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August 15, 2008

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LETTER OF COMMENT NO. 114

Via email: director(a)fasb.org

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

Re: File Reference No. 1590-100, Exposure Draft (ED) Accounting for Hedging Activities an amendment of FASB Statement No. 133

Dear Mr. Golden,

U.S. Bancorp, the parent company of the sixth largest commercial bank in the United States, with over \$245 billion in total assets, appreciates the opportunity to comment on the Exposure Draft entitled Accounting for Hedging Activities an amendment of FASB Statement No. 133, issued June 6, 2008 (the "ED"). We support the Board's efforts to simplify the accounting for hedging activities; however, we have concerns with some of the requirements included in the ED and wish to make the Board aware of what we believe are the potential ramifications of the proposed changes to hedge accounting standards. We believe further considerations of the objectives of the proposed accounting changes as well as the impact to potential users is warranted.

We are concerned that the proposed new accounting is inconsistent with the way that businesses manage risks and will impose a burden on businesses to change their existing risk management practices in order to maintain hedge accounting. Given that the stated goal of the ED is to simplify hedging activities, we are not convinced that the proposed guidance will achieve the Board's objectives. Our view is discussed in more detail below.

Elimination of Bifurcation by Risk

With a few exceptions¹, the ED would eliminate an entity's ability to designate a specific risk being hedged and would require an entity to hedge the overall fair value of the hedged asset or liability.

Elimination of the ability to obtain hedge accounting by hedging specific risks will restrict the flexibility many entities are now afforded to manage risks in a cost-effective manner. Assets and liabilities subject to hedge accounting are complex and contain multiple risks. Current

¹ The proposed Statement would permit designation of interest rate risk only with respect to an entity's own debt and only at the time of debt issuance. In addition, entities may designate as a hedge only foreign currency risk.

accounting standards permit entities to hedge interest rate, credit or foreign currency risk, a combination of those risks or the change in fair value. Many entities elect to hedge a specific risk only; for example, changes in a hedged item related to changes in a benchmark interest rate. This practice is consistent with their risk management strategy as it is not possible to hedge all risks associated with an asset or liability with a single derivative. Nor is it possible to identify a costeffective portfolio of derivatives that would serve to hedge all risks associated with an asset or liability. For example, the fair value of loans is impacted by many factors including changes in interest rates, credit risk and other market factors. Many entities achieve hedge accounting by hedging the change in fair value of loans as impacted by changes in interest rates. This can be accomplished in a cost effective way by using interest rate swaps as the hedging instrument. Requiring entities to also hedge changes in credit in order to achieve hedge accounting necessitates entering into a derivative(s) to offset changes in credit. Unlike interest rate swaps which require no upfront cost, in general, credit-related derivative products do have an upfront cost. The impact of the ED is yet to be seen, however, an entity may forego hedge accounting in order to avoid the additional costs associated with the derivative(s) that would be required in order to achieve hedge accounting under the proposed standard.

We believe that the ability to bifurcate-by-risk allows for accounting that mirrors the way that entities manage the risks inherent in their assets and liabilities. The elimination of such flexibility may result in entities making a choice between fair value accounting at an increased cost or foregoing fair value accounting. This may discourage hedge accounting, thereby introducing more volatility into financial statements. We strongly recommend that any amendment to Statement 133 continue to allow for the bifurcation of risk approach.

Change in Effectiveness Threshold

The proposed accounting guidance reduces the effectiveness threshold for qualifying for hedge accounting from "highly effective" to "reasonably effective". However, even under the revised standard, it may be difficult for entities to qualify for hedge accounting because, as discussed above, entities may not be able to identify a derivative that will be "reasonably effective" in offsetting all risks of an asset or liability. Although the threshold for effectiveness would be reduced, entities must continue to monitor the effectiveness of hedging relationships. There may still be periods of time in which a hedge relationship is determined to be ineffective, resulting in financial statement volatility. For example, an entity may determine that a hedge relationship is "reasonably effective" without hedging the credit risk of an asset or liability if that risk is deemed to be insignificant to the total fair value of the asset or liability. This may be an acceptable conclusion at the onset of a hedging relationship. However, the entity must continue to monitor the hedging relationship to determine if the credit risk of the asset or liability becomes a significant component of the fair value. Such monitoring may still require a quantitative analysis. If the entity determines that the hedging relationship is not effective, financial statement volatility increases. The proposed modification of the effectiveness threshold may not achieve the Board's stated goals of simplifying hedge accounting as it will continue to require effectiveness monitoring and may result in unexpected financial statement volatility.

Prohibition of the De-designation of a Hedging Relationship

The proposed accounting standard would prohibit the de-designation of an effective hedging relationship after it has been established.

We are concerned that this restriction would also reduce the flexibility to manage risks in an effective way as many entities employ a dynamic hedging strategy for hedging portfolios of

assets or liabilities. For example, many banks use a dynamic hedge practice to hedge portfolios of mortgage loans to protect against fluctuations in the value of the loans before the loans are sold in the secondary market. This hedge strategy may involve economically hedging interest rate lock commitments ("IRLC") and subsequently achieving hedge accounting on the loans. Due to the composition of the portfolio (i.e. IRLCs and loans) and its changing population, the loan portfolio under hedge accounting must be rebalanced daily. This rebalancing involves daily assignments of derivatives to the hedging relationship. From an accounting perspective, derivative assignments require de-designation and re-designation of the hedge relationship. The lack of the flexibility to de-designate a hedging relationship would eliminate the ability to employ this hedge accounting technique that is, to our knowledge, used by many loan financiers and may be used in other ways by other entities.

As discussed above, an entity's risk management strategy necessitates flexibility. The inability to de-designate a hedging relationship restricts that flexibility, resulting in possible changes to risk management practices. The ED concept of de-designating a hedging relationship by entering into an offsetting derivative may not be cost effective and we believe entities are unlikely to utilize this technique.

For the reasons discussed above, we strongly recommend that any amendment to Statement 133 allow for de-designation of a hedging relationship.

Consideration of International Accounting Standards Coverage

We recognize the Board's intent to reduce the complexity of hedge accounting and to develop more principles-based guidance. However, we believe the proposed guidance will not be beneficial to preparers or investors if significant changes are required to risk management and hedge accounting practices as these practices will need to be modified again when entities converge to international accounting standards. It appears that preparers will be faced with a timeline that includes adoption of the ED in its final form, adoption of IAS 39 under the convergence project, followed by adoption of an amended IAS 39. This will clearly be costly to entities and will divert resources from other critical projects. In addition, constant changes in practices put additional pressure on an entity's ability to maintain adequate controls around processes. Furthermore, frequent changes are confusing to financial statement users and are in contrast to providing transparent and consistent financial statement disclosure.

We strongly recommend that the Board postpone issuing a final draft of the ED and allow preparers to focus on the international accounting standards convergence.

In response to your specific issues, we provide the following comments:

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?

For the reasons cited above, we do not agree with the proposed elimination of the ability to designate individual risks as the hedged risk in a hedging relationship. We believe that bifurcation of risk is consistent with the risk management approach used by many entities and

that the accounting standards should continue to reflect that approach. We believe the elimination of the bifurcation of risk will not improve the usefulness of financial statements as such a change may continue to result in financial statement volatility.

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?

For the reasons cited above, we do not agree with the proposed elimination of the ability to designate individual risks as hedged risk. We do agree with the Board's decision to continue the designation of the specific risks for an entity's issued debt and for foreign currency risk. However, we believe that entities should be afforded the flexibility of entering into a hedge of issued debt for individual risks at anytime provided that hedge accounting requirements are met. Therefore, we do not agree with the proposal to restrict hedging to only at debt inception.

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?

We know that the shortcut method has been misused and understand the Board's desire to reduce the complexity in hedge accounting standards. While we believe that the elimination of the shortcut method and critical terms matching will not necessarily result in improved financial statement usefulness, we do not object to the elimination of these effectiveness methods.

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?

We believe that the replacement of a "reasonably effective" threshold for the current "highly effective" threshold will not necessarily result in improved financial reporting or a simplification of hedge accounting practices. Financial statement preparers and their auditors will likely struggle with the interpretation of "reasonably effective" and variances in practice may result from such individual interpretations. At this time, it is difficult to say whether entities will qualify for more or less hedge accounting under the proposed standard. However, we believe that this approach will not yield the consistent approach to hedge accounting that the Board appears to be seeking.

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 concerns 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?

Although the proposed standard changes the threshold for reassessing for hedge effectiveness, the requirement to reassess hedge effectiveness remains. While we agree that it is important to continue to require a reassessment of hedge effectiveness, we believe that the change in threshold may not result in less effort on the part of entities to reassess hedge effectiveness. It is difficult to determine whether the new threshold will result in more or less discontinued hedge relationships.

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?

As described in our comments above, we recognize that under the proposed standard "in and out" hedge accounting could result. We also believe that under a "reasonably effective" standard there will be variances in practice regarding the identification of when a hedge relationship is no longer effective. We do not, however, agree with an elimination of hedge effectiveness testing as we believe that it is important to monitor the effectiveness of a hedge on an ongoing basis.

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.

We believe that Statement 133 does not need to be amended to prescribe the presentation of hedging financial results. The disclosures under FASB Statement No. 161 are extensive and comprehensive incorporating the income statement and balance sheet impacts of derivatives and hedging relationships.

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?

As discussed above, we believe a more reasonable approach is to postpone the issuance of a final draft of this ED to allow entities to converge to IAS 39 under international accounting standards. Because it is likely that entities will be required to make the convergence within a few years, we believe entities should be afforded the opportunity to focus their efforts and resources on implementing one hedge accounting change. This approach will also result in less confusion to investors and other financial statement users.

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.

We have no comment on this matter.

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?

We believe that Statement 133 does not need amendment, however, if the ED is issued in final form we agree that the final standard should include the ability to elect fair value option.

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?

The Board should consider the potential cost required to revise existing infrastructure which was built to manage risk and assess hedge effectiveness consistent with the current accounting requirements. Revisions to existing practices and the development of entirely new practices will include both "hard" dollar costs and will also divert internal resources from other critical accounting projects. These costs are particularly concerning given that a convergence to international accounting standards is forthcoming. If this ED is issued in final form entities will be required to devote resources to evaluating and implementing this proposed guidance followed by further effort to implement international accounting standards. As recommended above, we propose that the current accounting requirements remain to allow entities to better prepare for the international accounting standards convergence.

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We appreciate the opportunity to submit our views and would be pleased to discuss our comments with you at your convenience. Please contact me at (612) 303-4352 with questions or if you need additional information.

Sincerely,

/s/ Terrance R. Dolan

Terrance R. Dolan
Executive Vice President and Controller