reporting for hedging activities from the perspective of users, and the resolution of major practice issues related to hedging activities). We do not believe that the proposed Statement would simplify the accounting for hedging activities, but would merely substitute one form of complexity for another form of complexity. If the Board’s intention is to simplify the accounting for hedging activities, and simultaneously reduce major practice issues, we believe that steps should be taken to make Statement 133 more objectives oriented. Currently, the difficulty behind the accounting for hedging activities is due to both complex guidance in Statement 133 and the development over time of rules-based interpretations that in certain cases go beyond the guidance in Statement 133. For example, Statement 133 requires that formal documentation be in place at the inception of a hedging relationship. In addition, Statement 133 describes the types of items to be included in the documentation (such as the entity’s risk management objective and strategy for undertaking the hedge, identification of the hedging instrument, the hedged item, the nature of the risk being hedged, and how the hedging instrument’s effectiveness in offsetting the exposure to changes in the hedged item’s fair value or cash flows attributable to the hedged risk will be assessed); however, it does not prescribe the level of detail required in the documentation to meet this requirement. Nevertheless, over time practice has developed such that the documentation requirements under Statement 133 are interpreted as a checklist and if one item is not clearly documented, then hedge accounting is not allowed. The development of this “all-or-nothing” interpretation has resulted in major practice issues, including restatements, related to hedging activities.

We believe significant improvements from the standpoint of simplification and resolution of major practice issues would be achieved if the Board modified Statement 133 as follows:

- Eliminate the prescriptive documentation requirements in Statement 133. We believe that the documentation requirements should be replaced with a more objectives oriented approach that would call for entities to demonstrate that compliance with hedge accounting objectives are met, based on indicators, which would be similar to the types of items already described in Statement 133 to be included in the documentation. The guidance would clarify that these indicators are not intended to be interpreted as a checklist and, together with all facts and circumstances and the totality of the evidence, would have to be analyzed to determine if the documentation is consistent with the objectives of hedge accounting.
- Simplify the current effectiveness testing requirements by requiring, without dictating the level or form of documentation, that an assessment of effectiveness be completed.
at the inception of the hedging relationship and on an on-going basis. In other words, leave the level and type of documentation to the judgment of the preparers. In addition, eliminate the shortcut method and critical terms match to avoid "all-or-nothing" applications of the standard.

Furthermore, and as discussed below, we do not believe that the proposed Statement would improve the financial reporting for hedging activities. The proposed Statement would retain the mixed attribute model and the use of exceptions, which serve to make the accounting for similar instruments by different entities more difficult to understand and less transparent. We do not agree that the accounting requirement that entities (in almost all cases) hedge total changes in fair value or cash flows, rather than specific risks, represents a significant improvement in the financial reporting for hedging activities, especially as an entity's risk management strategy to hedge a specific risk, such as changes in interest rates, may be clouded by the accounting requirement to hedge total changes in fair value or cash flows.

The following discussion provides our specific comments related to the proposed Statement and expands upon certain of the issues discussed above.

**Hedged Risk**

We do not believe that the prohibition placed on an entity's ability to hedge specific risks related to financial assets or liabilities (except in limited circumstances) simplifies the accounting or improves the financial reporting for hedging activities. We do not believe that preparers find it difficult to meet Statement 133's requirements to hedge specific risks and that significant practice issues have arisen related to this issue. In addition, although the proposed Statement implies that this change would simplify the accounting for hedging activities, as all entities would be required to hedge the same risk (total changes in fair value or cash flows), we do not believe this change would result in more understandable financial statements. The proposed Statement does not eliminate the mixed attribute model (which refers to the blending of the accounting for items under the historical cost model, the fair value model, and a combination of both), continues to allow certain exceptions (e.g., ability of an entity to hedge foreign currency risk in all cases and hedge interest rate risk on an entity's own issued debt if the hedging relationship is established when the debt is recognized), and retains the ability of entities to late hedge (e.g., enter into a hedging relationship after initial recognition of the asset or liability).

Even though we support the Board's continued consideration of its ultimate goal to present all financial instruments at fair value, we do not agree with requiring such fair value through the hedge accounting model. We do not believe that presenting the total...
changes in fair value or cash flows may provide less information as it does not take into account an entity's risk management strategy. We believe this approach is inconsistent with the intent-based model of Statement 133. If the Board believes that the most relevant measurement information is total changes in fair value or cash flows, the proposed Statement should not contain any exceptions and should look very similar to the fair value option model as described in FASB Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities.* In addition, based on the proposed Statement, if entities have to modify their risk management strategy to hedge the total changes in fair value or cash flows, additional complexity could arise since we are not aware of financial instruments being offered in the marketplace that would be effective at offsetting these risks.

If the restriction on an entity's ability to hedge specific risks is retained in the proposed Statement, we believe that the Board should provide additional guidance related to the meaning of the phrase “within a reasonably short period of time after the recognition of the debt” with regards to the exception that interest rate risk may be designated as the hedged risk on an entity's own issued debt if the hedging relationship is entered into when the debt is recognized. This would help avoid inconsistent application of the proposed Statement. We support the Board's decision to move from more rules-based standards towards more principles-based standards, which involves the removal of bright lines. However, during this period of transition from rules-based to principles-based standards, we believe that the Board should consider providing application guidance in the form of the considerations to be assessed in making this determination.

**Hedge Effectiveness Requirements**

We support the amendments to require (a) that a hedging relationship be *reasonably effective* (rather than highly effective), (b) a qualitative assessment of the effectiveness of a hedging relationship at inception and (c) no ongoing assessment of effectiveness, unless facts and circumstances suggest that the hedging relationship would no longer be reasonably effective. However, we believe that the revised guidance may not be applied in a consistent manner and therefore, may not provide comparable results among entities. Therefore, although we understand and support the Board's position not to provide bright lines, we believe that the Board should consider providing application guidance in the form of the considerations to be assessed in making determinations related to the following:
• Whether a hedging relationship is *reasonably effective*.
• When a quantitative assessment may be necessary at inception of a hedging relationship and when a reassessment (either qualitative or quantitative) may be necessary after hedge inception.

**Dedesignation of Hedging Relationship**

We do not agree with the proposed Statement's limitation on an entity's ability to dedesignate a hedging relationship. The Board has indicated that it does not believe that dedesignation should be used as a tool for changing measurement attributes and/or managing the classification of certain items reported in earnings. This view is inconsistent with the intent-based hedge accounting guidance in Statement 133. In addition, this view results in the accounting for the designation and dedesignation of hedging relationships to be based on different principles. For example, the proposed Statement does not limit an entity's ability to designate a hedging relationship; however, it would require that dedesignation may only result if an economic change (actual termination or effective termination) occurs. We do not believe that the proposed Statement is clear why a distinction should be made between these situations.

As part of its requirement that only an economic change would trigger the dedesignation of a hedging relationship, the proposed Statement provides specific guidance related to situations that would be considered effective terminations. We believe that the effective termination guidance is complex and unclear and will not be applied consistently. For example, the guidance would require entities to have contemporaneous documentation in place in order for a transaction to qualify as an effective termination and would require entities to continuously monitor the original derivative and offsetting derivative to ensure that they are not designated as hedging instruments in any future hedging relationships. We believe that such additional documentation requirements and ongoing monitoring are inconsistent with the Board’s objective of simplifying the accounting for hedging activities.

In previous communications, we have asked the Board to resolve current practice issues related to dedesignations by clarifying what events constitute a dedesignation event under Statement 133. We believe that there is diversity in practice related to this area, for example, in determining whether an addition or removal of a derivative instrument or hedged item from a group of derivative instruments or hedged items would be considered a dedesignation event of a portfolio hedging relationship. However, we do not believe that the proposed Statement provides an enhanced understanding of what constitutes a dedesignation event. For example, paragraphs 14 and 15 of the proposed Statement
indicate that “Adding a derivative to an existing hedging relationship that would not offset an existing derivative and would not reduce the effectiveness of the hedging relationship would not result in the termination of the hedging relationship.” We do not believe that the proposed Statement is clear regarding why the addition of such a derivative would not be considered a termination of the relationship, especially since it appears that the removal of a similar derivative from a group of derivatives would be considered a termination of the hedging relationship. If the Board believes that there is an important difference between these two scenarios that causes different accounting results, we believe that information should be included in the final Statement. In addition, the proposed Statement should clarify if the guidance related to derivative instruments is also applicable to scenarios where hedged items are added to or removed from a portfolio of hedged items.

Additionally, the proposed Statement appears to indicate that entities may continuously apply hedge accounting to dynamic or delta-neutral hedging strategies without redesignating and redesignating the relationships. This is inconsistent with some in practice who hold the view that any rebalancing of either the hedged items or the hedging instruments would cause the redesignation of the existing hedging relationship. Additionally, it is our understanding that dynamic and delta-neutral hedging strategies call not only for the addition of derivatives, but also the removal of derivatives from the portfolio on a regular basis. Therefore, if the proposed Statement intends to allow dynamic hedging or delta-neutral strategies under the same continuous hedging relationship, we believe that the Board should clarify how the removal of a derivative instrument would impact the determination of whether a redesignation event has occurred.

Measuring and Reporting Ineffectiveness in Cash Flow Hedging Relationships

We agree that the proposed Statement’s requirement that the measurement of hedge ineffectiveness be based on a comparison of the change in fair value of the actual derivative designated as the hedging instrument and the present value of the cumulative change in expected future cash flows of the hedged transaction is consistent with the requirements for measuring ineffectiveness in fair value and net investment hedging relationships. However, as this change would require that ineffectiveness related to underhedges be recorded, we are concerned that gains or losses on a hypothetical derivative (representing the forecasted transaction) would be recognized in earnings with an offset to other comprehensive income. We do not know where the support is found in US GAAP for such recognition based on a forecasted transaction that is probable of occurring. In addition, this proposed change would result in another difference between Statement 133 and IAS 39.
As the Board moves towards more principles-based standards, we believe that it is important that the guidance avoid using terms that imply a level of precision that cannot be attained. For example, paragraphs 23 and 25 of the proposed Statement state that "For example, an entity could compare the change in fair value of the actual derivative with the change in fair value of a derivative that would mature on the date of the forecasted transaction, be priced at market and provide cash flows that would exactly offset the hedged cash flows." We do not believe that the term "exactly" is appropriate, as it denotes a level of precision that may not be met rather than on the entity’s judgment regarding the terms of the hypothetical derivative that would meet the Board’s stated principles.

Additionally, the Board should clarify how the guidance in paragraphs 11 and 25 of the proposed Statement relate to one another. Paragraph 11 of the proposed Statement states that "For an entity to conclude that a hedging relationship is expected to be reasonably effective, the entity cannot ignore whether it will collect the payments it would be owed under the provisions of the derivative," while paragraph 25 states that "When measuring the ineffectiveness to be reported in earnings by using a derivative that would mature on the date of the forecasted transaction and provide cash flows that would exactly offset the hedged cash flows, an entity may use the same credit risk adjustment as that used in calculating the fair value of the actual derivative hedging instrument." Paragraph 11 seems to imply that any change in the creditworthiness of the derivative counterparty must be taken into account for purposes of the assessment of effectiveness, while paragraph 25 implies that for purposes of the measurement of ineffectiveness, there would be no recorded ineffectiveness related to changes in credit risk of the counterparty to the derivative instrument in a cash flow hedge. Under Statement 133 today, we believe that the methods used to assess effectiveness and measure ineffectiveness should be consistent; therefore we would like to understand if the proposed Statement is intended to be a change to that general concept. We would also suggest that due to the issuance of FASB Statement No. 157, Fair Value Measurements (Statement 157), that any discussion of credit risk clarify that the term "credit risk" refers to both counterparty credit risk and the entity’s own credit risk.

Other Amendments to Statement 133

In addition to the more substantial changes, the proposed Statement provides clarifying amendments to paragraphs 13 and 40 of Statement 133. Although we agree that additional guidance to clarify the appropriate interpretations of these paragraphs is warranted, we are concerned that the two changes in the proposed Statement and their potential impacts on current hedging relationships may not be readily apparent. For
example, the proposed Statement clarifies that paragraph 13 of Statement 133 only relates
to derivative instruments that have a single interest rate underlying. While we agree with
this clarification, we believe that the proposed Statement should include a brief
discussion in the basis for conclusions of why the revision was made. This clarification
may represent a change in how certain entities have analyzed whether an embedded
derivative is clearly and closely related to a host contract and therefore may impact the
separation and recognition of derivative instruments. As this revision affects the
recognition of a derivative and the proposed transition provisions address only hedge
accounting, we encourage the Board to provide specific transition guidance for this issue
in the final Statement.

Also, the proposed Statement includes additional language in paragraph 40 to clarify that
a potential earnings effect must not be eliminated in consolidation in order for a
forecasted transaction to be considered to present an exposure to variations in cash flows
that could affect reported earnings. We believe that the proposed Statement should clarify
the Board's intent for including this language, as the change could be interpreted in two
different ways. For example, is the language intended to serve as a reminder to
constituents of the current requirements or is it intended to limit certain hedging
relationships that are currently entered into in practice, such as some hedges of foreign
exchange risks of forecasted intercompany debt, expenses/revenues, or royalties. As
currently drafted, it is difficult to understand the impact of the proposed change. If the
additional language is intended to communicate a change in the accounting for hedging
relationships that are currently entered into in practice, we encourage that transition
guidance is included in the final Statement.

Effective Date and Transition

The proposed Statement would be effective for financial statements issued for fiscal years
beginning after June 15, 2009 and interim periods within those years. Although we
believe that the effective date would provide an adequate amount of time for calendar
year-end entities to implement the guidance, we are concerned that entities with fiscal
years that end on June 30th would not have adequate time to implement the proposed
Statement. We believe that entities will need a sufficient amount of time to review their
derivative and hedging relationship portfolios, determine which relationships will need to
be redesignated, consider if redesignation is appropriate, determine the effects of the
limited retrospective transition required for cash flow hedging relationships, and consider
if changes are needed to their systems and processes. Therefore, we would suggest that
the Board amend the effective date of the proposed Statement to be effective for financial
statements issued for fiscal years beginning after November 15, 2009 and interim periods
within those years.
We would be happy to further discuss the specifics of these issues in more detail at the request of the Board or the staff. If you have any questions about our comments or wish to discuss any of the matters addressed herein, please contact Enrique Tejerina at (212) 909-5530.

Sincerely,

KPMG LLP