European
Banking
Federation

Chief Executive

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Brussels, 19 March 2013

Subject: ***EBF comment letter on the EFRAG letter to IASB on the scope of exception for macro-hedging in IFRS9***

Dear Ms Flores,

In the EBF letter dated 21 February 2013 we commented, sharing your concerns, on the wording of paragraph 6.1.3 of the review draft «general hedging model».

It is important to consider the background of the issue of macro hedging and how it relates to IFRS9: Macro hedging was specifically expunged from the current draft IFRS9 standard so that other important and less complex areas could be addressed. The current draft of IFRS9 is focused from the perspective of single (i.e. non-macro) hedges, and we believe it is an improvement from IAS 39. The business model of all banks (our members) is that entities manage risk on an aggregate portfolio basis and hedge/manage the residual risk on a net basis which of course differs dramatically from the target of single hedgers. Because the aggregating and netting of risks is core to a bank's modern operations as also acknowledged and supported by regulators, our members require a robust solution to the macro hedging conundrum. We believe that the IASB given time and their continuing commitments and out-reach efforts will come to a good solution for all the stakeholders involved.

What we must consider is how core macro-hedging is to the understanding of a bank's financial performance. Given the importance of a bank's risk management and by extension macro-hedge accounting to understanding a bank's economic performance, we cannot allow during the transition period from IAS39 to IFRS9 of the macro-hedging standards a void in accounting guidance. Hence our strong opinion and desire to see the clear benefits of IFRS9 General Hedge Accounting implemented for the benefit of the members and, at the same time until macro-hedging is thoroughly addressed by the IASB, the application of all macro-relevant guidance from IAS39 (including the fair value hedge of portfolio of interest rate risk as well as the macro cash flow hedge) should be grandfathered.

The EBF thinks therefore that Paragraph 6.1.3 of the Review Draft can be written as follows:
"For transactions resulting from risk management of interest rate risk of open portfolios, hedging net positions operationally, but designated as fair value hedges of financial assets or financial liabilities, or cash flow hedges of exposures to cash flow mismatches (and only for

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those hedges), an entity may apply the hedge accounting requirements in IAS 39 instead of those in the IFRS.

As an accounting policy choice, the option must be disclosed in the notes. It is irreversible, until the IASB future text dedicated to those transactions becomes mandatory in the relevant jurisdiction of the entity."

That said, the proposed solution resulting from your draft letter to the IASB offers - in our view - some critical point that we would like to share with you.

More specifically, we stated in our letter of 21 February 2013 that the EBF does not object to the IASB's decision to decouple the general hedge accounting model from the macro-hedge accounting model since it is stated in the Review Draft that no specific accounting issues would be addressed for open portfolios or macro hedging (Paragraphs IN8(c.), BC6.9-15). In the EBF's view there is a contradiction between the goal of leaving current macro-hedge practices and the scope of the hedge accounting defined in the Review Draft. Indeed, since references in Paragraph 6.1.3 are limited to the notion of fair value hedge accounting, the Review Draft only scopes out fair value hedges from general hedge accounting. In addition, the Review Draft deletes some hedge-related paragraphs in IAS 39 including section F of the Implementation Guidance of IAS 39. This situation leaves the entities that currently apply the IAS 39 for macro cash flow hedge with uncertainty as there will no longer be specific paragraphs in the standard that they can point to."

In a new version of its draft, EFRAG opted for a different solution than our suggestion to scope out hedging relationships transacted within open portfolios.

On this basis, **EFRAG requires the IASB to write the scope exemption in IFRS 9 as an option to choose to comply either with IFRS 9 or IAS 39 for hedge accounting in its entirety.**

We believe that this solution, which could appear as a pragmatic one, has two main drawbacks:

1. It precludes an entity with macro hedging practices, to take advantage of the undoubted benefits of the new hedging requirements set by the general hedging model for their micro hedging relationship.

2. It will be difficult from the IASB standpoint to accept a partial implementation of a new standard. In our view, IASB could be more interested in moving over to the next step while temporally allowing some references to the old standard.

In more details, we question the analysis developed to reach the EFRAG's conclusion on a number of points.

The EFRAG's conclusion that macro hedging is not well defined is perhaps misleading. The term "macro hedging" is never in fact used in IFRS or in US GAAP, and therefore has to be defined for accounting purposes in the IASB project. Nevertheless, the term is clear when referred to ALM practice and risk management.

As a consequence of the prohibition of designating the real hedged risk as the hedged item in IAS 39, banks have chosen various solutions to accommodate their transactions arising from their risk management practices within the accounting requirements, depending on various factors as the structure of their balance sheet and information's systems development costs. Very few have used the "portfolio risk management of interest rate risk" exactly as described in IAS 39. Hence the narrow scope exception, as written in the Review Draft, would not easily allow the grandfathering of all the existing proxy accounting designations of the hedged items and of the hedging items.

In summary, the risk of improper use, which governs the reasoning of EFRAG in its final draft and leads to its proposal, is in our opinion de minimis and cannot lead to defining the scope exception. Further, we believe that the scope exception must be larger than the present wording in the review draft, as banks account for these operations under other paragraphs of IAS 39 than those dedicated to portfolio hedging of interest rate risk (81A, 89A, 92 and AG114-AG132). It must be based on risk management practices, taken into consideration in the review draft in paragraph IN 8 c) to be scoped out and yet described in the accounting literature under IAS 39 BC 176 b and IG F 6. Our recommended solution, as stated in our letter to EFRAG dated 21 February 2013, does not preclude entities with macro hedging activities from implementing the general hedging model for recording their stable micro hedging relationships as those arising from the medium long term liabilities. It will allow the same operations to be accounted for identically, whether the entity performs portfolio hedging for other relationships. It will avoid for example that the very same hedging relationship can be maintained under IFRS 9 in a non-financial company, but has be to be discontinued in a bank, because failing to satisfy the effectiveness range under IAS39. It will also avoid the accounting issues caused where IFRS 9 has more fully defined items that were implicit or poorly defined in IAS 39. For example, how a bank will account for hedges of cross currency funding (a very common practice) under EFRAG proposed solution? Does it follow the current practice under IAS 39 of designing adequately the hypothetical derivative or must consider the currency basis as cost of hedging as recently decided by the Board in its January 2013 session?

For all these rationales, we consider that the proposed option between IAS 39 and IFRS for all hedging transactions is unlikely to be acceptable by the IASB and very difficult to implement.

Yours sincerely,

Guido Ravoet