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August 15, 2008

LETTER OF COMMENT NO. 45

Mr. Russell Golden  
Director of Technical Application and Implementation Activities  
Financial Accounting Standards Board  
401 Merritt 7  
PO Box 5116  
Norwalk, CT 06856-5116

Re: File Reference No. 1590-100 – Proposed Statement of Financial Accounting Standards –  
Accounting for Hedging Activities an amendment of FASB Statement No. 133

Dear Mr. Golden:

Nationwide appreciates the opportunity to comment on the Exposure Draft on the revised FASB Statement No 133, *Accounting for Derivative Instruments and Hedging Activities* (Exposure Draft). Nationwide is one of the largest insurance and financial services companies in the United States and consists of three core domestic businesses; property and casualty insurance, life insurance and retirement savings, and specialty lines of insurance. Hedging plays an integral role in Nationwide's risk management strategy. Nationwide supports the Board's objectives of simplifying accounting for hedge activities, improving the reporting for hedge activities, and resolving the practice issues that currently exist under FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*.

We do not believe it would be beneficial to adopt the Exposure Draft because it does not represent a substantial improvement over the current guidance, which is needed to justify the extensive effort required to adopt it. We believe it would be more beneficial to work with the International Accounting Standards Board (IASB) and develop guidance under International Financial Reporting Standards (IFRS) than adjust current guidance since the IASB is currently working on a project to revise accounting for financial instruments.

We do not agree with the Exposure Draft's elimination of the bifurcation of risks in hedging strategies. Nationwide regularly chooses to hedge certain risks and retain other risks on either an instrument or portfolio basis and sometimes a combination thereof. Accounting for hedges with the bifurcation of risks provides the transparency to reflect the effectiveness of the hedges for these individual risks. Recognizing in the income statement the fair value of unhedged risks on hedged items that represent only a subset of assets and liabilities would not improve the transparency of the financial statements. We are concerned that the elimination of the bifurcation of risks in hedging strategies may lead to an abandonment of hedge accounting. This also may cause the accounting results to drive economic decisions in some situations, which could lead to less prudent risk management strategies. We believe the increased transparency of the hedged and unhedged risks will be provided by FASB Statement No. 161, *Disclosures about Derivative Instruments and Hedging Activities an amendment of FASB*

*Statement No. 133 (FAS 161)* through its increased disclosures, thus accomplishing the transparency goals of Exposure Draft.

Overall we do not believe the Exposure Draft will result in improved transparency or usefulness in financial reporting. The Exposure Draft requires recognition of fair value through the income statement on items in a hedge relationship, but does not require it on items not associated with a designated hedging relationship. Therefore, because of this mismatch, a user of the financial statements will not gain a better understanding of the overall risk management strategy of an entity than under the current guidance. As noted in the dissenting opinion, the Exposure Draft is a piece of what an overall integrated fair value standard would address and only applying this portion will not be a beneficial change to the accounting guidance. If the Exposure Draft is adopted, Nationwide supports an additional expanded FASB Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* election date to provide companies the opportunity to elect the fair value option.

We are concerned about the lack of clarity of the term "reasonably effective" as the criteria for determining if a hedge is effective. While we believe it is appropriate to use a principles based approach to the definition, it is also necessary to provide additional insight into the intent of its meaning. Sufficient guidance on the principles of "reasonably effective" is needed so that financial statement issuers, users, and auditors will be able to consistently apply this guidance. A lack of definition in the criteria will cause diversity in practice and affect the comparability of financial statements.

Our responses to the Board's questions are attached in the Appendix. We hope these comments are of assistance to the Board during their deliberations of the Exposure Draft. In the event that any Board or staff member would like any further clarification of our positions, we are happy to explain them in greater detail.

Respectfully,

A handwritten signature in black ink, appearing to read 'Martha Frye', with a long horizontal flourish extending to the right.

Martha Frye  
Senior Vice President and Chief Accounting Officer  
Nationwide Insurance

## Appendix

**Issue 1:** For the reasons stated in paragraph A16 of this proposed Statement, the Board decided to eliminate (with two exceptions) the ability of an entity to designate individual risks as the hedged risk in a fair value or cash flow hedge. As a result of that change, the financial statements would reflect information about the risks in the hedged item or transaction that an entity both chooses to manage and not to manage as part of a particular hedging relationship.

Do you believe that the proposed Statement would improve or impair the usefulness of financial statements by eliminating the ability of an entity to designate individual risks and requiring the reporting of the risks inherent in the hedged item or transaction?

**Response:** We believe that this approach will not improve the overall usefulness of financial statements. We believe that the accounting and reporting should be principles based such that it would reflect the risk management strategy including the hedging of individual risks. Derivatives in the capital markets are often designed to address individual risks and entities frequently manage these risks on this level. Therefore, the best way to approach hedge accounting, based upon the market convention, is the bifurcation of risk.

An example of a mismatch that will be created through the elimination of the bifurcation of risk approach is an entity managing a bond portfolio. It may manage the interest rate risk by entering into fair value hedges on a portion of the bonds. The income statement results would show a portion of the credit related fair value fluctuations in the income statement for bonds in a documented hedging relationship. The other credit related fair value changes for the non-hedge bonds are recognized in other comprehensive income (OCI), thus creating inconsistencies in how the hedged and unhedged risks are recognized in the financial statements.

The financial statements will not give a more complete economic picture because a portion of the credit risk changes are recorded in the income statement and a portion in OCI. This mismatch will add another layer of complexity to the understanding of how an entity is managing risk. Therefore, this Exposure Draft would impede the progress of the changes being made to improve the transparency and overall usefulness of reported financial information to investors and capital markets.

Furthermore, this mismatch could cause the accounting to unduly influence the risk management strategy rather than the underlying economics. This may be caused by management shifting its focus away from prudent risk management strategies due to the undesirable accounting results.

**Issue 2:** For the reasons stated in paragraphs A18–A20, the Board decided to continue to permit an entity the ability to designate the following individual risks as the hedged risk in a fair value or cash flow hedge: (a) interest rate risk related to its own issued debt (that is, its liability for funds borrowed), if hedged at inception, and (b) foreign currency exchange risk. For those two exceptions, the financial statements would not reflect information about the risks that an entity chooses not to manage as part of a particular hedging relationship.

Do you believe the Board should continue to permit an entity to designate those individual risks as a hedged risk?

**Response:** We believe it is important to include these two exceptions to the Exposure Draft to permit the individual risks to be hedged. Additionally, the definition for the own issued debt should be expanded to include all financial liabilities, as financial liabilities, whether an entity's own debt or other liability, will result in similar hedging difficulties under the Exposure Draft. This exception should also include hedges for the forecasted issuance of debt. It is common in many industries to hedge the forecasted issuance of debt, and including this in the exception will continue to allow this effective hedge without the issues associated with valuing an entity's changes in its own credit spread.

In addition to permitting the hedging of the individual risks associated with an entity's financial liabilities, there should not be any timing restrictions on when this exception could be applied. It is common for entities to enter into hedges after the issuance of debt or other liabilities due to changes in the interest rate environment or changes in the entity's risk management strategy. The different accounting treatment for the hedges based on when the hedge was designated will add additional layers of complexity. Therefore, due to the complexity of restricting this exception to inception of the debt, we support not having a timing restriction.

**Issue 3:** This proposed Statement would eliminate the shortcut method and critical terms matching. Therefore, an entity would no longer have the ability upon compliance with strict criteria to assume a hedging relationship is highly effective and recognize no ineffectiveness in earnings during the term of the hedge. As a result, when accounting for the hedging relationship, an entity would be required, in all cases, to independently determine the changes in fair value of the hedged item for fair value hedges and the present value of the cumulative change in expected future cash flows on the hedged transaction.

Do you foresee any significant operational concerns or constraints in calculating ineffectiveness for fair value hedging relationships and cash flow hedging relationships?

Do you believe that the proposed Statement would improve or impair the usefulness of financial statements by eliminating the shortcut method and critical terms matching, which would eliminate the ability of an entity to assume a hedging relationship is highly effective and to recognize no ineffectiveness in earnings?

**Response:** Under the Exposure Draft there would be few hedges that would qualify as having no ineffectiveness. Therefore the removal of these options would be consistent with the nature of the Exposure Draft and to reduce complexity.

**Issue 4:** This proposed Statement would modify the effectiveness threshold necessary for applying hedge accounting from *highly effective* to *reasonably effective* at offsetting changes in fair value or variability in cash flows.

Do you believe that modifying the effectiveness threshold from highly effective to reasonably effective is appropriate? Why or why not?

For situations in which interest rate risk is currently designated as the hedged risk for financial instruments but would no longer be permitted under this proposed Statement (except for an entity's own issued debt at inception), do you believe you would continue to qualify for hedge accounting utilizing your current hedging strategy? If not, would you (a) modify your hedging strategy to

incorporate other derivative instruments, (b) stop applying hedge accounting, (c) elect the fair value option for those financial instruments, or (d) adopt some other strategy for managing risk?

**Response:** We would like additional clarification around the term “reasonably effective” to provide insight into the qualitative level of offset required for hedging relationships under the Exposure Draft. We feel it is necessary to provide additional guidance on the principles that should be used to determine whether a hedge should be deemed to meet the reasonably effective criterion. Reasonably effective offers a wide range of interpretations, so it would be beneficial to provide a sufficient definition to allow for comparability of financial statements.

We are unable to determine if our current hedging relationships would still qualify for hedge accounting without additional insight into the term “reasonably effective.” However, based upon the Exposure Draft, these strategies will result in income statement volatility due to the risks that are not included in the current hedging relationships. The primary benefit of hedge accounting under the current standard is the linking of the timing of the financial statement impact with the economic impact of the specific risks hedged. Since the new hedging relationships under the Exposure Draft would result in income statement volatility due to the additional unhedged risk being recognized in the income statement, there would be limited benefit to performing the additional work to obtain hedge accounting. Thus, we anticipate that many interest rate-based hedging relationships will be discontinued if the Exposure Draft is adopted. While the Exposure Draft is attempting to simplify the ongoing hedge maintenance requirements, there will still be significant work to document and maintain the hedging relationship while requiring additional sources of ineffectiveness to be recognized through the income statement.

**Issue 5:** This proposed Statement always would require an effectiveness evaluation at inception of the hedging relationship. After inception of the hedging relationship, an effectiveness evaluation would be required if circumstances suggest that the hedging relationship may no longer be reasonably effective.

Do you foresee any significant operational concern in creating processes that will determine when circumstances suggest that a hedging relationship may no longer be reasonably effective without requiring reassessment of the hedge effectiveness each reporting period?

Do you believe that requiring an effectiveness evaluation after inception only if circumstances suggest that the hedging relationship may no longer be reasonably effective would result in a reduction in the number of times hedging relationships would be discontinued? If so, why?

**Response:** We believe it is necessary to evaluate the qualitative effectiveness at inception and on an ongoing basis if circumstances suggest the relationship may no longer be effective. We do not anticipate any operational concerns in creating a process to determine if there are circumstances that suggest a hedging relationship may no longer be effective. However, there will need to be sufficient lead time prior to the adoption of the Exposure Draft to interpret the standard, develop the process, and implement it. Refer to our response to Issue No. 8 for additional details on the adoption timeframe.

We believe this will result in a reduction in the frequency of discontinued relationships since these relationships will only be revisited when the circumstances indicate there is a change in the hedging effectiveness assessment of the relationship. Previously, hedges could fail the effectiveness requirements if there were slight market correlation changes.

**Issue 6:** The Board considered but decided against eliminating any assessment of effectiveness after the inception of the hedging relationship. The Board believes that eliminating such an assessment of effectiveness could result in the continuation of hedge accounting even when situations suggest that the hedge relationship may no longer be reasonably effective. Some observe that an implication of the decision to not eliminate any assessment after the inception of the hedging relationship could be that hedge accounting results would be reflected in some reporting periods and not in other reporting periods throughout the life of the relationship. Also, in a hedge accounting model that generally does not permit hedging of individual risks, changes in the relationship between the individual risks being managed and those not being managed could increase the likelihood that the hedging relationship would no longer be reasonably effective. That would result in hedge accounting no longer being permitted for a portion of an expected hedge term. That “in and out” of hedge accounting would make it more difficult for users to interpret financial statements.

Do you agree with the Board’s decision to continue to require that hedge accounting be discontinued if a hedge becomes ineffective? Alternatively, should an effectiveness evaluation not be required under any circumstances after inception of a hedging relationship if it was determined at inception that the hedging relationship was expected to be reasonably effective over the expected hedge term?

**Response:** We believe that hedge relationships deemed ineffective for the remainder of the term should be required to be discontinued because the alternative of leaving these relationships in place could cause misleading information to be presented in the financial statements.

**Issue 7:** In the statement of operations, Statement 133 does not prescribe the presentation of gains and losses associated with hedging instruments, including the effective portion, the ineffective portion, and any amounts excluded from the evaluation of effectiveness, such as forward points. Some have suggested that such a prescription would improve financial reporting by creating consistency in the presentation of these amounts across all entities. Others observe that FASB Statement No. 161, *Disclosures about Derivative Instruments and Hedging Activities*, requires disclosure about that information, and they question whether a prescriptive approach is appropriate given the diverse hedge accounting strategies employed by entities.

Do you believe that Statement 133 should be amended to prescribe the presentation of these amounts? For example, the Statement could require that the effective portion of derivatives hedging the interest rate risk in issued debt be classified within interest expense and that the ineffective portion and any amounts excluded from the evaluation of effectiveness be presented within other income or loss.

**Response:** We believe that the exclusion of prescriptive guidance on the presentation of gains and losses associated with derivative and hedging instruments generally is appropriate. Derivative use varies widely among companies and industries, so the presentation requirements should be principles based. We believe FAS 161 will provide the needed transparency into the classification of derivatives.

**Issue 8:** The Board’s goal is to issue a final Statement by December 31, 2008. The proposed Statement would require application of the amended hedging requirements for financial statements issued for fiscal years beginning after June 15, 2009, and interim periods within those fiscal years.

Do you believe that the proposed effective date would provide enough time for entities to adopt the proposed Statement? Why or why not?

**Response:** Nationwide, which has a December 31<sup>st</sup> year end, believes it will have sufficient time to adopt the proposed statement. However, for those that have a June 30<sup>th</sup> year end, we do not believe six months is a reasonable timeframe to adopt this standard because of the significant work required to dedesignate all the existing hedge relationships and designate new hedge relationships. This process will require significant time to analyze the issued guidance and determine and document the new hedge strategies. After these decisions are made, new hedge accounting documentation and a maintenance process will have to be implemented. This will include system changes and process changes. To properly plan and implement changes such as this, there should be at least a twelve month lead time prior to adoption.

**Issue 9:** The Board did not prescribe any specific transition disclosures upon the adoption of this Statement.

Do you believe that there are specific disclosures that should be required during transition? If so, what? Please be specific as to how any suggested disclosures would be used.

**Response:** We do not have any comments on specific transition disclosures.

**Issue 10:** The Board decided to permit an entity a one-time fair value option election under FASB Statements No. 156, *Accounting for Servicing of Financial Assets*, and No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*, for (a) servicing assets and servicing liabilities designated as a hedged item on the date immediately preceding initial application and (b) eligible financial instruments designated as a hedged item on the date immediately preceding initial application of this proposed Statement.

Do you agree with the Board's decision to allow a one-time fair value option at the initial adoption of this proposed Statement? Do you agree with the Board's decision to limit the option to assets and liabilities that are currently designated as hedged items under Statement 133?

**Response:** We believe the one time fair value option election under FAS 156 and 159 should be expanded to allow entities to reevaluate all items for the election, whether associated with a hedging relationship or not. If adopted, this change in the hedge accounting guidance would cause entities to reevaluate their accounting decisions around all risk management strategies. Companies may have made different elections at the initial election date if this Exposure Draft was in effect. Therefore, the option should be broader than just those items associated with an existing hedge upon adoption of the Exposure Draft.

**Issue 11:** The objective of financial reporting is to provide information that is useful to present and potential investors, creditors, donors, and other capital market participants in making rational investment, credit, and similar resource allocation decisions. However, the benefits of providing information for that purpose should justify the related costs. The benefit-cost considerations considered by the Board are provided in paragraphs A43–A50 in Appendix B of this proposed Statement.

Do you believe the Board identified the appropriate benefits and costs related to this proposed Statement? If not, what additional benefits or costs should the Board consider?

**Response:** We do not believe that the Exposure Draft is an improvement over the current guidance that would justify the change. Likewise, we believe that under the current hedge accounting guidance

the adoption of FAS 161 will provide additional transparency into derivatives and hedging relationships. We believe there should be compelling reasons to revise a current standard that will not converge with IFRS. The IASB is working on revising the current IFRS on financial instruments. Therefore, we feel the Board has not put enough emphasis on the potential divergence from IFRS that may be created by this Exposure Draft, which significantly decreases any benefits of issuing the Exposure Draft.