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International Accounting Standards Board
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Direct dial	:	Tel.: (+31) 20 301 0391 / Fax: (+31) 20 301 0279
Date	:	Amsterdam, 31 October 2003
Re	:	Exposure Draft of Proposed Amendments to IAS 39 Financial Instruments: Recognition and Measurement, Fair value Hedge Accounting for a Portfolio Hedge of Interest Rate Risk

Dear Sirs,

We appreciate the opportunity to respond to your invitation to comment on the *"Exposure Draft of Proposed Amendments to IAS 39 Financial Instruments: Recognition and Measurement, Fair value Hedge Accounting for a Portfolio Hedge of Interest Rate Risk" (Further referred to as ED)*. Our response consists of general comments and answers to the questions raised in the ED.

1 General comments

We welcome and appreciate the effort made by the IASB in developing in cooperation with European banks an ED to improve the implementation of IAS 39. Hedge accounting, in particular macro hedge accounting has been the subject of much debate in Europe and also in the Netherlands. Although we have comments of a technical nature, we generally agree with the attempt to create a possibility for applying a fair value hedge accounting model to what banks refer to as macro hedging.

Our major comments are the following:

- We support the introduction of fair value macro hedge accounting for interest within the IAS 39 framework. We are in favour of an approach as simple and practicable as possible, in line with the Cash Flow Hedge accounting methodology outlined in Q&A 121-1 and 2. We understand that ALM methodologies in the Netherlands and elsewhere differ from organisation to organisation. This creates a need for a relatively simple and practicable approach that can be aligned with ALM practice and that prevents a need for major changes in information systems.

- We favour a layer approach where ineffectiveness arises in situations of an "over-hedged" position only. We have suggested a further extension/amendment of approach B/C in our answer to question 1 below.

- We agree with the board to adhere to the major principles underlying IAS 39 as stated in the Appendix to the ED. We would like to repeat one comment made in our earlier comment letter on the amendments to IAS 39 (October 2002). We would like the board to ensure that in the finalisation of the redrafting of the hedge accounting paragraphs of IAS 39, the principles of the standards are emphasised and clarified, while at the same time providing sufficient guidance and interpretation rather than further rules to support the principles. We recommend that the guidance provided in IAS 39 on when to apply hedge accounting and when this is not allowed is more clearly linked to the criteria for hedge accounting: designation, measurability and effectiveness. In relation to that we recommend to reconsider whether any unnecessary rules and exceptions to rules can be deleted. The appendix to this ED forms an excellent basis for such an exercise.

- Apart from the proposed fair value hedge model for portfolios, the implementation guidance includes a cash flow hedge model also for portfolios with interest rate risk (Q&A 121) and an interpretation for foreign currency hedges of portfolios (Q&A 134-1). In our view, these approaches require a similar status in the standard and the interpretation guidance as this ED's proposal.

2 Answers to questions raised in the ED

Question 1: *Do you agree with the proposed designation and the resulting effect on measuring ineffectiveness?*

CAR response:

We agree with the proposed designation of an amount of hedged items rather than individual assets and liabilities.

We do not agree with the proposed percentage approach to measuring ineffectiveness. We prefer a layer approach. The reasons are as follows:

- We are of the view that prepayment risk and interest rate risk can be distinguished and are in fact distinguished by many banks in their ALM.

- The approach to ineffectiveness differs from the approach taken in the cash flow hedge accounting model included in Q&A's 121-1 and 2, which follows a layer approach.

- The way the ED proposes to measure ineffectiveness, by using percentages hedged and adjusted percentages hedged based on changes in expectations, is rather artificial. Also the removal of fair value changes ultimately when the related assets or liabilities are derecognised, may lead to more volatility than in the one-to-one fair value hedge model.

We believe that only an over-hedged and not an under-hedged situation should lead to ineffectiveness being recorded. In our view the main difference between the approaches A and B/C is that in approach A ineffectiveness is first allocated to the part of assets or liabilities hedged with primary instruments (as a result of which ineffectiveness is not recorded), while in approach B/C ineffectiveness is allocated to the part of assets or liabilities hedged with derivatives (as a result of which ineffectiveness is recorded after the un-hedged portion is fully absorbed).

In our view the layer approach needs to be (slightly) amended in the following way. In our view this would lead to the approach being more aligned with ALM practice than current approach B/C. We propose that in the layer approach, ineffectiveness results when the net amount of assets and liabilities - rather than gross assets or liabilities - is lower than the notional of the derivative designated as the hedge (a net "over-hedged" situation). The reason is that changes in expectations will influence both the amounts of assets and of liabilities. In proposing this approach, we are not suggesting that for measurement purposes a net should be used. Measurement could still be done on the basis of gross assets or liabilities. Our proposal is only that for the determination of the amount of ineffectiveness, the net of assets and liabilities and the changes therein are considered.

Question 1.a *Does ineffectiveness occur in case of partial hedging?*

CAR response:

In case only a part of a position is hedged, ineffectiveness should only be recorded after the position un-hedged is fully absorbed.

Question 1.b *Does revision of repricing to dates later than previously expected impact ineffectiveness?*

CAR response:

No, as under IAS 39 it is possible to hedge a part of a repricing term, assuming the term hedged has been appropriately designated. We understand that this would be consistent with ALM practice.

Question 1.c *How and when would amounts that are presented in the balance sheet line items referred to in paragraph 154 be removed from the balance sheet?*

CAR response:

The ED proposes to remove the fair value change of the assets or liabilities hedged from the balance sheet at the latest when the assets or liabilities to which they relate are derecognised. Although we do not have a better suggestion, an appropriate amortisation schedule and tracking of derecognised assets or liabilities, may require costly system changes. Also the proposal could in our view lead to more and unforeseen volatility than in the 'one-to-one' fair value hedge accounting model, in particular in the proposed percentage approach. The main reason is that in the percentage approach 'artificial' notional amounts are used to determine the fair value changes for the purpose of determining ineffectiveness.

Question 2: *Do you agree that a financial liability that the counterparty can redeem on demand cannot qualify for fair value hedge accounting for any time period beyond the shortest period in which the counterparty can demand payment?*

CAR response:

We agree that the fair value of core deposits cannot be less than their face value. We agree also that these core deposits are sensitive to interest rates in different ways than other assets and liabilities.
We agree that on the basis of current IAS 39 applying fair value hedge accounting to these deposits is not possible, however for other reasons than mentioned in the ED. IAS 39 has not been revised in respect of the requirements regarding hedging portions. Often these core deposits have interest rates that are not related to and are lower than the benchmark interest rates that other assets and liabilities included in the portfolio hedge share (ie the swap rate). The swap rate could generally not be a portion of the interest rate of the hedged items, consisting of these core deposits.

We agree with the example illustrated in the proposal that the core deposits would for risk management purposes be included in the analysis of repayment and repricing for different terms than the short term, based on their behaviour. However, we agree with the board that core deposits are not eligible for hedge accounting on an individual basis, nor as a portfolio.

3 Other (detailed) comments

An issue related to the designation that is not clear to us from the standard is at what level the analysis for the fair value portfolio hedge needs to be performed: is this a reporting enterprise as a whole, based on the entity's ALM practice, or can a part of the assets and liabilities be selected for the approach? In the latter case, it would be unnecessary to choose between A and B/C as the assets and liabilities could be selected in such a way that there would be no difference in practice. Although the standard does not specifically address this, the examples in the ED with only certain types of assets and liabilities included in the analysis, seem to suggest that a partial approach can be taken.

A28 The term portfolio is used here to refer to a combination of assets and liabilities. This is not in line with the definition of a portfolio used in IAS 39 (paragraphs 127 and 132).

A29 The proposal emphasises expected repricing dates. In our view the expectations were relevant for the cash flow hedge accounting portfolio approach as well as in one to one hedge accounting. The emphasize seems to state that in all other situation expectations may not be used for determining for example the timing of cash flows or repricing.

A33 Reference is made to statistical or other estimation techniques. We wonder how in using such techniques an amount of ineffectiveness could be determined.

A35 The approach disregards the effect that fair value adjustments of assets or liabilities have on their effective interest rate. When effective interest rates are not adjusted, removing the adjustment from the balance sheet may cause more than necessary volatility.

A35 The word ‘material’ is used. In our view this is unnecessary as materiality is a general principle relevant for all standards.

A35 Under (d) it is stated that interest rates below the benchmark interest rate cause ineffectiveness. Under current IAS 39 however, hedging a benchmark interest rate risk is not allowed when the hedged item bears an interest that is below the benchmark interest rate risk.

A36 The proposal assumes that it is possible to determine whether the amount hedged is now derecognised. We wonder whether this is a fair assumption.

If you have any queries regarding our comments and responses, please do not hesitate to contact us.

Yours sincerely,

Martin Hoogendoorn
(Chairman Dutch Council for Annual Reporting)