

Date

Le Président

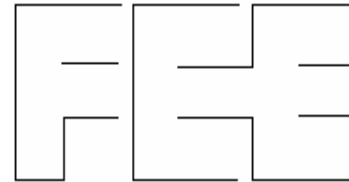
Fédération
des Experts
Comptables
Européens
AISBL

Av. d'Auderghem 22-28/8
1040 Bruxelles
Tél. 32 (0) 2 285 40 85
Fax: 32 (0) 2 231 11 12
E-mail: secretariat@fee.be

16 January 2008

Mr. Stig Enevoldsen
Chairman
Technical Expert Group
EFRAG
Avenue des Arts 13-14
B-1000 BRUXELLES

commentletter@efrag.org



Dear Mr. Enevoldsen,

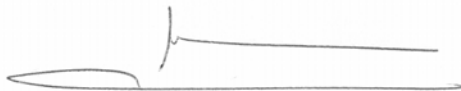
Re: EFRAG Draft Comment Letter on IASB Exposure Draft of Proposed Amendments to IAS 39 Financial Instruments: *Recognition and Measurement* Exposures Qualifying for Hedge Accounting

1. FEE (Fédération des Experts Comptables Européens, European Federation of Accountants) is pleased to submit its comments on the EFRAG Draft Comment Letter on the IASB Exposure Draft of Proposed Amendments to IAS 39 Financial Instruments: *Recognition and Measurement* Exposures Qualifying for Hedge Accounting (the ED).
2. We support the Board's intention to clarify exposures eligible for hedge accounting in order to converge the divergences in practice. However, we share EFRAG reservation on whether it is appropriate to amend the main body of IAS 39 by defining the items eligible to hedge accounting on the basis of a limited list of risks and portions.
3. Furthermore, based on the response of EFRAG to Question 1, we question whether the suggestion made by EFRAG of simply moving the proposed amendment of paragraph 80 from the main body of the standard to the application guidance section is a comprehensive solution. In our view, it would appear preferable that the standard be amended to set out the principles to be applied in assessing whether a risk is eligible for hedge accounting of financial instruments, for example on the basis of the main criteria established in the standard on what constitutes a qualified hedging relationship: designation of fair value or contractual cash-flow, effectiveness, ... The application of these underlying principles could then be illustrated in the AG by the examples currently proposed.
4. Consequently, we do not support the proposed amendments, which add more rules to IAS 39 whereas IAS 39 in our view is already too rules-based and we strongly believe a principle-based solution to this key issue based on the requirements of predictability and separate measurability (see IAS39 AG100) can be found, since the rules-based approach will hardly form an effective solution in the current rapidly developing diversity of financial instruments and hedging practices. Such new principle-based solution should clarify what risks qualify for designation as hedged risks when an entity hedges its exposure to a financial instrument, and which portions of a financial instrument an entity may designate as a hedged item. We noticed that EFRAG also prefers such approach and would propose to stress this more clearly in the comment letter.

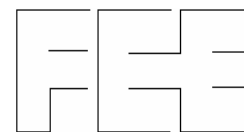
5. In case the Board adheres to the current approach despite of the key concerns stated above, apart from this preliminary remark we agree with most of the detailed observations mentioned by EFRAG even if we feel that the EFRAG Draft Comment Letter could benefit from being shortened in order to better highlight the key comments on the ED. In our opinion, the EFRAG Draft Comment letter could emphasise that providing a limited list of risks eligible to hedge accounting may result in unjustified restrictions. This is illustrated as detailed in paragraph 4 in the Appendix of the EFRAG Draft Comment Letter by the omission of the equity risk, particularly because separate hedging of the equity risk for equities denominated in foreign currency should be allowed in practice. Another undesirable consequence of stipulating the risks that can be hedged is that the list could become obsolete sooner or later.
6. We are of the opinion that EFRAG could usefully include a comment on the clarity of the guidance provided in AG99E-amended in its draft comment letter. FEE considers that this guidance is unclear since it does not deal specifically with hedging with options which is however the issue dealt with by IFRIC which led to its inclusion in this ED. It seems that the IASB considers that hedging a portion of cash-flows of a financial instrument and hedging only certain risks such as the downside or the upside risk are part of the same issue, without taking into consideration the specificities of one side risk hedging strategies. In particular, there is no guidance on how to compute the changes in fair value of the cash flows of the hedged item when hedged with options, i.e. what about the distribution of probabilities of the hedged cash flows? We also have the impression that using the hypothetical derivative method for assessing hedge effectiveness when hedging with options would not be allowed even if such a method is explicitly permitted in IAS 39-IGF5.5 for interest rate swaps and IAS 39-IGF5.6 for forward contracts for effects comparable to the time value of an option. For these reasons, we would suggest that the IASB redrafts this paragraph in order to deal specifically with the issue of hedging with options. We suggest that EFRAG caveats its support for AG99E accordingly.
7. The ED does not deal with hedging of non-financial instruments. However, we believe that there should be a balanced approach in that the hedging of both financial and non-financial instruments should be addressed in the same way.
8. Our responses to the Invitation to comment of the ED are presented in the Appendix to this letter.

We would be pleased to discuss any aspect of this letter that you may wish to raise with us.

Yours sincerely,



Jacques Potdevin
President



APPENDIX

Responses to the Invitation to comment

Question 1 – Specifying the qualifying risks

The proposed amendments restrict the risks qualifying for designation as hedged risks to those identified in paragraph 80Y.

Do you agree with the proposal to restrict the risks that qualify for designation as hedged risks? If not, why? Are there any other risks that should be included in the list and why?

Draft EFRAG comments on the IASB approach to the proposed amendment to restrict risks and portions eligible for hedge accounting

In contrast to EFRAG, FEE does not support the IASB's proposed amendments. In our view, it would appear preferable that the standard be amended to set out the principles to be applied in assessing whether a risk is eligible for hedge accounting of financial instruments, for example on the grounds of the main features mentioned in the standard on what constitutes a qualified hedging relationship: designation of fair value or contractual cash-flow, effectiveness, etc. The application of these underlying principles could then be illustrated in the AG by the examples currently proposed.

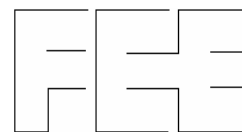
We agree with EFRAG's observations on a rules-based approach. We understand the logic for the reasons given for not finding convincing the advantages provided in the basis for conclusion (paragraph BC13) as a justification for the rule based approach proposed, as detailed in paragraph 1 in the Appendix of the EFRAG Draft Comment Letter.

However, based on the response of EFRAG to Question 1, we question whether the suggestion made by EFRAG of simply moving the proposed amendment of paragraph 80 from the main body of the standard to the application guidance section is a comprehensive solution. We also believe that this part of the EFRAG Draft Letter would benefit from being shortened.

We agree with the IASB that as a general principle hedging a risk that does not exist in the hedged item should not be allowed. Accordingly, we do agree that it is not possible to identify inflation as an eligible risk component in a fixed rate instrument. However, we disagree with paragraph 80Y(e) as it is currently drafted even if we recognize that it addresses the issue of hedging inflation in a fixed rate instrument. In particular, we are unsure whether this limitation could note have unintended consequences on certain hedge relationships that have not yet been identified. Also we are uncomfortable with the new notions introduced by the IASB in § 80Y(e) since they do not apply for example to hedging credit risk. It is impossible to say that credit risk corresponds to a risk associated with contractually specified cash flows or it is not a residual component. We believe that the IASB should redraft more carefully § 80Y(e) and clarify the underlying principle. This is the reason why, although we recognise that the proposition made by EFRAG in paragraph 2 of its draft comment letter is useful, we believe that this does not sufficiently address all the concerns we expressed above.

We support EFRAG's observation on the fact that equity risk is missing from the list of risks eligible to be designated as hedged risks under hedge accounting provisions of IAS 39, as detailed in paragraph 4 in the Appendix of the EFRAG Draft Comment Letter. We believe that this remark should also be included in the covering letter.

We support EFRAG's comment in paragraph 5 on the inconsistency in the list of risks in paragraph Y. We suggest that this remark should also be highlighted in the covering letter.



Question 2 – Specifying when an entity can designate a portion of the cash flows of a financial instrument as a hedged item

The proposed amendments specify when an entity can designate a portion of the cash flows of a financial instrument as a hedged item. Do you agree with the proposal to specify when an entity can designate a portion of the cash flows of a financial instrument as a hedged item? If you do not agree, why? Are there any other situations in which an entity should be permitted to designate a portion of the cash flows of a financial instrument as a hedged item? If so, which situations and why?

While we agree with the overall comments made by EFRAG, we have the same observations as mentioned in question 1. We consider that it would be preferable to ask the Board to define a principle enabling an entity to identify a portion instead of stating a limited list of hedgeable portions.

Question 3 – Effect of the proposed amendments on existing practice

The aim of the proposed amendments is to clarify the Board's original intentions regarding what can be designated as a hedged item and in that way to prevent divergence in practice from arising. Would the proposed amendments result in a significant change to existing practice? If so, what would those changes be?

We refer to our general remarks in paragraph 2 and 3 of the covering letter.

We share EFRAG's comments on the fact that the proposed treatment for inflation should not lead to important restatements because we are not aware of a divergence in existing practice.

We agree that there is currently some divergence in practice in designating in a hedge relationship the time value of a hypothetical written option as further discussed in paragraph 6 of covering letter and would prefer an explicit solution in line with the needs of preparers of financial statements rather than creating a further difference to US GAAP.

Question 4 – Transition

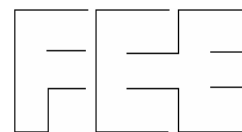
The proposed changes would be required to be applied retrospectively.

Is the requirement to apply the proposed changes retrospectively appropriate? If not, what do you propose and why?

We agree with EFRAG's general position to prefer the retrospective application of the changes in standards rather than prospective application, as long as retrospective application does not cause practical problems that cannot be overcome by a longer lead-time. However, we also agree with EFRAG's comments that, as far as the proposed amendments are concerned, retrospective application would not be possible in some circumstances, as detailed in paragraph 8 in the Appendix of the EFRAG Draft Comment Letter.

Question to constituents:

- (a) Do you support retrospective application of the amendments proposed in the exposure draft despite of the consequences as described above?
- Or
- (b) Do you believe that prospective application would be more appropriate in so far that entities would be able to keep their designations until the effective date of these amendments, but would have to redesignate all previously designated hedge relationship in accordance with the new requirements going forward from the effective date of the amendments? If you do believe this is more appropriate, please explain your reasoning.



On the basis of the practical issues that can arise, we do not support retrospective application of the amendments proposed in the ED. Companies that have applied IAS 39 in good faith before should not be forced to go back and reconsider what they have done before.

We favour response (b), as we believe that such application would be more appropriate in practice. In particular, when a change would affect the way to document hedge relationships, it would be difficult to do this retrospectively, as the documentation needs to be made at inception in order to apply hedge accounting.

Other EFRAG draft comments

Question to constituents:

Do you agree with EFRAG that the proposed guidance in AG99E is appropriate? If not, do you believe that hedge accounting provisions in IAS 39 should make it possible to designate option contracts in their entirety and designate time value of a hypothetical written option as part of the hedged item. Thus, when measuring hedge effectiveness and determining to which extent the hedge is effective, time value of a hypothetical written option would be included in estimation of changes in present value of cash flows of the hedged item attributable to the hedged one-sided risk? If so, how would you justify appropriateness of this method under IAS 39?

We do not agree with EFRAG that the proposed guidance in AG99E is appropriate. We are of the opinion that EFRAG could usefully include a comment on the clarity of the guidance provided in AG99E-amended in its draft comment letter. FEE considers that this guidance is unclear since it does not deal specifically with hedging with options, which is however the issue dealt with by IFRIC that led to its inclusion in this ED. It seems that the IASB considers that hedging a portion of cash-flows of a financial instrument and hedging only certain risks such as the downside or the upside risk are part of the same issue, without taking into consideration the specificities of one side risk hedging strategies. In particular, there is no guidance on how to compute the changes in fair value of the cash flows of the hedged item when hedged with options, i.e. what about the distribution of probabilities of the hedged cash flows? We also have the impression that using the hypothetical derivative method for assessing hedge effectiveness when hedging with options would not be allowed even if such a method is explicitly permitted in IAS 39-IGF5.5 for interest rate swaps and IAS 39-IGF5.6 for forward contracts for effects comparable to the time value of an option. For these reasons, we would suggest that the IASB redrafts this paragraph in order to deal specifically with the issue of hedging with options. We suggest that EFRAG caveats its support for AG99E accordingly.

The ED does not deal with hedging of non-financial instruments. However, we believe that there should be a balanced approach in that the hedging of both financial and non-financial instruments should be addressed in the same way.