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Re: IASB Exposure Draft on Hedge Accounting

Dear Mr. Flores,

Banco Bilbao Vizcaya Argentaria, S.A. appreciates the opportunity to provide you with our comments on two specific items related to the Hedge Accounting Exposure Draft ED/2010/13 issued in December 2010.

Hedge of equity instruments under the OCI option

According to the ED, the objective of hedge accounting is to represent in the financial statements the effect of an entity's risk management activities that use financial instruments to manage exposures arising from particular risks that could affect profit or loss. As gains and losses on equities under the OCI option would never be recycled to the income statement, these instruments are not valid hedged items.

However, some available for sale equity instruments are currently managed and hedged with the objective of achieving a certain level of gains in OCI, regardless whether those instruments are subsequently sold and the gains in OCI are recycled to P/L. OCI is part of the Equity of the entities and therefore, it has a direct impact in their solvency ratios. In other words, entities use valid hedging strategies for capital risk management purposes.

These available for sale equity instruments are valid hedged items under current IAS 39, resulting in an alignment between management practices and accounting (fair value hedge). If entities were not allowed to hedge these financial instruments, there would be volatility in P&L that would not reflect the true and fair view of the risk management activities, loosing the coherence that currently exists.

Therefore, we propose a model where instruments under the OCI option are eligible for hedge accounting and where the ineffectiveness of the hedge is recorded as part of the cost of the instrument being hedged. Therefore, the ineffectiveness of the instrument under the OCI option would never be recycled to profit or loss.

Hedge of forecast future results in net foreign operations

Current IAS 39 does not allow to do hedge accounting of forecast future results in net foreign operations as they are not included as hedged items. The ED does not change this approach and we consider that this issue should be reopened for discussion in the ED on hedge accounting.

There are two risks related to forecast results in foreign currency: translation risk and transaction risk. Both of them can be hedged:

1. Translation risk has traditionally been said to have only an accounting effect but it also has a very important economic effect; Exchange rates movements affect reserves and risk weighted assets, and therefore they will have a direct impact in all the components of the capital ratio. That is the reason why the exchange rates of future results are also being managed at Group level with a 2 or 3 years horizon.

2. Alternatively, transaction risk could be chosen to be hedged. This is the risk resulting from the exchange rate of future dividends from the subsidiary to the parent company. In this case companies want to assure favourable exchange rates for the cash that will be received from subsidiaries in the coming years. We consider that there is no conceptual reason why to wait to hedge those dividends until they are announced, as long as a good estimate can be done:

    - 2 or 3 years of forecasted results are predictable with a “highly probable” criterion, especially in retail businesses that are more stable.

    - Pay outs can also be predicted based on the entity strategy and group policy.

As a way to get closer to the “highly probable” criterion, companies should be able to hedge a percentage of forecast results based on the expertise of management and thus achieve a highly effective hedge.