



OICV-IOSCO

Organización Internacional de Comisiones de Valores  
International Organisation of Securities Commissions  
Organisation internationale des commissions de valeurs  
Organização Internacional das Comissões de Valores

January 18, 2008

Exposure Draft of Proposed Amendments to IAS 39 Financial Instruments: Recognition and Measurement; Exposures Qualifying for Hedge Accounting  
International Accounting Standards Board  
30 Cannon Street  
London EC4M 6XH  
United Kingdom

**RE: Exposure Draft -- Exposures Qualifying for Hedge Accounting**

Dear IASB Members:

The International Organization of Securities Commissions (IOSCO) Standing Committee No. 1 on Multinational Disclosure and Accounting (Standing Committee No. 1) thanks you for the opportunity to provide our comments regarding the International Accounting Standards Board (IASB or the Board) Exposure Draft on Exposures Qualifying for Hedge Accounting (the Exposure Draft or the ED).

IOSCO is committed to promoting the integrity of international markets through promotion of high quality accounting standards, including rigorous application and enforcement. Members of Standing Committee No. 1 seek to further IOSCO's mission through thoughtful consideration of accounting and disclosure concerns and pursuit of improved transparency of global financial reporting. The comments we have provided herein reflect a general consensus among the members of Standing Committee No. 1 and are not intended to include all of the comments that might be provided by individual securities regulator members on behalf of their respective jurisdictions.

**General Observation**

Standing Committee No. 1 is supportive of accounting guidance that is both principles-based and conducive to consistent application thereby satisfying users' general desire for comparability. We also acknowledge that in some circumstances, preparers and auditors of financial statements find the current hedge accounting guidance, included in International Accounting Standard No. 39 *Financial Instruments: Recognition and Measurement* (IAS 39) to lack clarity sufficient to promote consistent application of the hedge accounting principles. Therefore, we fully support the IASB's consideration and issuance of additional hedge accounting guidance.

Calle Oquendo 12  
28006 Madrid  
ESPAÑA  
Tel.: (34.91) 417.55.49 • Fax: (34.91)  
555.93.68  
mail@oicv.iosco.org • www.iosco.org

However, we find the ED's objectives identified in the Introduction and the proposed amendments to IAS 39 do not necessarily align. Specifically, paragraphs 2(b) and 3 of the ED state that the proposed amendments specify *when* an entity may designate a portion of the cash flows of a financial instrument as a hedged item. However, proposed paragraph 80Z focuses on *what portions* of the cash flows of a financial instrument may be designated as a hedged item. For improved clarity, we suggest that in a final standard, the IASB modify any introductory paragraphs that describe the amendments to refer to *what portions* of cash flows can be hedged, rather than *when* a portion of cash flows can be designated. (Please also refer to our response to Question 2 below.) Additionally, we believe the proposed guidance, and in particular the amplifying amendments included in the Application Guidance, can be improved without creating more criteria. Additional improvement suggestions are included below in response to the questions posed in the ED.

### **Responses to the Board's Questions**

**Question 1:** *Do you agree with the proposal to restrict the risks that qualify for designation as hedged risks? If not, why not? Are there any other risks that should be included in the list and why?*

We are supportive of the ED's proposed paragraph 80Y restrictions on risks that qualify for designation. However, we believe the proposed guidance could be enhanced if the Application Guidance addressed the following items:

1. *Paragraph AG99BB:* We appreciate that hedge effectiveness is improved by expressly permitting a portion of the hedged cash flows to serve as the hedged item. However, in that situation, it is not sufficiently clear how an entity would measure hedge ineffectiveness, even for the example given in paragraph *AG99BB*. In the example, is it the Board's intent that ineffectiveness be measured by comparing the changes in value due to a change in LIBOR on an instrument with the same notional amount as the actual instrument (e.g., CU1,000), but with a fixed interest rate of 7%, to the changes in value of the swap due to changes in LIBOR? Or does the Board intend the guidance to require that ineffectiveness be measured by comparing changes in LIBOR relative to the hedging instrument and the specific cash flows of the original instrument equivalent to the hedging instrument's contractual return? Additional discussion clarifying the Board's expectations as to how ineffectiveness should be measured in situations when it is not a specific identifiable subset of cash flows or a fixed proportion of all future cash flows that are hedged may be a simple yet effective improvement to the proposed amendment.
2. *Paragraphs AG99BA through AG99C:* The Board should clarify the last sentence of paragraph AG99BA to explain whether the prohibition against a designated risk that in the aggregate exceeds the total risk of the hedged financial instrument is applicable only to hedges of specific risks or to hedges of all risks or both. Without additional clarification, the interaction between paragraphs AG99BA through AG99C may be confusing to some. For example, a LIBOR minus 100 basis point instrument, which has all of its cash flows hedged with respect to LIBOR interest rates using a LIBOR instrument, may appear to some as hedging risks that exceed the total risk of the hedged instrument. Further, the examples in paragraphs AG99BB and AG99C could be improved to explain exactly how that last sentence in paragraph AG99BA is to be applied in circumstances where there appears to be an element of "overhedging" of the cash flows for one type of risk but not for other risks.

3. *Net Investment Hedges*: The guidance should clarify how hedges of net investments might apply the restrictions in paragraph 80Y. If the Board believes an instrument can hedge specific risks (for example foreign currency or credit risk) of a net investment hedge, an additional clarifying sentence would be helpful.

**Question 2:** *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?*

Please refer to our general observation above. We have two additional concerns. First, could the guidance in paragraph 80Z(d) that provides for *any* independent contractually specified cash flow to be the hedged portion effectively trump paragraph 80Y? We believe that it would be helpful for the Board to add the phrase “subject to the restrictions in paragraph 80Y” to the beginning of the first sentence of paragraph 80Z. Second, if the Board were to provide guidance on *when* a hedge relationship could begin, some questions on which we would like further guidance include:

- Can a fair value hedge relationship begin subsequent to inception of the hedged item?
- Is partial term fair value hedging appropriate? (If yes, we note that IAS 39 would be divergent from US GAAP on this point.)
- Are there specific amounts of fair value, of the hedged item, that may be eligible to be hedged?

**Question 3:** *Would the proposed amendments result in a significant change to existing practice? If so, what would those changes be?*

We believe that preparers of financial statements are in the best position to determine the extent that this guidance will be operational and may impact existing hedging practices. While we are not in a position to make a conclusive determination on this point, we are aware that the FASB has struggled in the past with this issue in the context of their Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities*, because of a lack of suitable inflation indices available to measure effectiveness. It is our understanding that often inflation indices are not derived from market data (often involving groups of goods and services) whose changes in value are sufficient to imply a correlation between that collective index and the risk inherent in the hedged item. For example, a market data grouping that includes consumer goods may not correlate with inflation increases related to certain precious metals. We also note that designation of inflation risk as a hedged risk under IAS 39 is divergent from US GAAP.

**Question 4:** *Is the requirement to apply the proposed changes retrospectively appropriate? If not, what do you propose and why?*

As noted in International Accounting Standard 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, retrospective application of new accounting literature provides users of financial information more relevant and comparable decision-useful information, and therefore we would not object to the ED’s proposed transition. To improve the clarity of the finalized guidance, the amplifying text in paragraph BC15, that explicitly states that retrospective application is required, should be included in paragraph 108C of IAS 39.

January 18, 2008

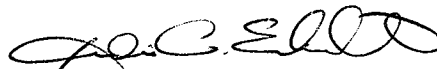
Finally, assuming retroactive application it is not clear how an entity would retroactively apply the proposed guidance. Therefore, the Basis for Conclusions should address potential application issues such as whether:

- Entities are permitted to re-construct hedging relationships that were previously determined to not be eligible for hedge accounting prior to the issuance of this guidance? *We do not believe reconstruction of undesignated hedging relationships should be eligible for retroactive application.*
- Entities are permitted to amend the hedged item and identify a specific portion of the cash flows, rather than all of the risk, thereby potentially mitigating previously reported earnings volatility? *We do not believe reconstruction of existing hedging relationships should be eligible for retroactive application.*
- Pre-existing hedging relationships that as a result of the guidance in the ED no longer qualify for hedge accounting would now be considered a change in accounting principle or an accounting error? *We would support treatment as a change in accounting principle provided disclosure of why the hedging relationship was previously considered to be permitted under IAS 39.*

\* \* \* \*

We appreciate your thoughtful consideration of the comments raised in this letter. If you have any questions or need additional information on the recommendations and comments that we have provided, please do not hesitate to contact me at 202-551-5300.

Sincerely,



Julie A. Erhardt  
Chairman

IOSCO Standing Committee No. 1