

August 31, 2010

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

Via email: director@fasb.org

File Reference: No. 1810-100 *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities*

Re: Derivative Instruments and Hedging Activities
(ABA comment letter 3 of 3 for File Reference 1810-100)

Dear Mr. Golden:

The American Bankers Association (ABA) appreciates the opportunity to comment on the Exposure Draft: *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities* (ED). ABA represents banks of all sizes and charters and is the voice for our nation's \$13 trillion banking industry and its two million employees. The majority of ABA's members are banks with less than \$165 million in assets. ABA's extensive resources enhance the success of the nation's banks and strengthen America's economy and communities.

Because of the importance of the issues addressed in the ED, as well as the wide range of issues within, ABA has split our response to the ED in three parts: 1) classification and measurement of financial assets and liabilities, 2) credit impairment of financial assets, and 3) derivative instruments and hedging activities. We have already sent you our comment letters regarding classification and measurement of financial assets and liabilities and regarding credit impairment of financial assets (both ABA letters dated August 31, 2010). This is the third of our three responses and it focuses on derivative instruments and hedging activities.

Convergence with IFRS is Needed.

ABA supports efforts by the Board to simplify accounting for hedging activities, but we are concerned that the resulting standards will not provide for convergence with International Financial Reporting Standards (IFRS). At this point, the International Accounting Standards Board (IASB) has not issued its exposure draft on hedge accounting. As many institutions are already investing time and dollars in planning and evaluating IFRS to determine how it may be applied in practice in preparation for its anticipated adoption in the U.S., ABA believes it would be unreasonable to ask the participants in the

U.S. markets to understand, interpret, and implement the changes proposed in the ED, followed by a change to IFRS in a relatively short amount of time.

Reasonably Effective Hedging Relationships is Supported, But More Guidance is Needed.

Overall, ABA supports the ED's most significant proposed change to hedge accounting, which is to require that hedge relationships be "reasonably effective", as opposed to the current requirement to be "highly effective". The amount of work to analyze and ensure highly effective relationships has burdened many organizations and discouraged entities from applying hedge accounting altogether. Simplifying the process will encourage more organizations to utilize hedge accounting, which will ultimately better reflect how their operations are conducted.

While we support this simplification of hedge accounting, it remains questionable whether, in practice, these modifications will result in a significant enough reduction in work and effort to support a hedging relationship. We encourage the Board to consider further clarifying the meaning of "reasonably effective" by referencing the degree to which key terms need to align in order to achieve the "reasonably effective" standard, as well as consider including examples or other implementation guidance.

With this in mind, however, there are serious concerns we have on other aspects of the ED for various reasons, including their impact on smaller institutions and their alignment with how the asset liability management process is conducted.

Shortcut and Critical Terms Matching Methods Should be Maintained.

ABA is concerned with the proposal to eliminate the shortcut and critical terms match methods of assessing hedge effectiveness. Many medium sized and smaller institutions still appropriately utilize these methodologies. The elimination of these methodologies will have a significant impact on these entities' decisions about whether to continue to enter into hedge transactions. Many institutions do not have system capabilities or will require significant implementation and ongoing costs to apply full hedge accounting, even with the reduced requirement for a reasonably effective hedging relationship. The additional costs to these institutions would likely outweigh perceived benefits.

While we understand that elimination of these methods is a result of historical restatements due to the view that there has been inappropriate application of these methodologies, we believe that these methods are consistent with the qualitative approach discussed within paragraphs 114 through 117 of the ED.

Institutions Should be Allowed to Subjectively Dedicinate Hedging Relationships.

Hedging various risks, both for specific risks and on overall "macro" portfolio levels, is a dynamic process that requires financial institutions to continually react and manage to their business strategies, the economic environment, and counterparty developments. With that in mind, the proposal to prohibit dedesignation of hedging relationships ignores this asset/liability management (ALM) process.

To require that the qualifying criteria be no longer met or the hedging instrument be sold, terminated, or exercised in order to dedesignate the hedging relationship, the Board appears to be implying that the ALM process must be static or that offsetting positions can always be easily executed in a cost-effective manner. Unfortunately, this is not the case. In fact, the process to merely enter into offsetting positions creates enormous operational difficulties as accounting departments must track ever expanding portfolios of “dead” positions – open positions that offset (or are offset by) other positions. Further, entering into an offsetting derivative at a time other than when the derivative is initially established may lead to an “off-market” transaction with significant structuring costs. As a result, higher than necessary costs are introduced into the hedging process. Further, these dead positions can distort the balance sheet and reduce transparency within an entity’s derivative disclosures, as it might not be possible to show the positions on a net basis on the balance sheet and current derivative disclosure requirements would require gross presentation. This seems to run counter to the efforts of the Board to streamline the hedge accounting process and increase transparency.

Transition Guidance Must be Better Outlined.

With the many changes that the Board is proposing, a greater amount of transition guidance is needed. Specific questions will need to be addressed. For example:

- Will hedging relationships that fail the “highly effective” relationship test prior to the effective date, but pass the “reasonably effective” test during that period qualify for hedge accounting during that time period?
- How will existing shortcut and critical terms method hedge relationships be treated at the effective date?
- Can hedges that have been dedesignated prior to the effective date be redesignated?

With these few questions in mind, we believe there should be an expansion of implementation guidance that will address the many other questions that will undoubtedly arise.

Allowable Cash Flow Hedge Indices Should be Expanded.

The requirement to hedge a benchmark interest rate as opposed to the entire interest rate was a concept introduced by Statement of Financial Accounting Standards (SFAS) No. 138, an amendment to SFAS 133. The benchmark interest rate is defined in the glossary to the Accounting Standards Codification (formerly in SFAS 138) as “a widely recognized and quoted rate in an active financial market that is broadly indicative of the overall level of interest rates attributable to high-credit-quality obligors in that market.” A benchmark interest rate is one that is widely used in a given financial market as an underlying basis for determining the interest rates of individual financial instruments and commonly referenced in interest-rate-related transactions. In theory, a benchmark rate should be a risk-free rate, such as government borrowing rates in some markets.

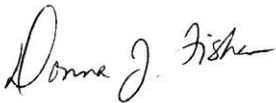
Currently, companies that desire to hedge interest rate risk separately from the total change in fair value of the underlying instrument are limited, for hedge accounting purposes, to hedging interest rate movements on U.S. Treasury securities or the London Interbank Offer Rate (LIBOR) swap rates.

While the basis of this limitation has some conceptual merit, as the movement in the U.S. Treasury obligations' interest rate is largely considered to be a risk free movement, ABA notes that the LIBOR rate includes movement due to credit risk. We also note that there are other indices in the U.S, such as the Federal Funds Rate and the Prime Interest Rate, that are broadly indicative of the overall level of interest rates attributable to high-credit quality obligors.

With this in mind, we recommend that the Board expand the allowable indices to Bench Mark Interest Rates to include the Federal Funds Rate and Prime Interest Rate. This would provide more circumstances for organizations to apply hedge accounting and, thus, provide more opportunities where the financial statements better reflect the entity's operations.

Thank you for your attention to these matters and for considering our views. Again, this letter follows our separate comment letters addressing the classification and measurement of financial assets and liabilities and credit impairment of financial assets. Please feel free to contact Mike Gullette (mgullette@aba.com; 202-663-4986) or me (dfisher@aba.com; 202-663-5318) if you would like to discuss our views.

Sincerely,

A handwritten signature in cursive script that reads "Donna J. Fisher".

Donna J. Fisher