EFRAG
European Financial Reporting Advisory Group

[Draft Comment Letter]

Comments should be submitted by 21 February 2013 to Commentletters@efrag.org

xx Month 2013

International Accounting Standards Board
Attn. Hans Hoogervorst
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Sir,

Impact of the Review Draft general hedge accounting on macro hedge accounting

On behalf of the European Financial Reporting Advisory Group (EFRAG), I am writing to inform you about the impact of the Review Draft (RD) *IFRS 9 General hedge accounting* on existing macro hedge relationships under IAS 39. This letter is part of our reaction to the publication of the Review Draft but is sent to you separately given the importance of the issue for European companies.

This letter is intended to contribute to the IASB's due process and does not necessarily indicate the conclusions that would be reached by EFRAG in its capacity as advisor to the European Commission on endorsement of definitive IFRS in the European Union and European Economic Area.

In May 2012 the IASB Board tentatively decided to decouple hedge accounting for open portfolios (macro hedge accounting) from IFRS 9. As part of its work on the Review Draft, the Board did not address the specific accounting for open portfolios.

Many participants in our field test of the Review Draft, reported that it was unclear to them whether the requirements in the Review Draft would change the way they deal with macro hedge relationships.

Paragraph BC6.12 of the Review Draft states that the IASB decided '…not to address open portfolios or 'macro' hedging (i.e. hedging at the level that aggregates portfolios) as part of the exposure draft'. Paragraph BC6.15 of the Review Draft states'…that during the project on accounting for macro hedging the status quo of 'macro' hedge accounting under previous IFRSs would broadly be maintained so that entities would not be worse off in the meantime'.

EFRAG believes that the revised wording of paragraph 71 of IAS 39 does not allow the IASB to achieve the goal of maintaining the status quo of macro hedge accounting. EFRAG supports that goal and believes that the IASB decision to make the general hedge accounting requirements effective before it completes its work on macro hedging of open portfolios should not result in piecemeal changes to current macro hedge accounting practices (cash flow and fair value hedge accounting).

To avoid such piecemeal changes, the IASB would need to modify the wording of paragraph 71 of IAS 39 to allow current hedge accounting requirements for open portfolios to be maintained under what remains of IAS 39. Accordingly, the related Implementation Guidance in Section F *Hedging* directly relevant to macro hedging should also be maintained.

If you would like to discuss our comments further, please do not hesitate to contact Didier Andries, Marc Labat or me.

Yours sincerely,

Françoise Flores

EFRAG Chairman

Appendix – Analysis of the impacts of the Review Draft on macro hedge accounting

Notes to constituents

1 *The table below describes which requirements will apply to the various types of hedge relationships*

	Review Draft	***Ref.***
Open portfolios		
– Cash flow hedges (macro)	*Review Draft*	*(d)*
– Fair value hedges (macro)	*Macro hedging project*	*(b)*
Closed portfolios		*(a)*
– Cash flow hedges (micro)	*Review Draft*	*(a)*
– Fair value hedges (micro)	*Review Draft*	*(a)*
– Continually rolled-over hedges	*Review Draft*	*(a)*
Portfolio fair value hedge of interest rate risk	*Continue IAS 39 or apply Review Draft, but to be replaced by macro hedging*	*(c)*

(a) *Paragraph IN8(a) of the Review Draft states that 'The Board comprehensively reviewed the hedge accounting requirements in IAS 39 and replaced them with the requirements in IFRS 9.'*

(b) *Paragraph IN8(c) of the Review Draft states that 'The Board did not address specific accounting for* open portfolios or macro hedging *as part of the general hedge accounting requirements in IFRS 9.'*

(c) *Paragraph IN8(c) of the Review Draft states that '…the Board has not reconsidered the exception in IAS 39 for a fair value hedge of an interest rate exposure of a portfolio of financial assets or financial liabilities. That exception continues to apply (see paragraphs 81A, 89A and AG114-AG132 of IAS 39).' (See also paragraph 6.1.3 of the Review Draft)'.*

(d) *Paragraphs 81A and 89A of IAS 39 refer only to the notion of 'fair value hedge of the interest rate exposure' and exclude cash flow hedges.*

The consequential amendments made to IAS 39 and the reference of IFRS 9 to IAS 39 reflect the above described requirements:

The consequential amendments in the Review Draft retain paragraphs 72 to 102 of IAS 39 without change. However, paragraph 71 is modified as follows:

> *If an entity applies IFRS 9 (as issued in [Date] 2012) it shall apply the hedge accounting requirements in chapter 6 of IFRS 9. However, for a fair value hedge of the interest rate exposure of a portion of a portfolio of financial assets or financial liabilities, an entity may, in accordance with paragraph 6.1.3 of IFRS 9, apply the hedge accounting requirements in this standard instead of those in IFRS 9. In that case the entity must also apply the specific requirements for fair value*

hedge accounting for a portfolio hedge of interest rate risk (see paragraphs 81A, 89A and AG114-AG132). ~~*If there is a designated hedging relationship between a hedging instrument and a hedged item as described in paragraphs 85–88 and Appendix A paragraphs AG102–AG104, accounting for the gain or loss on the hedging instrument and the hedged item shall follow paragraphs 89–102.*~~

2 In addition, Section F Hedging of the Implementation Guidance to IAS 39 is deleted in its entirety by the consequential amendments in the Review Draft.

3 The effect of the changes to paragraph 71 of IAS 39 is that while most of the hedge requirements of IAS 39 – other than the Implementation Guidance – are preserved, they now only apply to fair value hedges of the interest rate exposures and not to any other types of hedge relationships.

4 Paragraphs 81A and 89A of IAS 39 refer to the narrow notion of 'fair value hedge of the interest rate exposure'. Consequently, if European companies only apply the EU carve out to those 'portfolio hedges of interest rate risk' then the revised wording of paragraph 71 of IAS 39 would not affect the working of the carve out. However, if the carve out is used for other types of hedges (e.g. cash flow hedges, or hedges of currency or commodity risks) then the revised paragraph 71 would deny those companies the use of IAS 39 and with it the use of the carve out.

5 Additionally, as the retained hedge requirements of IAS 39 only apply to fair value hedges of interest rate exposures, cash flow hedges of open and closed portfolios fall within the scope of the Review Draft. IASB staff Paper 4B Scope and interaction with macro hedging activities for the IASB meeting in January 2013 confirms this conclusion.

EFRAG's analysis

6 The comprehensive revision of IAS 39 includes reconsidering all aspects of hedge accounting. However, as the extracts below show, the decision of the IASB to consider general hedging separately from macro hedging was based on the distinction between hedging of closed and open portfolios:

(a) The Review Draft (paragraphs IN8(c) and BC6.9-15) specifically note that the draft requirements do not address specific accounting issues for open portfolios.

(b) Paragraph BC6.12 of the Review Draft states that 'The Board decided not to address open portfolios or 'macro' hedging (ie hedging at the level that aggregates portfolios) as part of the exposure draft. The Board considered hedge accounting only in the context of groups of items that constitute a gross or net position for which the items that make up that position are included in a specified overall group of items.'

(c) In addition, paragraph BC6.15 of Review Draft states that 'The Board noted that this is a complex topic that warrants thorough research and input from constituents. Accordingly, the Board decided to separately deliberate accounting for macro hedging as part of its active agenda with the objective of issuing a discussion paper. The Board noted that this would enable IFRS 9 to be completed more quickly and would enable the new 'general' hedge accounting requirements to be available as part of IFRS 9. The Board also noted that during the project on accounting for macro hedging the status quo of 'macro' hedge accounting under previous IFRSs would broadly be maintained so that entities would not be worse off in the meantime.'

(d) Also, paragraph IN8(c) of the Review Draft states that 'The Board did not address specific accounting for open portfolios or macro hedging as part of the general hedge accounting requirements in IFRS 9. The Board is discussing proposals for accounting for open portfolios and macro hedging as part of its active agenda with the objective of issuing a discussion paper. Consequently, the Board has not reconsidered the exception in IAS 39 for a fair value hedge of an interest rate exposure of a portfolio of financial assets or financial liabilities. That exception continues to apply (see paragraphs 81A, 89A and AG114-AG132 of IAS 39).'

(e) Finally, the stated objective of the project Accounting for macro hedging is '…to simplify and improve the usefulness of financial statements by developing accounting requirements for hedging within the context of open portfolios that are more closely aligned with a company's risk management activities.'

7 Initial EFRAG's recommendation was that IFRS 9 should be completed, including macro hedging requirements. Following the IASB's decision to delay the revision of macro hedging requirements, EFRAG believes that:

(a) It is essential that the IASB sticks to its objective and announcements that the status quo of current macro hedge accounting under IAS 39 be maintained; this to avoid unnecessary implementation costs for companies;

(b) Macro hedge accounting (i.e. accounting requirements for hedging within the context of open portfolios) should consider comprehensively the various practices and stakeholders' needs. In particular, the question whether the use of different requirements for open portfolios should be limited to the narrow exception of the fair value hedge of interest rate risk remains to be submitted to a full due process. EFRAG would expect the upcoming Discussion Paper to argue for the scope of the revised macro hedge accounting requirements.

8 EFRAG believes that the revised wording of paragraph 71 of IAS 39 does not allow the IASB to achieve its goal of maintaining the status quo of macro hedge accounting. EFRAG supports that goal and believes that the IASB decision to make the general hedge accounting requirements effective before it completes its work on macro hedging of open portfolios should not result in piecemeal changes to current macro hedge accounting practices (cash flow and fair value hedge accounting).

9 To avoid such piecemeal changes, the IASB would need:

(a) to modify the wording of paragraph 71 of IAS 39 to allow for current hedging requirements applicable to open portfolios to be available under what remains of IAS 39;

(b) to maintain the related implementation guidance in Section F directly relevant to macro hedging. Indeed although the implementation guidance has no authoritative status, deletion of some parts of it creates a change. This would be contrary to the objective of leaving current macro hedge practices as they are, and such a change would induce uncertainty.