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For the attention of Ms Sandra Thompson, Senior Project Manager

Vevey, 14 November 2003

EXPOSURE DRAFT OF PROPOSED AMENDMENTS TO IAS 39 FOR FAIR VALUE HEDGE ACCOUNTING OF A PORTFOLIO HEDGE OF INTEREST RATE RISK

Ladies and Gentlemen,

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 making hedge accounting requirements in line with the risk management policies of the enterprises. As you will see in our response below and in the other points that we want to raise, there are still unanswered issues, namely the impossibility to designate a net position as a hedged item and the fact that the ED addresses only interest hedges whereas enterprises also use portfolio hedge for currency exposures.

Answers to Specific Questions

Question 1 – Designation and resulting effect on measuring ineffectiveness

While we support the designation of portfolios of similar transactions for applying hedge accounting, we disagree with the requirements of paragraph 128A that say that an amount designated for hedge accounting is "an amount of assets or an amount of liabilities", and that the "designation of a net amount including assets and liabilities is not permitted".

We consider that, to be transparent and relevant for the users, the revised IAS 39 should implement requirements that correspond to the risk management policies of the enterprises. We are not convinced by the arguments of the basis for conclusion (BC5 (b)) that just leave paragraph 133 of IAS 39 unchanged. Since the objective of the current revision of IAS 39 is "to enable fair value hedge accounting to be used more readily for a portfolio of interest rate risk" (background information page 4), we consider that this revision would not meet its objectives if IAS 39 paragraph 133 was not modified to allow the designation of net positions as hedged items.

Concerning your specific points:

a) As said above, the hedged item should be a net position because enterprises designate net positions as hedged items in their risk management policies. Inasmuch as such positions are homogenous in their critical terms such as risk, duration, types of instruments hedged, currencies and maturities, we do not see why they would be unacceptable for hedge accounting.

b) Yes we consider they would because the portfolios should be homogeneous as said under (a) above.

c) In principle at the maturity of the portfolio.

Question 2 – Demand deposits

We do not comment on this issue that does not apply to us.

<u>**Other Points**</u>

Portfolios hedge of currency positions

As said in the introductory part of this letter, we consider that the draft amendment is not complete since it does not address the issue of portfolio hedges that enterprises perform with their treasury centres. Typically enterprises treasury centres regroup the currency positions transmitted by their subsidiaries (sales and purchases in foreign currencies) and hedge net amounts by currencies and maturities with financial institutions.

However under the current requirements of IAS 39 §133, a derivative cannot hedge a net asset or liability position. It should be designated as a partial hedge of several gross asset or liability positions which either makes the effectiveness tests almost impossible or requires administrative costs which do not justify the benefits.

If the prohibition of designating net positions in paragraph 133 would be removed, then the enterprise could apply hedging accounting to the net currency hedges of their treasury centres and not confuse the users by having to recognise risk management operations of their treasury centres as so-called trading derivatives which have a highly misleading speculation connotation.

Initial Ineffectiveness

The current requirement of IAS 39 § 142 (b) that says that "the hedge is expected to be highly effective (see paragraph 146) in achieving offsetting changes in fair value or cash flows attributable to the hedged risk [...]" could be interpreted in a very restricted manner in the sense that the terms "highly effective" mean almost 100%. Such interpretation of the requirement makes the initial designation of hedging instruments very difficult, in particular in the area of commodity accounting. To clarify this issue, we recommend that the Board either defines the terms "highly effective" as being between 80 to 125% as in the retrospective hedge effectiveness assessment per § 146 or, even better, explicitly says that such a definition is left to the judgement of the preparers.

We are aware that the incorporation of the above suggestions would probably require a re-exposure on hedge accounting but we believe that the standard would be unnecessarily arbitrary without their incorporation.

We thank you for allowing us to comment on this exposure draft and for your attention to our comments.

Yours very truly,

NESTLE S.A.

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