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Via email

Sir David Tweedie, Chairman
International Accounting Standards Board
30 Cannon Street, First Floor
London, EC4M 6XH
United Kingdom

Re: Exposure Draft: ED/2010/13, Hedge Accounting

Dear Sir:

Wells Fargo & Company (Wells Fargo) is a diversified financial services company with over \$1.3 trillion in assets providing banking, insurance, trust and investments, mortgage banking, investment banking, retail banking, and consumer finance services. Wells Fargo prepares financial statements in accordance with U.S. Generally Accepted Accounting Principles and accordingly follows the hedge accounting requirements in ASC Topic 815, *Derivatives and Hedge Accounting*. We appreciate the opportunity to comment on the IASB's Exposure Draft on Hedge Accounting (the "Exposure Draft").

The proposed simplification and increased flexibility of the hedge accounting model is a long-awaited and welcome change. Accordingly, we are encouraged by the IASB's decision to comprehensively address the shortcomings of the current models and fully support a principles-based model based on the underlying economics of an entity's risk management activities. We believe the proposed guidance is a superior starting point to address the limitations of the existing hedge accounting model, but the proposed guidance must ultimately address macro hedging strategies. We are pleased that a model for such strategies is under deliberation by the IASB and thus qualify our response until a proposal for macro hedging strategies is incorporated into the overall hedge accounting model.

Areas that we support

We strongly support the following aspects of the proposed guidance:

- The replacement of arbitrary rules with a principles-based approach to hedge accounting through the alignment of hedge accounting with risk management activities;
- A more flexible designation of hedged items, including risk components of financial and non-financial instruments, synthetic exposures and cash instruments measured at fair value through earnings;
- The ability to rebalance in lieu of de-designating and re-designating hedging relationships;
- The ability to assess hedge effectiveness qualitatively; and
- The elimination of retrospective assessment of hedge effectiveness.

Areas that Need Further Consideration

To further improve the proposed guidance, we offer the following recommendations for your consideration:

- The proposed guidance must more fully address situations where individual or micro hedging strategies relate to risk management activities performed on a portfolio or macro basis;
- Mitigation of credit and prepayment risk is integral to risk management; accordingly, we encourage the IASB to develop suitable solutions to facilitate hedge accounting for these risks; and
- The unbiased and neutral requirement in the assessment of hedge effectiveness should be more clearly defined to avoid unnecessary rebalancing and quantitative effectiveness testing because as currently drafted, unbiased and neutral may be interpreted to require a “perfect” or “optimal” hedging relationship”.

Convergence

Wells Fargo supports the efforts of the IASB and FASB to develop a converged set of high quality global accounting standards. Both Boards have agreed to harmonize their respective hedge accounting models in connection with the Financial Instruments Project; however, thus far, they have pursued fundamentally different approaches to both hedge accounting and classification and measurement. Consequently, we are concerned that the decision by the IASB to eliminate recycling of gains and losses to earnings for financial instruments measured at fair value through other comprehensive income (“OCI”) may perpetuate the differences in the respective hedge accounting models of each Board. We support the proposed use of OCI for hedge accounting and the recycling of hedge ineffectiveness to earnings and encourage the IASB and the FASB to fully converge on the use of other comprehensive income.

As noted above, we believe the changes proposed by the IASB represent a superior starting point to address the limitations in the existing hedge accounting models. We note that additional differences exist in the existing hedge accounting models that are not addressed in either of the Board’s proposals and strongly encourage the IASB and FASB to reconcile their differences and pursue a fully converged hedge accounting standard.

In addition to our summary comments, we have also responded to your questions posed in the Exposure Draft in detail. Please find our responses to your questions in Appendix A.

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We appreciate the opportunity to comment on the issues contained in the FASB’s invitation. If you have any questions, please contact me at (415) 222-3119.

Sincerely,

/s/ Richard D. Levy

Richard D. Levy
Executive Vice President & Controller

cc: Leslie Seidman, Financial Accounting Standards Board
Kathy Murphy – Office of the Comptroller of the Currency
Art Lindo – Federal Reserve Board
Robert Storch – Federal Deposit Insurance Corporation
Donna Fisher – American Bankers Association
Gail Haas – New York Clearing House Association

Objective of hedge accounting

Question 1

Do you agree with the proposed objective of hedge accounting? Why or why not? If not, what changes do you recommend and why?

- We agree with the IASB's objective to establish a more principles-based approach to hedge accounting that more closely aligns hedge accounting with risk management activities. We believe that a hedge accounting model that emphasizes the alignment of hedge accounting with risk management activities is superior to the existing rules-based approach that does not always reflect how companies manage their risks.
- While we are encouraged by the proposed guidance, the proposed hedge accounting objective may be difficult to evaluate under certain circumstances until deliberations on the macro hedging project are completed. We encourage the IASB to finalize the macro hedge accounting project and clarify the objective in light of these concerns. Please consider the following examples to illustrate these concerns:
 - The proposed guidance considers risk management at a transaction level rather than a portfolio or macro (aggregation of multiple portfolios) level. However, financial institutions manage risks at various levels, i.e., instrument, portfolio or macro level. To the extent risks are managed at a particular level, decision-making at that level is not performed in isolation. The proposed guidance should more fully consider how hedging strategies designed to mitigate exposures arising at one or more levels of an organization are aligned with an entity's overall risk management strategy. For example,
 - If a hedging strategy managed at the instrument-level is changed, but the revised strategy remains consistent with portfolio or macro risk management strategies, is that considered a *change* in the risk management strategy for purposes of applying the proposed rebalancing and termination provisions (see our responses to Questions 7 and 8)?
 - If a portfolio or macro level risk management strategy cannot qualify for hedge accounting, is it permissible to designate individual items (or groups of items) as the hedged item that represents a proxy for the macro level hedged risk? This may include designation of proxy items that are not managed directly as part of the risk management strategy. This type of designation, which is common under existing guidance, would accommodate hedge accounting for portfolio or macro level risk management strategies.
- Due to the current status of the competing positions of the IASB and FASB on classification and measurement, the preclusion of hedge accounting financial instruments measured at fair value through OCI will likely impact a broader population of instruments for US entities¹. The IASB reasoned that these instruments should not qualify for hedge accounting because such qualification is counter to its principal that gains and losses recorded in OCI should not be recycled to earnings. This rationale seems to contradict the proposed use of OCI for hedge accounting gains and losses and the recycling of hedge ineffectiveness to earnings. We fully support this use of OCI and strongly encourage convergence in this area due to the correlating impact on hedge accounting for financial instruments measured at fair value through OCI. If the IASB and FASB are unable to converge,

¹ It is expected that banking book securities will be measured at amortized cost under the classification and measurement proposal of IFRS 9. Banking book securities will likely be measured at fair value with changes in OCI under the classification and measurement proposal offered by the FASB.

expanded guidance may be necessary for US entities that wish to use hedge accounting for these instruments.

Instruments that qualify for designation as hedging instruments

Question 2

Do you agree that a non-derivative financial asset and a non-derivative financial liability measured at fair value through profit or loss should be eligible hedging instruments? Why or why not? If not, what changes do you recommend and why?

- We support the designation of non-derivative instruments measured at fair value through earnings. In practice, many institutions economically hedge their risks with non-derivative financial assets and liabilities, or hedge exposures that are combinations of a derivative and another exposure. Accordingly, this change would be consistent with companies risk management activities.

Derivatives that qualify for designation as hedged items

Question 3

Do you agree that an aggregated exposure that is a combination of another exposure and a derivative may be designated as a hedged item? Why or why not? If not, what changes do you recommend and why?

- We support the designation of an aggregation of a derivative and non-derivative exposure (synthetic position) as a hedged item. In practice, companies manage, in aggregate, risks arising from synthetic positions. Accordingly, the proposal would be consistent with risk management activities.
- Paragraphs 15 and B9 permit the combination of an exposure and a derivative as a designated hedged item. We believe the IASB should clarify “exposure” to include all eligible hedged items as defined in paragraphs 12-14.
- We recommend that the IASB provide additional implementation guidance that illustrates the initial and subsequent measurement of these hedging relationships. For example:
 - Clarification that the derivative component of a synthetic position continues to be measured at fair value;
 - Whether a change in the hedged risk is determined separately for each derivative and non-derivative component of the synthetic position or modeled as a single position; and
 - Whether the entire change in fair value of the derivative component of the synthetic position is recorded in OCI or just the change in fair value due to the hedged risk. If the latter, we note that the IASB has not yet determined an approach for disaggregation of derivative instruments into risk components.

Designation of risk components as hedged items

Question 4

Do you agree that an entity should be allowed to designate as a hedged item in a hedging relationship changes in the cash flows or fair value of an item attributable to a specific risk or risks (ie a risk component), provided that the risk component is separately identifiable and reliably measurable? Why or why not? If not, what changes do you recommend and why?

- The ability to designate risk components of both financial and non-financial instruments as hedged items should be emphasized as one of the fundamental principles of the proposed guidance. This principle is a necessary and welcome change relative to the existing and recently proposed US GAAP model. Designating risk components in this fashion will provide much needed flexibility to align hedging strategies with risk management activities.
- Mitigation of credit and prepayment risk is integral to risk management. Accordingly, we encourage the IASB to develop suitable solutions to facilitate hedge accounting for these risks. In light of the objective to produce a more principles-based hedge accounting model, we do not believe it is necessary to specifically exclude, by rule, these risks as eligible risk components. The principles of “separately identifiable” and “reliably measurable” should be sufficient, as rules have difficulty adjusting to market and product evolutions over time.

Designation of a layer component of the nominal amount

Question 5

- a) Do you agree that an entity should be allowed to designate a layer of the nominal amount of an item as the hedged item? Why or why not? If not, what changes do you recommend and why?
- b) Do you agree that a layer component of a contract that includes a prepayment option should not be eligible as a hedged item in a fair value hedge if the option’s fair value is affected by changes in the hedged risk? Why or why not? If not, what changes do you recommend and why?

- We support the proposal as it permits more flexibility in designating layer components of individual or groups of items (including designating a ‘bottom layer’). For financial institutions, the designation of the layer component of a group of items may be important to ensure alignment of macro or portfolio hedging strategies with risk management activities. We encourage the IASB to complete its deliberations on the macro hedge accounting project and incorporate and re-expose the overall hedge accounting model in its entirety to facilitate full evaluation of the proposed layering guidance.
- It is essential that financial institutions have a feasible approach for hedging portfolios of prepayable assets. We are pleased the IASB considering this issue in the macro hedge accounting project and encourage the IASB to develop approaches applicable to both open and closed portfolios of prepayable assets. With regard to the proposal to preclude designation of a layer component in a fair value hedge that includes a prepayment option that is sensitive to changes in the hedged risk, we encourage the IASB to reconsider this guidance. We are concerned that this concept, if carried forward to the overall hedge accounting model, effectively prevents the designation of portfolios of prepayable assets, such as residential mortgage loans and mortgage servicing rights, in hedge accounting relationships.
- Consistent with our response to Question 4, we believe the risk component principle of “separately identifiable” and “reliably measurable” should be sufficient guidance to determine risk component eligibility. Therefore, we recommend removing the specific preclusion related to hedging layer components with prepayment risk. Alternatively, the IASB could consider an approach that allows

designation of such components conditioned upon including prepayment risk as a component of interest rate risk for purposes of hedge effectiveness assessment and measurement.

Hedge effectiveness requirements to qualify for hedge accounting

Question 6

Do you agree with the hedge effectiveness requirements as a qualifying criterion for hedge accounting? Why or why not? If not, what do you think the requirements should be?

- We support the proposed flexibility to determine the appropriate effectiveness method and the ability to perform the effectiveness assessment on a qualitative and prospective-only basis. We ask that the IASB clarify certain aspects of the objective of the hedge effectiveness assessment.
- Paragraph B29 of the proposed guidance states the objective of hedge effectiveness assessment is to ensure that the hedge relationship will produce an “unbiased result” and “minimize hedge ineffectiveness”. It further states, the hedging relationship must not reflect a deliberate mismatch in the weightings of the hedging instrument and hedged item that would result in systematic over-hedging or under-hedging as that represents a biased result. Yet, in the same paragraph, the proposed guidance states this does not mean perfect effectiveness is required in order to qualify for hedge accounting. We find these statements contradictory and are concerned this may require the designation of either a “perfect” or “optimal” (i.e., most effective) hedge, both at inception of the hedging relationship and on an ongoing basis, even if that is not consistent with the risk management strategy. For example:
 - Perhaps a risk management strategy targets a hedge ratio at inception of a hedging relationship that does not result in complete offset because it has a view on the expected change of certain risk components, e.g., direction of market interest rates, or there is a “natural” offset of the risk from another portfolio.
 - Similarly, companies continually monitor and adjust risk exposures. Accordingly, target hedge ratios may evolve over time given changes in market conditions and other factors.
 - Risk management strategies may prefer certain types of hedging instruments (e.g., forwards or futures) due to more suitable pricing or liquidity characteristics relative to other types of hedging instruments (e.g., swaps) that may represent a more precise offset of the hedged risk.

The IASB should clarify that hedge accounting can be achieved in these and similar circumstances to avoid the potential incentive for companies to change its risk management strategy only to “make the accounting work”.

- When considered in conjunction with the unbiased and neutral, and rebalancing requirements, the IASB approach may have the unintended consequence of requiring frequent quantitative reassessments to support the designation of the perfect or optimal hedge ratio both at inception of the hedging relationship and on an ongoing basis.
- We acknowledge that the “reasonably effective” criteria for hedge effectiveness assessment proposed by the FASB may be subject to further refinement and interpretation. We prefer the “reasonably effective” criteria as quantitative effectiveness testing may be required less frequently. Alternatively, the IASB could replace the unbiased and neutral requirement with an evaluation of whether an

economic hedging relationship exists between the hedging instrument and the hedged item and require ineffectiveness from under-hedging to be recognized in earnings².

Rebalancing of a hedging relationship

Question 7

- a) Do you agree that if the hedging relationship fails to meet the objective of the hedge effectiveness assessment an entity should be required to rebalance the hedging relationship, provided that the risk management objective for a hedging relationship remains the same? Why or why not? If not, what changes do you recommend and why?
- b) Do you agree that if an entity expects that a designated hedging relationship might fail to meet the objective of the hedge effectiveness assessment in the future, it may also proactively rebalance the hedge relationship? Why or why not? If not, what changes do you recommend and why?

- We support the concept of rebalancing but are concerned that the requirement to rebalance to a “perfect” or “optimal” hedge ratio will lead to unnecessary rebalancing and frequent quantitative testing (see our response to Question 6). Such a requirement could separate the hedge accounting from the risk management objectives of a company. Accordingly, we believe that the IASB should permit, but not require, an entity to rebalance its hedging relationships. We believe this would more closely align hedge accounting with the underlying economic strategies.
- The ability to determine whether rebalancing or de-designation is appropriate under the proposed guidance will be dependent upon the level at which the hedging strategy is documented and how that strategy interacts with other risk management activities. As noted in our response to Question 1, in order to make this determination it is important to understand the level at which changes in risk management strategies are to be assessed.
- The focus of rebalancing in the proposed guidance is almost entirely discussed by reference to changing the volume of the hedged item or the hedging instrument. However, there may be other situations where alternative action may be appropriate, such as transacting additional derivatives that change the risk profile of the hedging instrument. For example:
 - A change in basis risk may be necessary when hedging interest rate risk as part of a cash flow hedge because a borrower, under the terms of its facility, changes its funding basis from one month to three month Libor. The lender may have originally hedged the one month Libor rate based on the expectations of cash flows at the initial designation of the hedging relationship. The lender may wish to transact a basis swap to convert the funding basis to three month Libor and designate it in combination with the existing hedging relationship to eliminate ineffectiveness from the basis risk. We believe it should be acceptable to rebalance hedging relationships in this and similar circumstances.

² Under the model proposed by the FASB, ineffectiveness due to under-hedging is recognized in earnings.

Discontinuing hedge accounting

Question 8

- a) Do you agree that an entity should discontinue hedge accounting prospectively only when the hedging relationship (or part of a hedging relationship) ceases to meet the qualifying criteria (after taking into account any rebalancing of the hedging relationship, if applicable)? Why or why not? If not, what changes do you recommend and why?
- b) Do you agree that an entity should not be permitted to discontinue hedge accounting for a hedging relationship that still meets the risk management objective and strategy on the basis of which it qualified for hedge accounting and that continues to meet all other qualifying criteria? Why or why not? If not, what changes do you recommend and why?

- We believe the proposed guidance should permit de-designation of hedging relationships. However, additional clarification is necessary regarding the appropriate level to assess changes in the qualifying criteria so as not to unduly limit the ability to voluntarily de-designate hedging relationships (see our response to Questions 1).
- We can envision scenarios in which an entity's overall risk management strategy has not changed, but the risk management strategy for individual hedging relationships may have changed such that rather than rebalancing or replacing the hedging instrument, the entity simply wishes to utilize the hedging instrument for alternative purposes that are within the entity's overall risk management framework. For example:
 - An entity may wish to designate the hedging instrument in a separate hedge accounting relationship or use the hedging instrument to economically hedge the risk of hedged items that are measured at fair value through earnings (thus obviating the need for hedge accounting designation).
 - In lieu of macro hedging, entities frequently designate specific transactions or individual instruments, which are representative of a macro risk component, as hedged items. As changes occur in the risk profile of the macro risk component, it may be necessary to adjust the hedging relationship through de-designation and re-designation of existing hedging instruments as hedges of similar but not the same hedged items.

Similar effects may be achieved through the termination and replacement of the hedging instrument or adding new derivatives to the existing hedging instrument. However, this would not be cost effective as risk exposures may and often change frequently. We do not believe the perceived benefits will outweigh the incremental costs related to this proposal.

Accounting for fair value hedges

Question 9

- a) Do you agree that for a fair value hedge the gain or loss on the hedging instrument and the hedged item should be recognised in other comprehensive income with the ineffective portion of the gain or loss transferred to profit or loss? Why or why not? If not, what changes do you recommend and why?
- b) Do you agree that the gain or loss on the hedged item attributable to the hedged risk should be presented as a separate line item in the statement of financial position? Why or why not? If not, what changes do you recommend and why?
- c) Do you agree that linked presentation should not be allowed for fair value hedges? Why or why not? If you disagree, when do you think linked presentation should be allowed and how should it be presented?

- We support the proposal to use OCI to reflect gains or losses associated with hedging activities for both cash flow and fair value hedges. We also support the proposed recycling of hedge ineffectiveness to earnings.
- However, we do not support the proposal to require separate presentation of gains or losses attributable to hedged risks on the face of the balance sheet. We believe this information is more appropriately disclosed in the footnotes, particularly when considered against the recent trend of disclosing more detailed information on the face of the primary financial statements. Adoption of this proposal will simply result in a more cluttered balance sheet that is difficult for users to understand.
- If the IASB proceeds with the proposal to separately record gains and losses attributable to hedged risks on the face of the balance sheet, we encourage the IASB to permit a linked presentation. A linked presentation represents a better reflection of risk exposures compared to separate gross presentation which tends to inflate or distort an entity's true exposure.

Accounting for the time value of options for cash flow and fair value hedges

Question 10

- a) Do you agree that for transaction related hedged items, the change in fair value of the option's time value accumulated in other comprehensive income should be reclassified in accordance with the general requirements (e.g., like a basis adjustment if capitalised into a non-financial asset or into profit or loss when hedged sales affect profit or loss)? Why or why not? If not, what changes do you recommend and why?
- b) Do you agree that for period related hedged items, the part of the aligned time value that relates to the current period should be transferred from accumulated other comprehensive income to profit or loss on a rational basis? Why or why not? If not, what changes do you recommend and why?
- c) Do you agree that the accounting for the time value of options should only apply to the extent that the time value relates to the hedged item (ie the 'aligned time value' determined using the valuation of an option that would have critical terms that perfectly match the hedged item)? Why or why not? If not, what changes do you recommend and why?

- We support the proposals to defer the time value component of changes in fair value to other comprehensive income for options designated in both fair value and cash flow hedging relationships and the methods for reclassifying such amounts to OCI.
- We agree with the guidance in paragraphs B68 and B69 regarding "aligned" time value. This provides guidance for accounting for the time value of options whose critical terms do not match the hedged item. Aligned time value is a newly introduced term that appears to be the same as or similar

to the time value of a hypothetical derivative. If so, in an effort to reduce complexity, we recommend the use of existing terminology rather than the introduction of new vernacular.

Eligibility of a group of items as the hedged item

Question 11

Do you agree with the criteria for the eligibility of groups of items as a hedged item? Why or why not? If not, what changes do you recommend and why?

- We support the proposal as it permits more flexibility to designate groups of items, including net positions. However, as we have noted in our response to Questions 1 and 5, we are unable to fully evaluate the proposed guidance and thus qualify our response as the proposed guidance does not address hedging layer components in an open portfolio or macro hedging. For financial institutions, the designation of the layer component of a group of items may be important to ensure alignment of macro or portfolio hedging strategies with risk management activities. We encourage the IASB to complete its deliberation on the macro hedge accounting project and incorporate and re-expose the overall hedge accounting model in its entirety to facilitate full evaluation of this aspect of the proposed guidance.
- We note that the IASB deliberately removed the “homogeneity” requirement for hedging groups of items³ from IAS 39. However, it appears that a similar requirement has been re-introduced in paragraph 36(c) of the proposed guidance. Paragraph 36(c) requires that “items in the overall group of items from which the layer is identified must be exposed to the same hedged risk (so that the measurement of the hedged layer is not dependent upon which items from the overall group form part of the hedged layer)”. We encourage the IASB to clarify how this requirement differs from the “homogeneity” requirement in IAS 39.

Presentation (groups of hedged items)

Question 12

Do you agree that for a hedge of a group of items with offsetting risk positions that affect different line items in the income statement (e.g., in a net position hedge), any hedging instrument gains or losses recognised in profit or loss should be presented in a separate line from those affected by the hedged items? Why or why not? If not, what changes do you recommend and why?

- We agree with the proposal that prohibits the gross-up of affected income statement line items when recognizing hedge gains or losses on a net position hedge (which is a group of hedged items that includes offsetting positions). The proposed guidance requires such hedge gains or losses to be recognized in a single and separate line item apart from the line items that are affected by the hedged items making up the net position hedge.

³ IAS 39 and the FASB hedge model required that the change in the fair value attributable to the hedged risk for each individual item in the group must be ‘approximately proportional’ to the overall change in the fair value of the group for the hedged risk.

Disclosures

Question 13

- a) Do you agree with the proposed disclosure requirements? Why or why not? If not, what changes do you recommend and why?
- b) What other disclosures do you believe would provide useful information (whether in addition to or instead of the proposed disclosures) and why?

- In general, we support the objectives of the proposed disclosures within the Exposure Draft. However, we believe additional clarification and implementation guidance is necessary to better understand the disclosure requirements.
- Consistent with our response to Question 1 regarding the need for better articulation of the linkage of hedge accounting strategies to risk management strategies, we do not support the assumed perfect correlation of risk management activities to hedge accounting strategies, as they often differ in practice. This may diminish the ability of users to understand risk management activities or hedge accounting activities for a particular institution when comparing the amounts disclosed. Also, the proposed guidance is unclear as to whether the disclosures are to be presented on the basis of risk management strategy or hedge accounting strategy as these strategies often differ in level and method of application. For example, disclosures based on hedge accounting strategies may result in a scope that is too narrow, which could omit several risk management strategies applicable to a particular risk category.
- The Exposure Draft should provide additional clarity for the meaning of “risk category” relative to the meaning of “risk exposure” when quantitative disclosures are required. Certain disclosures are required to be in terms of “risk exposure” only, which may be difficult for both preparers and users to understand and correlate to the other quantitative disclosures presented at a “risk category” level.

Accounting for a contract for a non-financial item that can be settled net in cash as a derivative

Question 14

Do you agree that if it is in accordance with the entity’s fair value-based risk management strategy derivative accounting would apply to contracts that can be settled net in cash that were entered into and continue to be held for the purpose of the receipt or delivery of a non-financial item in accordance with the entity’s expected purchase, sale or usage requirements? Why or why not? If not, what changes do you recommend and why?

- This guidance allows derivative accounting, i.e., measured at fair value through earnings, for commodity contracts that do not qualify for such accounting due to the scope exception under current guidance for normal purchases or sales. This proposed change will facilitate earnings symmetry for entities that hedge these contracts with derivatives. While this is not a significantly relevant issue for us, we support the proposal as it consistent with the object to align hedging strategies with risk management activities.

Accounting for credit risk using credit derivatives

Question 15

- a) Do you agree that all of the three alternative accounting treatments (other than hedge accounting) to account for hedges of credit risk using credit derivatives would add unnecessary complexity to accounting for financial instruments? Why or why not?
- b) If not, which of the three alternatives considered by the IASB in paragraphs BC226–BC246 should the IASB develop further and what changes to that alternative would you recommend and why?
- As noted in paragraphs BC226-246 of the proposed guidance, the IASB acknowledges the inherent complexity in hedging credit exposures and the difficulty in applying the proposed qualifying criteria to credit derivatives. However, credit derivatives can be a useful risk management tool and in line with the overall objective to align hedge accounting with risk management practices. Accordingly, we strongly encourage the IASB to permit hedge accounting for hedges of credit risk. We do not believe such an accommodation would add unnecessary complexity to the accounting for financial instruments, but rather is a necessary component of the hedge accounting framework.
 - As noted in our response to Question 4, we encourage the IASB to permit the designation of credit risk as an eligible risk component. We believe principle-based guidance of “separately identifiable” and “reliably measurable” are sufficient. We note, for the Board’s reference, that US GAAP already includes measurement models that attempt to isolate changes in fair value solely due to credit risk, such as the calculation of impairment for loans and securities. Establishing an arbitrary rule to exclude credit risk as an eligible risk component will not be responsive to evolutions of measurement techniques, market conditions and products that occur over time.
 - An additional approach to hedging credit risk using credit derivatives would be to separately identify all risks except for the interest rate risk component (benchmark rate) for hedge accounting and specifically designate that as the hedged item. This would allow the credit derivative, such as a credit default swap to more effectively hedge the designated item, largely consisting of credit risk.
 - We acknowledge that the IASB has considered three alternatives to address hedges of credit risk. However, these approaches will have limited application as they require designation of the full change in fair value of the hedged item rather than a specific designation of credit risk. Of these alternatives, we recommend Alternative 3. Alternative 3 is preferable to Alternatives 1 and 2 because Alternative 3 allows for fair value election at any time with the deferral of existing unrealized gains or losses.

Effective date and transition

Question 16

Do you agree with the proposed transition requirements? Why or why not? If not, what changes do you recommend and why?

- As our financial statements are prepared in accordance with US GAAP, our comments regarding effective date and transition are made through the lens of converging FASB and IASB hedge accounting models. We strongly believe the IASB and FASB should issue uniform hedge accounting standards with uniform effective dates. We also reiterate our encouragement to include any changes to the proposed model related to the macro hedging project in the final standard. This will ensure consistency and comparability of financial information in today’s increasingly competitive global marketplace.

- Consistent with our response to the Effective Date and Transition Discussion Paper⁴, we would support a single effective date (with an early adoption alternative if single date not practical) for the projects referenced in the Discussion Paper. We believe a minimum implementation period is 5 years from issuance of final guidance is required. As hedge accounting is a component of the Financial Instruments Project, its effective date should be considered in conjunction with the projects referenced in the Discussion Paper.
- Although we indicated a preference for a limited retrospective transition in our response to the Effective Date and Transition Discussion Paper, we would support prospective application of the proposed guidance.

⁴ We filed our response on January 27, 2011