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August 15, 2008

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



LETTER OF COMMENT NO. 79

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:

Capital One Financial Corporation ("Capital One") appreciates the opportunity to provide comments on the Exposure Draft issued by the Financial Accounting Standards Board (the "Board") entitled *Accounting for Hedging Activities, an amendment to FASB Statement No. 133* (the "Proposed Statement").

We agree that FASB Statement No 133 ("FAS 133") is complex and we support the Board's efforts to simplify accounting for hedging activities and improve 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. However, we question the assertion that the proposed changes will simplify hedge accounting and in certain instances believe the changes will result in added complexity, increased costs and inconsistency in financial reporting for similar transactions. Additionally, the Proposed Statement diverges from International Accounting Standards at a time when convergence is at a high priority and the Board should consider the operational impacts and financial burden that will stem from the need to convert multiple times to multiple standards that will be created by this amendment.

As discussed in greater detail below, we recommend the Board reconsider some of the changes within the Proposed Statement in light of considerable possible strategic and operational impacts.

International Financial Reporting Standards

We question whether it is prudent to require implementation of these proposed changes outside of a joint project with the IASB and the increased likelihood that US public companies will be required to adopt IFRS in the foreseeable future. We also do not believe it is reasonable for the Board to require companies to implement the Proposed

Statement and then possibly have to convert to IAS 39 relatively shortly thereafter. The accounting for hedging activities under the Proposed Statement would diverge from the hedge accounting requirements currently contained in IAS 39, *Financial Instruments: Recognition and Measurement*. Further, we believe this divergence potentially puts U.S. companies at a disadvantage over non-U.S. companies when managing risk exposures even when using the same risk management strategies.

In addition, the IASB is considering two general approaches to changing hedge accounting requirements as documented in their Discussion Paper, *Reducing the Complexity in Reporting Financial Instruments*. Pending the outcome of these efforts and movement to IFRS, a third change to the accounting is possible. We question whether the ultimate benefits of these specific proposed changes outweigh the body of work that would be required to change derivatives accounting and reporting potentially three times within a short period of time.

Hedged Risk

The Proposed Statement eliminates the ability of an entity to designate solely the benchmark interest rate as the hedged risk except for hedges on an entity's own issued debt or other borrowings when such hedge is initiated at inception of that debt. For hedging relationships entered into after inception of the debt, the Proposed Statement requires designation of the risk in changes in overall fair value of the hedged item or the risk of overall changes in the hedged cash flows.

We strongly disagree with this proposed change. It adds a new level of complexity as we have concerns that even commonly used plain vanilla hedging strategies may no longer qualify for hedge accounting. In addition, this proposed methodology change is inconsistent with how financial companies manage risks and would impair the usefulness of financial statements as the accounting results would be inconsistent and not representative of risk management strategies designed to manage discrete risks.

Financial companies frequently utilize derivative instruments to manage only the risk of changes in interest rates. Interest rate exposure changes frequently for financial companies through the course of the business cycle. Thus, it is a prudent and effective risk management strategy for financial companies to enter into derivatives after debt issuance in response to the changing interest rate environment and changes in the mix of interest bearing assets and liabilities on the balance sheet. The proposed changes prohibiting bifurcation-of-risk after issuance could prevent financial companies from using simple interest rate hedging strategies because of the requirement to include credit risk in the effectiveness assessment. As market conditions may impact changes in interest rates differently than they affect changes in credit and new issue premiums, the requirement to include credit in assessing effectiveness may prevent qualification for hedge accounting even under the relaxed proposed criteria of "reasonably effective."

In addition, once a company concludes that they do qualify under the “reasonably effective” criteria, they would be required to record their credit spread risk directly to earnings. This alone might discourage financial companies from utilizing late interest rate hedging strategies due to the increased earnings volatility when the intent was to discretely manage interest rate risk. If the bifurcation-of-risk model is eliminated, financial companies will be forced to choose between accepting earnings volatility or departing from current risk management strategies which effectively hedge their interest rate exposure. Furthermore, publishing and calibrating credit curves and including past credit data to measure effectiveness would require entities to dedicate significantly more time and resources to prove they meet hedge accounting requirements.

We understand that the motivation behind the removal of the bifurcation-of-risk approach is to be consistent with the overall goal of measuring all financial instruments at fair value. However, we do not believe that this objective is being met because, by limiting the ability to solely designate interest rate risk subsequent to debt issuance and the likelihood that late hedges would not be able to meet the “reasonably effective” criteria, companies would not be able to achieve hedge accounting and thus, the hedged items will not be recorded at fair value which is counterintuitive to the Board’s desired result of having more assets and liabilities recorded at fair value. We agree with the Alternate Views in the Proposed Statement that a broader project on the accounting for financial instruments is a more appropriate way to solve that problem comprehensively instead of through changes to the process of hedge accounting. Otherwise, fair value accounting is only being extended to those who choose to hedge certain of their market risks. Those that choose not to hedge those risks will avoid this expansion of fair value accounting.

Hedge Effectiveness Requirements

The Proposed Statement will 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. We understand that the Board decided to amend the hedge effectiveness requirements to reduce the complexity of qualifying for hedge accounting, to make it easier for entities to consistently apply hedge accounting from period to period, and to provide comparability and consistency in financial statement results.

We support the Board’s goals to simplify the qualification for hedge accounting and to reduce the costs of compliance. While we would prefer a clearer definition of what is considered reasonably effective, we understand that the Board intentionally excluded a definition from the Proposed Statement. However, we request that the Board provide examples of what would constitute “reasonably effective.” The resulting requirement for entities to apply more of their own judgment when determining whether a hedging relationship is reasonably effective will not contribute to the achievement of the above goals unless auditors and regulators accept reasonable interpretations of the reasonably effective threshold, with possible variation among entities, and accept

qualitative evidence, instead of quantitative statistical models, to prove a hedging relationship is effective. This change will require cooperation from all members of the financial reporting community. Without acceptance from auditors and regulators, the practice problems and restatements will not be reduced.

Furthermore, if the provision in the Proposed Statement eliminating the ability of an entity to designate individual risks as the hedged risk is made effective, then we believe that only partial benefits from the elimination of the requirement for ongoing effectiveness testing will be realized. We believe that our process for determining when circumstances suggest that a hedging relationship may no longer be reasonably effective will require, in many cases, a quantitative reassessment of the hedge effectiveness each reporting period, due to the requirement to quantify the impact of credit risk. As stated earlier in our comments, the elimination of benchmark hedging does not support the Board's stated objective of simplifying accounting for hedging activities.

Shortcut Method and Critical Terms Matching

The Proposed Statement would eliminate the current provisions in FAS 133 allowing an entity to assume a hedging relationship is highly effective and recognize no ineffectiveness in earnings if the hedging relationship meets the strict criteria of the shortcut method or critical terms matching. There are simple and straightforward hedging strategies that would successfully qualify for the shortcut method or critical terms matching. For example, hedges of debt instruments using "plain vanilla" interest rate swaps where the interest rate swap terms exactly match the terms of the issued debt. We believe the short cut method and critical terms matching is still useful in these instances because by eliminating them, additional costs would be incurred to record insignificant amounts of ineffectiveness. We ask the Board to reconsider complete elimination of these methods particularly for very simple, straightforward debt instruments.

Conclusion

If finalized, the Proposed Statement will significantly affect a financial company's risk management strategies by requiring them to either incur additional costs to effectively manage earnings volatility or accept interest rate exposure which is not in the best interest of investors.

We agree with the Alternate Views in the Proposed Statement that a broader project on the accounting for financial instruments is a more appropriate way to achieve the objective of measuring all financial instruments at fair value instead of through changes to the existing process of hedge accounting. However, the proposed changes prohibiting bifurcation-of-risk after debt issuance for accounting purposes could discourage financial companies from using simple interest rate hedging strategies because of the requirement to include credit risk in the effectiveness assessment. Those that

choose to continue existing hedging strategies under the new requirements will likely be forced to accept a higher degree of earnings volatility in the financial statements despite the continued economic effectiveness of such hedging strategies, due to the inability to qualify for hedge accounting under the more stringent criteria. This, we believe, will only be an added source of confusion and complexity in the interpretation of financial statements by investors and lead to potentially inappropriate conclusions regarding the effectiveness of a company's hedging abilities.

We also believe that there will be considerable operational and system impacts to implement the proposed changes including major changes to documentation, control procedures, and accounting and risk management systems.

For the reasons cited above, we urge the Board to reconsider whether the proposed changes collectively simplify the application of FAS133 and outweigh the costs of implementation, especially in light of the probability of conversion to IFRS.

Sincerely,

A handwritten signature in black ink, appearing to read "Gary L. Perlin", with a long horizontal flourish extending to the right.

Gary L. Perlin
Chief Financial Officer
Principal Accounting Officer