CL 49

Sandra Thompson
Senior Project Manager
International Accounting Standards Board
30 Cannon Street
London
EC4M 6XH

11th November 03

Dear Ms Thompson

RE: IAS 39, Financial Instruments: Recognition and Measurement Fair Value Hedge Accounting for a Portfolio Hedge of Interest Rate Risk

We have read with interest the above Exposure Draft and would like to make the following comments.

We welcome the decision of the Board to address the issues of accounting for macro-hedging. The Exposure Draft is a step in the right direction of bringing hedge accounting requirements closer into line with actual risk management strategies.

However, we believe there remains significant unresolved issues, particularly the inability to hedge a net position and the arbitrary restriction of hedge accounting to certain types of item. We are also concerned at the recent Board proposal to remove the proposed extension of prospective hedge effectiveness and return to its earlier more restrictive proposal.

Question 1

Current hedge accounting rules under IAS 39 do not allow an entity to aggregate dissimilar risks in a portfolio of instruments that are then designated as the hedged item in hedging relationship. Those rules additionally preclude an entity from netting offsetting contractual positions to determine a net exposure amount, which is then designated as the hedged item in a hedging relationship. However, we understand that the proposed Exposure Draft would allow financial institutions and others with contracts containing interest rate risk to combine those positions and designate the net exposure as the hedged item in a fair value hedge relationship. We believe certain energy commodity contracts (including firm commitments) and anticipated commodity transactions present an entity with a risk profile that is similar to the exposure that an entity has relative to interest rate-sensitive instruments and is consistent with the rationale put forward to support interest rate portfolio hedging. We therefore believe that the extension of hedge accounting treatment to portfolios of interest rate should be extended to include other similar portfolios of risk. We also believe that the proposed Exposure Draft discussion should include reference to portfolios of risk related to cash flow hedging alternatives, as opposed to its current limitations only to fair value hedge relationships.

Hedge Effectiveness Testing

We are also concerned that the Board at its most recent meeting in Toronto, has reverted to a narrow prospective effectiveness test which requires that an almost full offset be achieved at the inception of the contract. This significantly increases the barrier to achieving hedge accounting and we see little reason for why the prospective hedge should be any different from the less onerous retrospective test. We would urge the Board to reconsider its approach which is also at variance with the equivalent US treatment under FAS 133.

We also remain concerned at the lack of availability of the "short cut" method of applying the effectiveness test, which is available under FAS 133 in relation to interest rate hedges. For otherwise simple transactions this will significantly increase our documentation workload with no perceptible benefits. The short cut test avoids unnecessary extensive work without impacting the principles on which the standard is based.

We would welcome the opportunity to explore these points with you, and particularly how this standard can accommodate the rather different circumstances of the energy trading market place.

I look forward to hearing from you.

Yours sincerely

Keith Cochrance
Director of Financial Reporting.