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Dear Madam,

Invitation to comment – IASB ED *Hedge Accounting*

The Belgian Accounting Standards Board (BASB) is pleased to respond to the Exposure Draft on Hedge Accounting issued by the IASB (the “Board”) in December 2010 (hereinafter the “ED”). In order to facilitate the discussion within in its Advisory Panel, the BASB has commented on the view of the European Financial Reporting Advisory Group (EFRAG) reflected in their draft Comment Letter.

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?

EFRAG’s response

EFRAG agrees with the direction of the proposed objective to reflect, in the financial reporting, the extent and effects of an entity’s risk management activities. We do not believe that hedge accounting should be restricted to risks that affect profit or loss only. We therefore urge the IASB to reconsider carefully why it is necessary to prohibit hedge accounting for items that affect other comprehensive income or equity as well.

BASB’s response

We concur with EFRAG’s view but would also propose that the Board should clearly define what is understood by *risk management* and what type of transactions is understood to be covered via risk management.

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?

EFRAG's response

EFRAG agrees that a non-derivative financial asset and a non-derivative financial liability measured at fair value through profit or loss should be eligible as hedging instruments. Furthermore, we also believe that non-derivative instruments other than those at fair value through profit or loss should be eligible as hedging instruments.

BASB's response

We concur with EFRAG's view and are of the opinion that a wider range of instruments to be designated as hedging instruments will better reflect how entities effectively hedge certain risks from an economical point-of-view.

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?

EFRAG's response

EFRAG agrees that a synthetic exposure may be designated as a hedged item.

BASB's response

We concur with EFRAG's view and believe that the ability to include a derivative within a hedged item will make hedge accounting possible for certain common risk management strategies.

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 (i.e. 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?

EFRAG's response

EFRAG welcomes the proposal to allow the designation of a risk component as a hedged item if it is separately identifiable and measurable. We question why non-contractually specified inflation cannot be designated as a component and urge the IASB to reconsider this issue.

BASB's response

We concur with EFRAG's view and we are of the opinion that both contractually and non-contractually inflation risk should be eligible for hedge accounting. With regard to the sub-

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LIBOR we fail to understand why the Board has opted that a LIBOR component cannot be designated as the hedged item in a sub-LIBOR hedge relationship. We believe that the reason for this restriction (i.e. if benchmark interest rates decrease significantly such that the negative spread is actually greater than the benchmark and hence no offset would be achieved) is a rather theoretical example and are of the opinion that a consistent treatment for non sub-LIBOR hedging should be applied for sub-LIBOR hedge relationships.

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?

EFRAG's response

EFRAG agrees that an entity should be allowed to designate a layer of the nominal amount of an item as the hedged item.

BASB's response

We concur with EFRAG's view and believe that the ability to hedge a bottom / top layer in a fair value hedge is a sensible approach, and permits better alignment to risk management strategy, rather than a proportional approach.

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?

EFRAG's response

EFRAG welcomes the removal of the 80 to 125 per cent bright line test for assessing and measuring hedge effectiveness and the introduction of an objectives-based assessment. We are concerned that the proposed guidance may create inconsistencies between risk management and accounting as explained in paragraph 54 below.

BASB's response

We concur with EFRAG's view and welcome the move away from an arbitrary bright line test where small differences in levels of ineffectiveness could result in significantly different accounting results.

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?

EFRAG's response

EFRAG agrees with the notion of 'rebalancing' hedging relationships, because this enables an entity to reflect in hedge accounting the changes in hedge ratio that it makes for risk management purposes. The notion of rebalancing is not yet well understood and we therefore suggest that the IASB undertake the necessary field-testing to ensure that the proposals can be operationalised.

BASB's response

We concur with EFRAG's view although we have concerns with regard to the following: the criteria that must be applied in order to decide whether or not a hedge relationship needs to be rebalanced, and the focus of rebalancing / eliminating bias on changing the volume of the hedged item or the hedging instrument and would recommend that the Board provides additional clarity with regard to before-mentioned concerns.

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?

EFRAG's response

EFRAG agrees 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. EFRAG agrees that an entity should not be permitted to discontinue hedge accounting for a hedging relationship that still meets the risk management objective and strategy, and that continues to meet the qualifying criteria.

BASB's response

We agree that hedges should be discontinued on a prospective basis when the hedge relationship no longer meets the qualifying criteria. We believe this is appropriate because the ED also permits entities to pro-actively de-designate proportions of the hedged item,

either as part of rebalancing or because a proportion of the hedged item is no longer highly probable.

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?

EFRAG's response

EFRAG acknowledges that the proposed presentation of fair value hedges would show the effect of hedging transactions in a single place of the financial statements. However, we fail to see what additional information that this would provide to users of financial statements. EFRAG does not support linked presentation where gross assets and gross liabilities that are related by way of a fair value hedge are presented together on the same side of the statement of financial position.

BASB's response

We concur with EFRAG's view.

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 (eg 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?

EFRAG's response

EFRAG welcomes the proposals, which address the issue of ineffectiveness due to the time value component in options and provide a solution to an important practical issue. The Board should consider a single approach for the reclassification from other comprehensive income to profit or loss of the time value component accumulated in other comprehensive income. EFRAG believes that an allocation over the relevant period on a rational basis would be the most appropriate method.

BASB's response

We concur with EFRAG's view.

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?

EFRAG's response

EFRAG will not be able to comment on these proposals in full until we gain a better understanding of the Board's direction in respect of macro hedging. It is not immediately evident from the ED, what the underlying principle is for the treatment of groups of items. We believe that further outreach and field-testing should be undertaken to avoid replacing one set of complex, rules-based, requirements with another.

BASB's response

We concur with EFRAG's view.

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 (eg 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?

EFRAG's response

EFRAG agrees with the proposals regarding the presentation in profit or loss of the effects of hedge accounting for groups of items. EFRAG disagrees with the way gains or losses from fair value hedges of net positions are proposed to be presented. Rather than requiring presentation on a gross and disaggregated basis in the statement of financial position, we would recommend that all fair value changes be aggregated into a single item in the statement of financial position and to provide details in the notes.

BASB's response

We concur with EFRAG's view.

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?

EFRAG's response

EFRAG supports the categories of disclosures proposed in the ED. We believe that disclosures play a fundamental role in providing users with an understanding of an entity's risk management strategy and hedging activities. We are concerned about the prescriptive nature of the disclosure requirements and the interaction with the disclosure requirements of IFRS 7.

BASB's response

We concur with EFRAG's view but are concerned that the information required to be disclosed is extensive but mandatory in order to gain a good understanding of the risk management policies of an entity.

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?

EFRAG's response

EFRAG agrees that the proposals are a step in the right direction, but urge the IASB to investigate this issue further in finalising the proposals.

BASB's response

We are concerned that only a summary of the proposed changes have been included in the appendix of the ED, and that there needs to be sufficient due process on the wording of the proposed changes. It appears that fair value accounting would be required if an entity's risk management strategy is based on fair values. Therefore, there would be no choice for entities that clearly manage their commodity exposure including all own use contracts on a fair value basis, i.e., it would not be possible to apply to some of the own use contracts expect if these are held in different business units and only these are managed on a fair value basis.

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 Board in paragraphs BC226–BC246 should the Board develop further and what changes to that alternative would you recommend and why?

EFRAG's response

EFRAG believes that, where the hedged item is credit risk, there is not any inherent obstacle to achieving hedge accounting per se and hedge accounting should be permitted provided that the hedging relationship meets the general requirements for qualification and is consistent with the risk management activities. We acknowledge this may be difficult to achieve in practice. Therefore, we support the IASB in its efforts to investigate further the development of the proposed accounting alternatives.

BASB's response

We prefer not to comment on this question.

Question 16

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

EFRAG's response

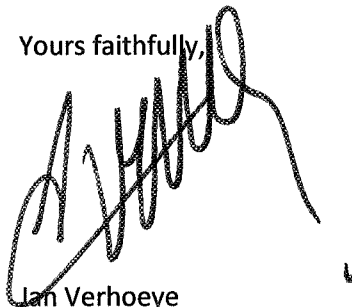
EFRAG supports an effective date of 1 January 2015 for all phases of IFRS 9 and the other major projects currently under the consideration of the IASB. EFRAG supports prospective application of the proposals.

BASB's response

We agree with the proposal that the ED should be applied prospectively and concur with EFRAG's view.

Should you wish to discuss the content of this letter with us, please contact Jan Verhoeve at jan.verhoeve@cnc-cbn.be.

Yours faithfully,



Jan Verhoeve

Chairman BASB