Korea Accounting Institute KAI

Korea Accounting Standards Board KASB

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12 November 2003

CL 14

Ms. Sandra Thompson
Senior Project Manager
International Accounting Standards Board
30 Cannon Street, London EC4M 6XH
United Kingdom

Dear Ms. Sandra Thompson:

I am happy to inform you that the International Accounting Standards Review Committee (IASRC) of the Korea Accounting Standards Board (KASB) has held a successful meeting and has finalized on its comments to the Exposure Draft of Proposed Amendments to IAS39, ***Financial Instruments: Recognition and Measurement "Fair Value Hedge Accounting for a Portfolio Hedge of Interest Rate Risk"***. I would appreciate your including our comments in your summary of analyses that will be presented to the IASB.

The enclosed comments are those of the IASRC and do not represent an official position of the KASB. The official position of the KASB is determined only after extensive due process and deliberation, to which this letter has not been subjected.

Please do not hesitate to contact us if you have any inquiries regarding our comments; you may forward your inquiries either to Mr. Jae-ho Kim, KASB Researcher (jhkim@kasb.or.kr) or Mr. Kyoung-chun Yu, KASB Researcher (yukc@kasb.or.kr).

Best regards,

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Dr. Kyung-ho Kim
Chairman, International Accounting Standards Review Committee
Vice Chairman, Korea Accounting Standards Board

Encl: IASRC's comments on the Exposure Draft of Proposed Amendments to IAS39, ***Financial Instruments: Recognition and Measurement "Fair Value Hedge Accounting for a Portfolio Hedge of Interest Rate Risk"***

IASRC's comments on

the Exposure Draft of Proposed Amendments to IAS39, ***Financial Instruments: Recognition and Measurement "Fair Value Hedge Accounting for a Portfolio Hedge of Interest Rate Risk"***

Question 1

Draft paragraph 128A proposes that in a fair value hedge of the interest rate risk associated with a portion of a portfolio of financial assets (or financial liabilities), the hedged item may be designated in terms of an amount of assets (or liabilities) in a maturity time period, rather than as individual assets or liabilities or the overall net position. It also proposes that the entity may hedge a portion of the interest rate risk associated with this designated amount. For example, it may hedge the change in the fair value of the designated amount attributable to changes in interest rates on the basis of expected, rather than contractual, repricing dates(The repricing date of an item is the date on which the item will be repaid or repriced to market rates). However, the Board concluded that ineffectiveness arises if these expected repricing dates are revised (eg in the light of recent prepayment experience), or actual repricing dates differ from those expected. Draft paragraph A36 describes how the amount of such ineffectiveness is calculated. Paragraphs BC16-BC27 of the Basis for Conclusions set out alternative methods of designation that the Board considered, their effect on measuring ineffectiveness and the basis for the Board's decisions including why it rejected these alternative methods.

Do you agree with the proposed designation and the resulting effect on measuring ineffectiveness? If not,

(a) in your view how should the hedged item be designated and why?

(b) would your approach meet the principle underlying IAS 39 that all material ineffectiveness (arising from both over- and under-hedging) should be identified and recognised in profit or loss?

(c) under your approach, 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?

The IASRC agrees with the Board's proposal to designate the hedged item in terms of an amount of assets or liabilities in a maturity time period, rather than as individual assets or liabilities, because it is inappropriate to assume that the change in fair value of the hedging instrument is equal to the change in fair value of the net position. In particular the IASRC believes that, among the alternative methods of designation set out in the Basis for Conclusions, Approach D is preferable to other three approaches because it can prevent both large cushion and arbitrariness. Furthermore, the IASRC agrees with the Board's proposed approach to the measurement of ineffectiveness considering practicable appliance.

Question 2

Draft paragraph A30(b) proposes that all of the assets (or liabilities) from which the hedged amount is drawn must be items that could have qualified for fair value hedge accounting if they had been designated individually. It follows that a financial liability that the counterparty can redeem on demand (ie demand deposits and some time deposits) cannot qualify for fair value hedge accounting for any time period beyond the shortest period in which the counterparty can demand payment. Paragraphs BC13-BC15 of the Basis for Conclusions set out the reasons for this proposal.

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? If not,

- **(a) do you agree with the Board's decision (which confirms an existing requirement in IAS 32) that the fair value of such a financial liability is not less than the amount payable on demand? If not, why not?**
- **(b) would your view result in such a liability being recognised initially at less than the amount received from the depositor, thus potentially giving rise to a gain on initial recognition? If not, why not?**

If you do not agree that the situation outlined in (b) is the result, how would you characterise the change in value of the hedged item?

The IASRC believes that a core deposit cannot qualify for fair value hedge accounting for any time period beyond the shortest period in which the counterparty can demand payment for the reasons set out in paragraph BC14.