ASC
ACCOUNTING STANDARDS COUNCIL

9 March 2011

International Accounting Standards Board
1st Floor 30 Cannon Street
London EC4M 6XH
United Kingdom

(By online submission)

Dear Sir

RESPONSE TO EXPOSURE DRAFT ON HEDGE ACCOUNTING

The Accounting Standards Council (ASC) appreciates the opportunity to comment on the Exposure Draft on Hedge Accounting (the ED) issued by the International Accounting Standards Board (the IASB or the Board) in Dec 2010.

General

We support the IASB's efforts to improve the hedge accounting framework and agree with the Board's direction to align financial reporting with an entity's risk management activities and policies. We believe that compared to IAS 39, the overall approach proposed by the Board in this ED is a more principle-based approach that reflects an entity's risk management decisions. However, we are of the view that the proposals in the ED can be further improved in order to further align hedge accounting and risk management and to provide greater clarity and understandability so as to ensure ease and consistency in application. In particular, we believe the Board needs to give further consideration in the following key areas:

- Expansion of hedge accounting to risks that impact other than profit or loss;
- Eligibility of derivatives embedded in financial assets as hedging instruments;
- Disaggregation of non-derivative hedging instruments into risk components other than foreign currency risk;
- Better articulation of the concepts on assessing hedge effectiveness and rebalancing requirements;

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- Eligibility of cash flow hedges of net positions for which the offsetting risk positions affect profit or loss in different reporting periods;
- Development of alternative approaches to hedge accounting for hedges of credit risk using credit derivatives;
- Extension of the proposed treatment for the time value of options to the interest element of forward contracts;
- Expedition of the project on macro hedging; and
- Clarification of the role of OCI in the context of measuring and reporting an entity's performance.

Our detailed comments and suggestions can be found in the following paragraphs.

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?

Yes, we agree with the overall direction of the proposed objective to reflect the effects of an entity's risk management activities in its financial statements as it is consistent with what hedge accounting is used to achieve in practice. Moreover, "looking through the eyes of management" is consistent with the approach taken for IFRS 8 Segment Reporting and IFRS 7 Financial Instruments: Disclosures which is a practical way to better reflect the business model of an entity.

However, we believe that hedge accounting should not be restricted to risks that only affect profit or loss. Besides profit or loss volatility, entities are also concerned about fluctuations in other comprehensive income (OCI). Whilst we can understand the Board's rationale not to permit hedge accounting of risks that affect OCI as this would result in reclassification of gains or losses out of OCI to profit or loss, we believe that there could be risk management strategies of risks that are reflected in OCI as well. For example, it is common in practice to hedge investments in equity instruments that are designated as at fair value through OCI (FVTOCI) and it would create an accounting anomaly by reflecting gains or losses on the hedging instruments in profit or loss but in OCI on those relating to the equity investments. This does not, in our view, portray an accurate picture of the effects of an entity's risk management activities. Hence, we urge the Board to reconsider the proposal to restrict hedge accounting to risks that affect only profit or loss (and in particular the proposal in paragraph 4 of the ED that hedge accounting shall not be applied to FVTOCI equity investments) in order to align financial reporting with an entity's risk management activities.

To this end, we would also like to reiterate our view (as expressed in our comment letter to the Exposure Draft on Financial Instruments: Classification and Measurement) that reclassification of gains or losses out of OCI to profit or loss for FVTOCI equity investments is appropriate upon realization, i.e. disposal of the investment which represents the culmination of an earnings process, as this would more faithfully reflect the actual return on the investment.

Furthermore, while we understand the Board's intent not to create any exception to the decision made in Phase 1 of IFRS 9 in the formulation of the current ED (i.e. prohibition of reclassification between OCI and profit or loss), we urge the Board to be mindful that alignment to the Board's previous decisions should not take undue precedence over a sound and logical decision on the remaining phases of IFRS 9.

Accordingly, we would like to propose rewording the objective of hedge accounting as follows:

"…the objective of hedge accounting is to reflect the effects of an entity's risk management activities that use financial instruments to manage exposures arising from particular financial risks that could have an impact on the entity's financial statements."

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, we agree with the proposal to extend the eligibility of hedging instruments to non-derivative financial instruments as we believe it would achieve greater alignment between hedge accounting and risk management objectives.

However, there appears to be no strong conceptual basis to exclude as eligible hedging instruments any non-derivative financial instruments that are not measured at fair value through profit or loss (FVTPL). We understand that in practice, the basis of measurement of a financial instrument is not normally considered by an entity in its selection of the hedging instruments to be used to manage its risk exposures. This emphasis on "FVTPL" as a pre-requisite could therefore result in financial statements which do not faithfully reflect the economic consequences of an entity's hedging activities. As such, we urge the Board to consider expanding the eligibility of hedging instruments to financial instruments that are not measured at FVTPL, such as FVTOCI equity investments, so that financial statements can better encapsulate risk management objectives.

We also note that the Board has proposed not to allow the disaggregation of a non-derivative hedging instrument into risk components other than foreign currency risk (i.e. the instrument is required to be designated in its entirety). We understand from BC33 of the Basis for Conclusion that this is because doing so would result in a significant expansion of the scope of the hedge accounting project (as the Board would need to

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address the question of how to disaggregate a hedging instrument into components) and could significantly delay the project. We do not believe that the possible delay in the project is a valid reason to stop the Board from exploring all possible ways to improve hedge accounting. To make a hasty decision to prohibit the disaggregation of a non-derivative hedging instrument into risk components other than foreign currency risk due to time constraint could possibly lead to undesirable consequences in future (e.g. the need for further amendments to a standard). In order to arrive at a set of robust standards that is principle-based, the Board should take time to carefully consider all the aspects and implications of its decisions, rather than to prioritize the completion of the standards by a hard timeline over the formulation of a high-quality and well-thought through set of standards. Likewise, we propose that the same considerations be made for derivative hedging instruments.

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 that a synthetic exposure (i.e. a combination of a non-derivative instrument and a derivative) may be designated as a hedged item. Entities usually hedge risk exposures based on different risk management strategies and to a different extent for each type of risk. We believe that this proposed accounting treatment will eliminate the unnecessary restriction that currently exist in IAS 39 (prohibition of the designation of a derivative as hedged item) and should enable hedge accounting for entities that enter into transactions that give rise to a combination of different risks and brings about closer alignment between hedge accounting and actual risk management practices.

However, the ED does not provide sufficient clarity on the accounting mechanics for the aggregated exposure. Even though examples on when an entity may designate the hedged item on the basis of the aggregated exposure have been provided in paragraph B9 of the ED, there is no clear guidance on how an aggregated exposure should be accounted for (i.e. the actual accounting mechanics). We believe that more guidance, especially in the form of numerical examples, is required to provide greater clarity on the intended accounting treatment in such cases.

To ease implementation issues and to ensure consistency in application, there must also be greater clarity in the wordings of the proposed requirements. For example, in paragraph B9(a) of the ED, an exposure arises from expected coffee purchases in two years. It appears that the coffee purchases were only "expected" and not "highly probable", which seems to be inconsistent with paragraph 14 of the ED where a forecast transaction must be highly probable. The wordings in the ED should be tightened for greater consistency and clarity so as to avoid confusion and significant diversity in practice.

One further suggestion to ensure consistent interpretation of terms such as “exposure”, “risks” and “risk components” is to have a glossary to explain what these terms mean in the context of the ED.

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 with the proposal as this is a more principle-based approach to determine the eligibility of hedged items, as opposed to determining what can be hedged by type of item. The current restriction in IAS 39 for designation as hedged items of risk components on the basis of whether the risk component is part of a financial or a non-financial item has no conceptual merit and the removal of the different eligibility criterion for financial and non-financial items is an improvement in hedge accounting.

However, the ED’s explanation on whether a risk component is “separately identifiable” could be further improved. For example, paragraph B15 of the ED indicates that when designating risk components as hedged items, an entity should consider whether the risk components are ***explicit*** (i.e. contractually specified risk components) or are ***implicit*** in the fair value or cash flows of an item (i.e. non-contractually specified risk components) to determine if they are separately identifiable. The latter is, in our view, a rather generic criterion which could potentially result in the abuse of hedge accounting and we urge the Board to provide more guidance in the evaluation of the “separately identifiable” criterion for non-contractually specified risk components.

Also, we note that paragraph B18 of the ED did not explain why the Board views inflation as not being separately identifiable and reliably measurable and hence, cannot be designated as a risk component of a financial instrument unless it is contractually specified. It also does not explain why only financial instruments have been considered and not non-financial instruments. This is in our view, a rather rule-based approach to restrict non-contractual inflation components to be designated as hedged items and we strongly encourage the Board to set out a more principle-based set of criteria in determining what can or cannot be designated as hedged items.

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?

Yes, we agree with the proposal as we believe this will help to align hedge accounting with risk management objectives for entities that manage layer components in their risk management strategies.

(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?

We are not able to provide detailed comments on this question as we understand that prepayment options are more commonly dealt with at open portfolio level, which is not addressed in this ED.

However, in line with our response to Question 4, we believe that as long as a risk component is separately identifiable and reliably measurable, it should be eligible for designation as a hedged item.

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?

In principle, we agree with the proposed hedge effectiveness requirements as a qualifying criterion for hedge accounting and applaud the Board's proposal to replace the artificial and onerous 80-125% bright line rule with an objective-based approach for assessing if hedging relationships qualify for hedge accounting. We are also supportive of the removal of the retrospective hedge effectiveness test.

However, we are concerned that the ED does not provide sufficient clarity on how a hedging relationship could be assessed as meeting the hedge effectiveness requirements by producing "*an unbiased result and minimizes expected ineffectiveness*" and achieving "*other than accidental offsetting*". As it is currently worded, the ED would be subject to diverse interpretation and application. For the proposals to be operational, we believe that further refinement, and pertinent guidance and application examples would be required in the following areas:

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- Paragraph B30 of the ED requires an entity to consider the relationship between the weightings of the hedging instrument and the hedged item (i.e. the hedge ratio) when assessing whether the hedging relationship will minimize "expected ineffectiveness". We believe that this could potentially be construed differently in practice. A possible, albeit liberal, interpretation could result in entities freely defining their hedge ratios with differing degrees of hedge ineffectiveness based on their own risk management policies and appetites. This could result in a wide range of "ineffectiveness" which entities can argue to be acceptable as part of their risk management policy. For instance, we envisioned that there could be instances where an entity may elect a hedge ratio that would minimize the "expected ineffectiveness" to say approximately 30%. We believe that this interpretation is not intended by the Board as it would not be consistent with the proposed requirement that a hedging relationship should produce an "unbiased result", i.e. that there should not be any systematic over or under hedge.

  Another possible interpretation of the proposed hedge effectiveness requirements is that minimum mismatch or ineffectiveness should be anticipated in any hedging relationship before hedge accounting can even be applied. In other words, an entity is required at the outset to hunt down an instrument that hedges the hedged item most perfectly. We believe that it is also not the intention of the Board to adopt this restrictive view as supported by the Board's positive affirmation in paragraph B29 of the ED that a hedging relationship does not have to be perfectly effective in order to qualify for hedge accounting.

  To avoid significant diversity in practice and to ensure consistent application across entities, we urge the Board to refine the proposal and to provide further guidance and application examples.

- The ED requires the hedging relationship to be expected to achieve other than "accidental offsetting" by analyzing the economic relationship between the hedged item and the hedging instrument. We believe this notion is susceptible to diverse interpretation and would be opened to significant debate. For example, paragraph B31 of the ED suggests that a statistical correlation between two variables that have no "substantive" economic relationship would not support a valid expectation of other than accidental offsetting. However, the ED does not provide any further guidance on what constitutes "substantive". For instance, is a 20% correlation (or for that matter, a 49% correlation) between two variables considered "substantive" economic relationship? In the absence of any clear and explicit guidance on what constitutes "other than accidental offsetting", we are concerned that significant divergence would result and we urge the Board to provide further clarification and guidance in this regard.

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?

Yes, we agree with the proposal on rebalancing as it avoids frequent discontinuation and restarting of hedging relationships when the risk management objective remains the same.

However, we believe that the proposal could potentially add new complexities to hedge accounting as a significant degree of judgment would be required in applying the rebalancing requirements. For instance, paragraphs B50 to B52 of the ED explain that not every change in the extent of offset between the changes in the fair value of the hedging instrument and the hedged item's fair value or cash flows constitutes a change in the relationship between the hedging instrument and the hedged item which triggers rebalancing. In other words, the change in the extent of offset could be a matter of measuring and recognizing hedge ineffectiveness but not of rebalancing by adjusting the hedge ratio (and vice versa). We believe this is likely to pose significant operational challenges and we urge the Board to articulate the concept of rebalancing more clearly and to provide further guidance and examples in applying the requirements.

In the light of the significant judgment involved in applying the rebalancing requirements, the Board should also consider whether disclosures of the circumstances that trigger rebalancing, and the frequency, method and consequences of rebalancing should be made in the financial statements (also for proactive rebalancing).

(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 an entity should be allowed, but not mandated, to proactively rebalance the hedging relationship if the hedging relationship might fail to meet the objective of the hedge effectiveness assessment in the future.

However, we believe that proactive rebalancing should be allowed only if the expected failure is not due to a change in risk management policy, which is consistent with the principles required by the ED for rebalancing. In addition, for proactive rebalancing to be operational and auditable, we propose that entities be required to set out clearly in their risk management policy the boundary for which such proactive rebalancing exercise can be carried out.

Furthermore, we believe that the proposal in paragraph B59 of the ED which proposes that an entity is permitted to rebalance a hedging relationship on the basis that the new hedging relationship would "*reduce the likelihood of ceasing to meet the objective in the future*" is likely to pose several implementation issues such as what is an acceptable range of "likelihood" and how long is "the future". We urge the Board to provide pertinent guidance on how this can be applied in a practical scenario.

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?

Yes, we agree with the Board's proposal that entities which have opted for hedge accounting should discontinue hedge accounting prospectively only when the hedging relationship ceases to meet the qualifying criteria.

(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?

Yes, we agree with the proposal. As risk management objective and strategy is up to an entity to define for itself, hedge accounting becomes very much an accounting policy choice. In order not to undermine the comparability and reliability of financial reporting, the standard should minimize the opportunities for entities to make changes to policy choices too easily without valid reasons. In this regard, we 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, and that continues to meet all other qualifying criteria.

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 recognized 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?

Yes, we agree with the proposal as we are of the view that risk management strategies are generally not classified as cash flow or fair value strategies and hence, it makes sense to align the accounting for both cash flow and fair value hedges closer which helps to reduce complexity in financial reporting. By capturing the related movements of gains or losses in one place on the face of the primary financial statements, users of financial statements are also able to see a complete picture of the effects of the hedging activities that an entity undertakes. In addition, the proposal could provide useful information about the extent of offsetting achieved for fair value hedges.

To ease implementation issues, we suggest that the Board considers including a numerical example to illustrate the mechanics of the accounting for fair value hedge, including how the movements should be presented in the Statement of Comprehensive Income.

One related key concern that we have is the lack of clarity over the role of OCI as the number of items in OCI continues to grow. Till the Board's deliberation on this issue is completed and the role of OCI clarified, the notion of OCI remains an elusive one without a clear framework that determines the items that qualify as such and we are not fully able to see the impact the proposals would have.

(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 agree that presenting the gain or loss on the hedged item attributable to the hedged risk as a separate item alongside the hedged item in the Statement of Financial Position (the Statement) is useful to allow users to have a clearer understanding of the effect of the hedging activity and seeks to eliminate the mixed measurement for the hedged items (e.g. an amount that is amortized cost with a partial fair value adjustment).

However, the presentation proposed in the ED will make the Statement too cluttered and reduce understandability, as the number of line items presented on the Statement increase in tandem with the number of hedging activity undertaken by the entity. We recommend that, instead of presenting the measurement adjustment as a separate line on the face of the Statement adjacent to the line item that includes each hedged asset or liability, all measurement adjustments be aggregated into a single net amount on the face of the

Statement (to be shown on the asset side for debit balance and on the liability side for credit balance). The net amount should then be disaggregated in the notes to the financial statements at the appropriate level of detail.

(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?

Yes, we agree that linked presentation should not be allowed as it could cause misunderstanding that the entire hedged item is subject to hedging, even though in reality, only a component of the risks has been hedged. In other words, the linked presentation does not differentiate between the types of risks covered by the hedging relationship and those that are not. We believe that appropriate disclosure about hedging activities in the notes to the financial statements would be a better alternative to provide information that allows users to assess an entity's risk management activities.

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?

Yes, we agree with the proposals as we are of the view that the time value of an option is akin to payment of insurance premium to the option writer/seller for protection against the downside of an exposure while retaining the upside and should therefore be treated as a cost of the hedging activity.

We note that the ED is silent on the treatment of the interest element of a forward contract which, similar to the time value of an option, is permitted to be separated from the spot price as entities typically designate as hedging instrument only the spot price of the forward contract. A case in example is the prevalence of the utilization of a funding swap as a hedging instrument by financial institutions in Asia when they deploy surplus deposits in one currency into lendings of another currency through foreign exchange swaps. In line with the proposals for the treatment of the time value of an option, we suggest that the Board considers extending similar treatment to the interest element of a forward contract (e.g. the swap points in a funding swap) as the interest element is also typically considered a cost of hedging by entities.

Please also see our comment under question 9(a) on the role of OCI.

(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?

Yes, we agree with the proposal. This concept is similar to the "hedge effectiveness" concept and is in-line with the overall principal that only the portion of the hedging instrument that relates to the hedged item should be capitalized. Any portion that is not part of the "hedging relationship" should not be capitalized.

However, in practice, it is likely to be difficult to dissect time value into the portion that is part of the hedging relationship and the portion that is not. This could result in arbitrary allocation and significant diversity in practice. We believe further guidance and examples in this area would be useful to ease implementation issues.

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 are broadly supportive of the Board's proposal as in practice, many entities do enter into hedges for groups of items and we believe it is necessary to allow entities to account for hedging activities in the manner they are managed so as to align risk management objectives with accounting standards.

However, we have one key concern on the proposal relating to cash flow hedge of a net position. For the purpose of cash flow hedge accounting, the ED specifies an additional criterion to allow a net position to be designated as a hedged item only if the offsetting cash flows in the group of hedged items exposed to the hedged risk affect profit or loss in their entirety in the same reporting period (including interim periods). This criterion could pose significant constraint in situations where risk management is based on the timing of cash flows rather than the timing of profit or loss impact. The effect of this restriction is made even greater for entities that report on a quarterly or half-yearly basis. We are not convinced by the Board's rationale for the restriction as set out in BC168 to BC173 of the Basis for Conclusion and urge the Board to reconsider the proposal in order to bridge the gap between hedge accounting and risk management in situations where the risk management objective and strategy is to hedge on a net basis but not all hedged items affect profit or loss in the same reporting period.

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In addition, until the Board issues its proposals for macro hedges, we will not be able to comment on the proposal in full.

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 recognized 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?

Yes, we agree with the proposed presentation in the income statement as this would avoid artificially grossing up the gains or losses on the hedging instrument.

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?

Yes, we agree with the proposed disclosure requirements.

However, to ease implementation, we suggest that further guidance be given for paragraph 40 (i.e. disclosures on risk management strategy, how the hedging activities would affect cash flows and the effect hedge accounting has on the financial statements), paragraph 43 (i.e. how much detail to disclose and emphasis, appropriate level of aggregation or disaggregation and whether users of financial statements need any additional information to evaluate the quantitative information disclosed) and paragraph 44 (i.e. explanation of risk management strategy for each category of risk exposure that is hedged).

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?

Yes, we agree with the proposal to use derivative accounting for contracts that would otherwise meet the "own use" scope exception if that is in accordance with the entity's

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fair value-based risk management strategy as this is a practical approach to reflect an entity's underlying business model and how the contracts are managed.

However, we do not agree with the proposed consequential amendments to be made to paragraph 8 of IAS 32 Financial Instruments: Presentation as this could potentially confound the definition of a financial instrument. We are of the view that to include such contracts in the ambit of the ED, amendments should be made within the context of the ED rather than IAS 32.

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?

Yes, we agree that none of the three alternative accounting treatments proposed would reduce complexity or improve the quality of financial reporting. In our view, all three alternative accounting treatments appear to depart from the intention of the standard to reduce complexity/move away from a rule-based approach and are onerous in application.

We urge the Board to continue to explore/develop alternative approaches to hedge accounting when credit derivatives are used to hedge credit risk as this represents a significant area of concern especially for financial institutions.

(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?

If the Board were to develop further the alternatives, alternative 3 may be more appropriate as it is less susceptible to earnings management.

Question 16

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

Yes, we agree with the Board's proposal with regards to the prospective application of the proposed hedge accounting requirements for all hedging relationships. However, as highlighted in our comment letter to the Board's Request for Views on Effective Dates and Transition Methods, we believe that a single effective date should be adopted for IFRS 9 (all phases) as well as the proposed new IFRSs on Fair Value Measurement, Insurance Contracts, Leases and Revenue from Contracts with Customers, and that the

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mandatory effective date for these IFRSs should be at least 3 years from the date of issuance of the last IFRS in the group of standards mentioned.

Other Comments:

Bifurcation of embedded derivatives in financial assets

In the light of the Board's decision in phase 1 of IFRS 9 to prohibit the bifurcation of derivatives embedded in financial assets, the ED proposes not to allow such derivatives to be eligible for designation as hedging instruments. However, from our consultations with various stakeholders (particularly financial institutions), we understand that derivatives embedded in financial assets are frequently used by entities to hedge their financial risk exposures. The prohibition on designation of such derivatives as hedging instruments would thus result in misalignment between financial reporting and risk management activities. Hence, we urge the Board to reconsider the proposal with respect to the prohibition and reiterate that alignment to the Board's decisions made in phase 1 of IFRS 9 should not take undue precedence over a sound and logical decision on the remaining phases of IFRS 9.

We would also like to reiterate our view (as expressed in our comment letter to the Exposure Draft on Financial Instruments: Classification and Measurement) that the option to bifurcate embedded derivatives from financial assets should be retained to better reflect the economic reality of hybrid financial instruments.

Macro hedging

The ED on hedge accounting only addresses hedging activities for closed portfolio. However, the risk management strategy of an entity generally assesses risk exposure on a continuous and at an open portfolio basis (portfolio overlay where the assets can be added or removed from the portfolio). We understand that open portfolio/macro hedging is the subject of a new Exposure Draft to be released in Q2 2011. However, without the proposals on macro hedging, our assessment on hedge accounting could be limited or impaired, especially on proposals relating to groups of items. Given the importance of macro hedging, we urge the Board to expedite its development of a model for macro hedging and to finalize a standard on hedge accounting only when both general and macro hedging have been addressed.

Role of OCI

As highlighted in our response to Question 9(a), with the increasing use of OCI, evident from the requirements in Phase 1 of IFRS 9 (e.g. irrevocable election to present in OCI changes in the fair value of an equity investment that is not held for trading with no recycling allowed) and the proposals in this ED (e.g. gains or losses on hedging instrument and hedged item to be recognized in OCI), we are concerned with the following issues relating to OCI which the Board has yet to address and urge the Board to expedite its efforts in addressing them:

- The characteristics of OCI items and the types of items that should be presented in OCI;
- The role of OCI in the context of measuring and reporting an entity's performance; and
- The notion of recycling and when OCI items can or cannot be recycled to profit or loss in subsequent periods.

<u>Implementation guidance</u>

As suggested in our responses, there are a number of proposals in the ED that requires further clarification and guidance from the Board. As a suggestion, the Board may wish to consider retaining some of the implementation guidance (IG) in IAS 39 that could be useful in clarifying some of the requirements in the new standard. For example, the guidance in F.3.7 of the IG on evaluating whether a forecast hedged item meets the requirement to be highly probable should be retained as it is useful in providing clarity over this requirement. It is also not clear from the ED whether an "all in one" hedge as described in F.2.5 of the IG would be permitted. In our view this is a valid hedging strategy and we recommend that it is made explicit that this type of hedge designation is permitted.

<u>Global convergence</u>

Whilst the FASB and IASB have reaffirmed their commitment to work towards a converged set of accounting standards by June 2011, we note that there are still a fair number of differences in the proposed standard on hedge accounting. For example, there is a difference in: 1) approach to assess hedge effectiveness (FASB – "reasonably effective" threshold; IASB – whether hedging relationship leads to "an unbiased result and minimizes expected ineffectiveness" and is expected to achieve "other than accidental offsetting"; 2) basis for discontinuation (FASB – rebalancing results in hedge discontinuation but not necessarily so if risk management objective changes; IASB – changes in risk management objectives results in hedge discontinuation but not if hedge relationship is rebalanced). We urge the Board to continue to work closely with the FASB to align IFRS and US GAAP.

We hope that our comments will contribute to the IASB's deliberation on this ED. Should you require any further clarification, please contact the project manager Kate Ho at Kate_Ho@acra.gov.sg.

Yours faithfully

Siew Luie Soh
Secretary, ASC