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

Re: File Reference Number 1810-100, Proposed Accounting Standards Update: *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities*

Dear Mr. Golden:

The International Swaps and Derivatives Association's (ISDA) Accounting Policy Committee¹ appreciates the opportunity to provide comments and observations on the Financial Accounting Standards Board's ("FASB") Exposure Draft of Proposed Accounting Standards Update: *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities* (the "Exposure Draft"). This letter supplements our letter submitted to the FASB regarding the Exposure Draft on September 1, 2010 and is intended to convey certain additional observations and recommendations recently identified that our membership requests the Board to consider during its redeliberation process.

In light of the Board's goal of simplifying the accounting for financial instruments and hedging activities, we strongly encourage the FASB to take a fresh look at the current hedge accounting model and comprehensively assess all aspects of the model consistent with the Board's approach for classification, measurement, and impairment. However, we realize that hedge accounting is merely one aspect of the financial instruments project in which the Board has attempted to address a multitude of pervasive financial reporting issues. As the Board begins its redeliberation process on the project, we encourage the FASB to monitor and consider the tentative and final decisions reached by the IASB under the hedge

¹ ISDA's Accounting Policy Committee members represent leading participants in the privately negotiated derivatives industry and include most of the world's major financial institutions, as well as many of the businesses, governmental entities and other end users that rely on over-the-counter derivatives to manage efficiently the financial market risks inherent in their core economic activities. Collectively, the membership of ISDA has substantial professional expertise and practical experience addressing accounting policy issues with respect to financial instruments and specifically derivative financial instruments.

accounting phase of its financial instruments project and incorporate those decisions which yield greater simplification and convergence within the FASB's final hedge accounting standard.

Immediately below we have summarized specific areas for which preparers have faced difficulty in fitting prudent and valid economic hedges into the current U.S. GAAP hedge accounting framework since the issuance of SFAS 133 (as amended). ISDA encourages the FASB to consider these areas in further deliberations regarding hedge accounting and, where possible, incorporate them into any final guidance. The issues below address the difficulty in applying the current U.S. GAAP hedge accounting framework to hedges of foreign currency risks to which multinational businesses in all industry sectors commonly are exposed. ISDA would be happy to assist the FASB in developing a set of principles for allowing these common business risks to qualify for hedge accounting under the proposed U.S. GAAP hedge accounting framework or sharing our perspectives on the issues facing preparers in these areas and their impact on financial reporting.

- **Hedging foreign currency exposure of probable, forecasted business combinations consummated in a foreign currency**

In many cases a reporting enterprise may acquire, through a purchase business combination, a foreign entity in which the purchase price is denominated in a foreign currency. Under U.S. GAAP, the acquirer in a purchase business combination is not permitted to designate a probable, forecasted acquisition in which the purchase price is denominated in a foreign currency as an eligible hedged item in a cash flow hedge on the basis that applying cash flow hedge accounting is inconsistent with the notion of a business combination. While this transaction poses a valid economic risk to the acquirer prior to the final closing of a business combination, the inability to qualify for hedge accounting often requires the acquiring entity to decide between not hedging at all (a less than optimal economic choice) or hedging but explaining the earnings volatility associated with the nondesignated hedging instrument. We note that IAS 39 has recognized this issue and permits the acquiring enterprise to hedge a firm commitment to acquire a business in a business combination in which the purchase price is denominated in a foreign currency. Although the guidance in IAS 39 does not specifically address hedging forecasted business combinations for foreign currency risk, we understand that in practice companies have been able to demonstrate that certain forecasted business combinations meet the requirement of being highly probable and, therefore, qualify for cash flow hedge accounting under IFRS. Cross-boarder business combinations are prevalent (especially in industries which experience global consolidation in certain economic cycles) and in an effort to converge IFRS with U.S. GAAP, we ask the FASB to reconsider its prior decisions under SFAS 133 (paragraph 473 of the Basis for Conclusions) and allow companies to hedge the foreign currency risk associated with a probable forecasted business combination. This is one area for which we believe convergence could easily be achieved without requiring a change to the underpinning principles of ASC Topic 815.

- **Hedging foreign currency exposure of probable, forecasted net income of a consolidated foreign subsidiary**

We recommend that the FASB reconsider its prohibition on designating probable forecasted net income of a foreign subsidiary as a hedged item in a cash flow hedge of foreign currency exposure. In an era of increased globalization, a greater number of multinational companies generate a significant portion of their earnings from consolidated foreign operating subsidiaries which creates a multitude of challenges including the forecasting of consolidated earnings exposed to currency fluctuations. As many companies manage their revenues, expenses, and net income in the reporting currency (or the parent company's functional currency), prudent risk management strategies are put in place to neutralize the impact of foreign exchange. However,

the prohibition for designating net income of a consolidated, foreign subsidiary as an eligible hedged item in cash flow hedge of foreign currency exposure under U.S. GAAP has created challenges for companies that desire to reduce economic risk but do not wish to recognize the earnings volatility (and income statement mismatch) associated with an undesignated hedging instrument.

We therefore ask the FASB to reconsider the restrictions on hedging the foreign currency exposure of a consolidated foreign subsidiary's net income in light of the increased globalization and the hesitancy of companies to enter into the quantum of derivatives which would be needed to hedge these risks. A change in this area would put multinational companies with foreign subsidiaries that have disparate functional currencies relative to the parent and companies whose foreign subsidiaries have the same functional currency as the parent on a similar accounting footing (as the consolidated financial statements of the parent companies in either of the aforementioned cases would reflect comparable accounting for the same economic risk vis-à-vis the parent company shareholders). We acknowledge that the current and proposed hedge accounting models do not permit an entity to designate the hedged item in a qualifying cash flow hedge as a net position comprising transactions with different risk characteristics (e.g., revenues and expenses) which may raise concerns that any proposal to allow the foreign currency exposure associated with the net income of a consolidated foreign subsidiary to qualify as the hedged item conflicts with existing hedge accounting principles. In order to alleviate these concerns, the FASB could permit a parent company to apply hedge accounting for a percentage of their consolidated foreign subsidiaries' revenues or expenses that equates to the expected net income of such subsidiaries in the consolidated financial statements only. This approach would allow the hedge transaction to be defined in a way that complies with existing hedge accounting principles and, at the same time, achieve the intended economic objectives of the hedge.

We hope you find ISDA's comments informative and useful. Should you have any questions or desire further clarification on any of the matters discussed in this letter please do not hesitate to contact the undersigned.



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