The Hundred Group
of Finance Directors

Financial Reporting Committee

Sir David Tweedie
Chairman
International Accounting Standards Board
30 Cannon Street
London
EC4M 6XH

31 March 2011

Dear Sir David

Exposure Draft: Hedge Accounting

We are pleased to submit our comments on the above proposals.

Who we are
The Hundred Group represents the views of the finance directors of the UK's largest companies drawn largely, but not entirely, from the constituents of the FTSE100 Index. Our members are the finance directors of companies whose market capitalisation collectively represents over 80% of that of companies listed on the London Stock Exchange. The views expressed in this letter are not necessarily those of all of our individual members or of their respective employers.

Summary
Overall we are strongly supportive of the progress made by the Board and the direction of development of the current proposals, in particular the Board's objective to more closely align risk management and financial reporting of the same activities. We feel that this will result in financial statements that are more relevant to investors, and are more reflective of the underlying activities undertaken by management. In addition we believe that the proposals will make hedge accounting more flexible and therefore more accessible to preparers.

We are also supportive of a converged IFRS and US GAAP requirement for hedge accounting and believe that the current proposals are a significant improvement on current IFRS or US GAAP hedge accounting requirements, or the more limited changes on hedge accounting that the US Financial Accounting Standards Board have proposed in their recent due process documents.

We do however have concerns about practical application of the principles set out in the ED and believer that further guidance is required. In particular, the challenge of making the link between risk management and the proposed accounting is fundamental throughout the various elements of the ED.

In our view the individual accounting hedges in aggregate, at the level at which the risk is managed, should reflect the application of the overall risk management strategy as documented by the entity and as reported to and reviewed by senior management for risk management purposes. This will naturally vary between different entities depending on their management structures and the nature of the risks being managed, but should be consistent with the determination of the business model in IFRS9 (so above the individual instrument level).

Our specific answers are included in the appendix, but in summary our views are as follows:

- Whilst we are supportive of the Board's proposals to align risk management and financial reporting, we believe that limiting hedge accounting to exposures that only affect profit or loss items limits the usefulness of the standard both to investors and to users as this will create a deviation between management intent and practice and financial reporting thereby contradicting the underlying objective of the ED. We also believe it is inconsistent with the Board's objective of considering one performance statement of income, expenses, gains and losses.

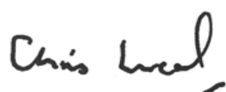
- We consider that the rebalancing proposals are confusing and complicated. In addition, if rebalancing is not part of the risk management objective of entities we do not consider it appropriate to require rebalancing. Instead we continue to support the current de-designation rules in IAS 39,which we believe more strongly aligns the approach taken by management and accounting. We also have concerns about the practical elements of rebalancing including audit implications.

- We do not believe it appropriate for the final standard to prohibit hedge accounting for credit risk and inflation risk. The standard indicates that if a risk is separately identifiable and reliably measureable it should be eligible for hedge accounting and permits hedge accounting for non-financial items. This practice has worked well for financial items, and has resulted in appropriate recognition and measurement of ineffectiveness. In our opinion, if an entity can separately identify and reliably measure a risk component, and the entity is then hedging that risk, hedge accounting should be permitted for it.

- Regarding disclosures we support a holistic approach to disclosures and are concerned that the current proposals have the potential to lead to extensive and excessive disclosures within financial statements. In addition the disclosure requirements focus on items that have been hedge accounted, whereas items which have not been hedge accounted for or are not hedged at all can outweigh the size and impact of those that have. A more principles based approach to disclosure could help reduce potentially confusing complexity in our financial statements. On completion of IFRS9 we would ask the Board to review the disclosures in totality and alongside those required in IFRS7. In particular we do not support the requirements to include disclosures on the face of the balance sheet if they are not material.

Please feel free to contact me if you wish to discuss our comments on the proposals.

Yours sincerely



Chris Lucas
Chairman
The Hundred Group - Financial Reporting Committee

APPENDIX

Question 1: Do you agree with the proposed objective of hedge accounting? Why or why not? If not, what changes do you recommend and why?
We are generally supportive of the proposed objectives of hedge accounting to align hedge accounting to risk management activities and the financial reporting of these activities, and believe that this will provide more relevant, meaningful information to our investors. We also support the Board's proposals that the use of hedge accounting should be voluntary.

We do however have some concerns that we set out below.

We believe that limiting hedge accounting to exposures to particular risks that could only affect profit or loss limits the usefulness of this information to investors. We agree that hedge accounting is medication of the normal recognition and measurement requirements. However, the use of financial instruments in hedging risk exposures is not limited to items that might affect profit or loss, and therefore such a limitation is in direct conflict to the Board's stated objectives. We also believe it undermines the position of the IASB that the OCI is a key component of financial reporting.

We urge the board to provide further clarity over the risk management approach it foresees to be applied to entities. In our view the accounting for individual hedges should, in aggregate, reflect the application of the overall risk management strategy at the level at which the risk is managed as documented by the entity and as reported to and reviewed by senior management for risk management purposes. This will naturally vary between different entities depending on their management structures and the nature of the risks being managed, but should be consistent with the determination of the business model in IFRS9 (so above the individual instrument level). The ED, however, considers, on the whole, individual risks covered by individual instruments. For many of our members risk management is approached on an aggregated basis rather than individual transaction basis. By excluding portfolio hedges we are concerned that this could limit the wider acceptance and relevance of the ED.

The Board should also clarify the impact of the proposals at the individual entity level and the consequences on subsidiary units where the risk management strategy is established at Group level. We would consider it inappropriate for the standards to require separate risk management for each legal entity if this is not considered appropriate by a group's management.

Question 2: Do you agree that a non-derivative financial asset and a non-derivative financial liability measured at fair value through profit or loss should be eligible hedging instruments? Why or why not? If not, what changes do you recommend and why?
Yes, on the basis that this is aligned with the entity's risk management strategy, we believe that such assets and liabilities should be eligible hedging instruments.

We would also ask the Board to consider further extending the definition of eligible hedging instruments as in practice other items may be used as part of a valid risk management strategy and excluding them from the definition of hedging instruments would be inconsistent with the principle of aligning risk management objectives with accounting.

Question 3: Do you agree that an aggregated exposure that is a combination of another exposure and a derivative may be designated as a hedged item? Why or why not? If not, what changes do you recommend and why?
Yes, we agree with the combination of aggregated exposures and a derivative as a hedge item as this allows the accounting to reflect what can be a practical way to hedge the different risks that underlie the item.

We would encourage the board to consider if further guidance is required for those entities that manage changes in the hedging relationship by layering derivatives on derivatives where significant complexity arises from the interaction between hedge accounting mechanisms. We believe it would be appropriate for the Board to consider additional application guidance to prevent divergence of practice.

Question 4 Do you agree that an entity should be allowed to designate as a hedged item in a hedging relationship changes in the cash flows or fair value of an item attributable to a specific risk or risks (ie a risk component), provided that the risk component is separately identifiable and reliably measurable? Why or why not? If not, what changes do you recommend and why?
Yes, we agree that an entity should be allowed to designate a component risk as the hedged item, predominantly as again this permits the accounting to be tied to the practical risk management undertaken by management.

The Board may wish to consider further guidance in order to ensure consistency of application and there should be appropriate guidelines stipulating that the movement in the hedged risk component cannot simply be equal to the movement in the hedging instrument (e.g. such as an assumption that a credit default swap price simply mirrors the credit component of a loan). To be eligible, an entity must be able to demonstrate the different elements and inputs that contribute to the price and movement of the hedged component.

While we support the more principles based approach to determining the risk components based on the evaluation of the facts and circumstances, however we do not agree with the bright line that inflation and credit risk cannot be designated as a risk component of a financial instrument unless it is contractually specified. Whilst it may be difficult to separately identify and reliably measure inflation as a risk component, each entity should be able to determine whether they can do this rather than prohibit it within the ED. In addition, no such restriction exists for non-financial items which results in an inconsistency with the treatment for financial items. This will also provide the necessary flexibility to enable the current accounting standards framework to prevail into the future.

We are aware of instances where inflation is not contractually specified, including in the utility industry where inflation may be specified for the first, say, 5 years of a contract but not after this point, but the full contract is to be hedged. We would urge the Board to reconsider their conclusions in this area.

Question 5

(a) Do you agree that an entity should be allowed to designate a layer of the nominal amount of an item as the hedged item? Why or why not? If not, what changes do you recommend and why?
We agree that this should be allowed within the ED. We believe that layering is critical for the macro hedging accounting model and we are likely to comment further when we understand these proposals.

We do have a concern that the technical language within the standard is complex and that the idiosynchronies may be challenging for accountants whose first language is not English.

(b) Do you agree that a layer component of a contract that includes a prepayment option should not be eligible as a hedged item in a fair value hedge if the option's fair value is affected by changes in the hedged risk? Why or why not? If not, what changes do you recommend and why?

No, we do not believe that this is an appropriate exclusion from hedge accounting. We believe that layer components that include prepayment options should be eligible hedged items and that all risk components should be eligible hedged items provided that they are separately identifiable and reliably measurable.

This is a more significant issue in the context of macro hedging and further consideration needs to be given to whether this restriction is appropriate in the context of portfolios.

Question 6: Do you agree with the hedge effectiveness requirements as a qualifying criterion for hedge accounting? Why or why not? If not, what do you think the requirements should be?

We support the removal of the 80-125% 'bright line' test to determine whether a hedging relationship qualifies for hedge accounting. We agree with the views expressed in paragraph BC77 of the ED that the 'bright line' assessment criteria is difficult and onerous and does not reflect an entity's risk management strategy. We also support the elimination of retrospective effectiveness testing.

We believe that the removal of these restrictions will increase the accessibility of hedge accounting.

Paragraph 19(c) and paragraphs B27-B39 require that the hedging relationship meets the hedge effectiveness requirements. A clearer explanation of the objective of hedging effectiveness assessment would be helpful to preparers particularly around the references to an 'unbiased' result and minimise hedge ineffectiveness, which some may view as implying 100%, or close to 100%, effectiveness. We understand that this was not the Board's intention, and such an interpretation would not reflect the practical or operational realities of risk management.

There is currently a danger of disconnection between the risk management view of hedge effectiveness and the accounting conclusions which would lead to a departure from the ED's stated objectives.

Question 7

(a) Do you agree that if the hedging relationship fails to meet the objective of the hedge effectiveness assessment an entity should be required to rebalance the hedging relationship, provided that the risk management objective for a hedging relationship remains the same? Why or why not? If not, what changes do you recommend and why?

We are concerned that the current proposals could be considered complex, confusing and inconsistently applied.

We agree with the introduction of the concept of rebalancing as this acknowledges that a company can, and in fact does, make adjustments to hedge relationships without the need to discontinue and then re-designate a new hedge in order to achieve hedge accounting.

However, we do have concerns based on the current level of guidance over the practical application of rebalancing and would urge the Board to consider increased guidance as we are concerned that current guidance has the potential to create divergence in practice. In particular we are concerned that the current guidance does not provide for the distinction to be drawn between temporary and permanent changes in performance assessment. It is also not clear to us how an entity's specific risk appetite should be built in to rebalancing

procedures. Entities with a high risk appetite could legitimately continue to consider a hedging relationship to be effective in circumstances that other entities could consider to be unperforming. This could lead to significant differences in application of accounting between entities. We would ask for clarification over the Board's intent in these situations.

We would also ask the Board to reconsider if rebalancing should be mandatory. Under the current proposals we do not consider that this is necessary or appropriate. We believe that rebalancing should not be mandated but should be aligned with the risk management approach taken by management, and as set out in the principles of the ED.

(b) Do you agree that if an entity expects that a designated hedging relationship might fail to meet the objective of the hedge effectiveness assessment in the future, it may also proactively rebalance the hedge relationship? Why or why not? If not, what changes do you recommend and why?

Yes, we agree that proactive rebalancing is appropriate and should be permitted as this will contribute towards the matching of risk management and accounting. However for entities that engage in manifold complex hedging relationships where risk exposures change on a daily basis, the rebalancing proposals could result in a substantial number of layers of separate hedge accounting relationships, which become very difficult to manage operationally. Thus rebalancing should also be supported by an ability to discontinue hedge accounting on a voluntary basis, to allow reasonable flexibility for an entity to discontinue hedge accounting relationships and replace with new hedge accounting relationships in line with their own risk management strategy.

Question 8

(a) Do you agree that an entity should discontinue hedge accounting prospectively only when the hedging relationship (or part of a hedging relationship) ceases to meet the qualifying criteria (after taking into account any rebalancing of the hedging relationship, if applicable)? Why or why not? If not, what changes do you recommend and why?

(b) Do you agree that an entity should not be permitted to discontinue hedge accounting for a hedging relationship that still meets the risk management objective and strategy on the basis of which it qualified for hedge accounting and that continues to meet all other qualifying criteria? Why or why not? If not, what changes do you recommend and why?

We believe that the Board should allow an entity to voluntarily revoke a hedging relationship without restriction should the entity no longer wish to pursue hedge accounting. We would therefore support voluntary discontinuation when this is in line with a company's hedge accounting strategy which would be aligned with the objectives of the ED.

In the current ED, paragraph 64, a hedging relationship can only be discontinued in its entirety when the hedge relationship no longer meets the risk management objective and strategy. The ED is not clear as to what constitutes a change in risk management objective and strategy and interpretations could differ.

We believe that the Board's current proposals would result in an inconsistency with an entity's hedging strategy

Question 9

(a) Do you agree that for a fair value hedge the gain or loss on the hedging instrument and the hedged item should be recognised in other comprehensive income with the ineffective portion of the gain or loss transferred to profit or loss? Why or why not? If not, what changes do you recommend and why?

We agree that for a fair value hedge the gain or loss on the hedging instrument and the hedged item should be recognised in other comprehensive income with the ineffective portion of the gain or loss transferred to profit or loss. We acknowledge that the presentation in other comprehensive income would result in a net nil position but that the proposed recognition and presentation approach will allow investors to see in one location in comprehensive income the hedge accounting effects, as well as highlighting ineffectiveness in profit or loss.

(b) Do you agree that the gain or loss on the hedged item attributable to the hedged risk should be presented as a separate line item in the statement of financial position? Why or why not? If not, what changes do you recommend and why?
We do not support the proposal that the gain or loss on the hedged item attributable to the hedged risk should be presented separately on the face of the statement of financial position as we believe this will lead to a highly cluttered, uninformative statement of financial position. Any changes to the statement of financial position should be considered by the Board under current projects for Financial Statement Presentation.

Our preference is to retain the current approach in IAS39 and adjust the carrying amount of the hedged item for the gains or loss associated with the risk being hedged supported by a note disclosure that disaggregates the balance sheet value into amortised cost and fair value adjustment for the risk being hedged.

We believe that this provides the appropriate level of transparency for investors if coupled with appropriate disclosures to explain the basis of the carrying value.

We are significantly concerned that the current proposals as they stand in the ED would lead to excessive complexity within the financial statements and lead to a lack of transparency and understanding for investors within the primary statements.

(c) Do you agree that linked presentation should not be allowed for fair value hedges? Why or why not? If you disagree, when do you think linked presentation should be allowed and how should it be presented?
We agree that linked presentation should not be allowed for fair value hedges, as is currently the case under IFRS. We note that an entity can, if it so wishes, present disclosures to help investors understand the relationship between hedging instruments and hedged items.

Question 10

(a) Do you agree that for transaction related hedged items, the change in fair value of the option's time value accumulated in other comprehensive income should be reclassified in accordance with the general requirements (eg like a basis adjustment if capitalised into a non-financial asset or into profit or loss when hedged sales affect profit or loss)? Why or why not? If not, what changes do you recommend and why?

(b) Do you agree that for period related hedged items, the part of the aligned time value that relates to the current period should be transferred from accumulated other comprehensive income to profit or loss on a rational basis? Why or why not? If not, what changes do you recommend and why?

(c) Do you agree that the accounting for the time value of options should only apply to the extent that the time value relates to the hedged item (ie the 'aligned time value' determined using the valuation of an option that would have critical terms that perfectly match the hedged item)? Why or why not? If not, what changes do you recommend and why?

We are supportive of the Board's proposals for accounting for the time value component of an option. However, we are concerned with the complexity that may result. We would encourage the Board to consider a single approach for the reclassification of amounts from other comprehensive income to profit or loss of the time value component accumulated in other comprehensive income. We would support an allocation of time value amounts to be transferred over the relevant period on a rational basis with appropriate disclosure.

We also believe that the Board should continue to allow an entity the choice of recognising the time value of the option as a derivative at fair value through profit or loss, as permitted under IAS39.

Question 11: Do you agree with the criteria for the eligibility of groups of items as a hedged item? Why or why not? If not, what changes do you recommend and why?
We understand that the proposals represent an intermediate step towards the development of an accounting model for hedges of open portfolios, however we feel that it would be inappropriate to comment on these proposals until we have a better understanding of the Board's approach for macro hedging.

It is not immediately evident to us, from the ED, what the underlying principle is for the treatment of groups of items. We believe that further outreach and field-testing should be undertaken to avoid replacing one set of complex, rules-based, requirements with another and would encourage the Board to consider a principles based standard for their proposals.

Question 12: Do you agree that for a hedge of a group of items with offsetting risk positions that affect different line items in the income statement (eg in a net position hedge), any hedging instrument gains or losses recognised in profit or loss should be presented in a separate line from those affected by the hedged items? Why or why not? If not, what changes do you recommend and why?
We agree with the proposals regarding the presentation in profit or loss of the effects of hedge accounting for groups of items.

However, we disagree with the way that gains or losses from fair value hedges of net positions are proposed to be presented. Rather than requiring presentation on a gross and disaggregated basis in the statement of financial position, we would recommend that all fair value changes be aggregated into a single item in the statement of financial position and to provide details in the notes.

Question 13

(a) Do you agree with the proposed disclosure requirements? Why or why not? If not, what changes do you recommend and why?

(b) What other disclosures do you believe would provide useful information (whether in addition to or instead of the proposed disclosures) and why?
We seek a principles based approach to disclosures and have concerns that the current requirements will lead to extensive, complex and cluttered disclosures within the financial statements.

We are concerned that disclosures are requested only for risks that are subject to hedge accounting rather than covering all risks that are both hedged and unhedged within the financial statements. We also believe that management should be required to disclose the level of risk appetite held by management and therefore the level of ineffectiveness their risk management strategies will tolerate for each category of hedged risk.

In particular we believe that requirements to disclose a description of all sources of potential hedge ineffectiveness has potential to result in boilerplate disclosure.

We recommend that the Board undertake a review of the disclosure requirements on completion of all the elements of IFRS9 and in addition how the requirements interact with the disclosures in IFRS 7.

Question 14: Do you agree that if it is in accordance with the entity's fair value-based risk management strategy derivative accounting would apply to contracts that can be settled net in cash that were entered into and continue to be held for the purpose of the receipt or delivery of a non-financial item in accordance with the entity's expected purchase, sale or usage requirements? Why or why not? If not, what changes do you recommend and why?

Generally we support amendments that assist entities to present financial information about their risk management activities meaningfully and believe that this should be permitted if this is in line with an entity's risk management strategy.

We believe these provisions of the ED should also address non-cash settled contracts, and to embrace a stand-alone derivative capable of being hedged.

Question 15

(a) Do you agree that all of the three alternative accounting treatments (other than hedge accounting) to account for hedges of credit risk using credit derivatives would add unnecessary complexity to accounting for financial instruments? Why or why not?

(b) If not, which of the three alternatives considered by the Board in paragraphs BC226–BC246 should the Board develop further and what changes to that alternative would you recommend and why?

No, we do not agree and support the principle that risk components should be eligible as hedged items. We note that the use of credit derivatives to manage credit risk is a common risk management strategy for financial institutions and do not believe that an explicit prohibition is appropriate.

We agree that it is operationally difficult to isolate and measure the credit risk components of a financial asset in order to meet the eligibility criteria for hedged items, but this in itself not sufficient criteria to simply prohibit hedge accounting.

Question 16: Do you agree with the proposed transition requirements? Why or why not? If not, what changes do you recommend and why?

In line with our response to the Board's request for views on Effective Dates and Transition Methods we support an effective date of 1 January 2015 for all phases of IFRS 9 with voluntary adoption permitted.