



March 9, 2011

Sir David Tweedie
Chairman
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

EXPOSURE DRAFT: Hedge Accounting (ED/2010/13)

Dear Sir David:

Reval.com, Inc. appreciates the opportunity to provide comments and observations on the Exposure Draft issued by the IASB regarding hedge accounting, proposed as amendments to IFRS 9 *Financial Instruments*. Reval provides the leading web-based/Software-as-a-Service (SaaS) solution for derivative risk management and hedging accounting, and also offers a complementary suite of services including outsourcing. Reval offers financial executives front-to-back office capabilities for managing interest rate, foreign exchange, and commodity hedging portfolios, including integrated market data, pricing, risk management and reporting. Reval's client base spans over 500 of the world's largest organisations reporting under both IFRS and US accounting standards.

We commend and support the Board's desire to align hedge accounting with risk management and to address the issues of the current guidance under IAS 39. Many of our clients have expressed frustrations at the complexities and inconsistencies of the existing rules and will welcome many of the changes outlined in this Exposure Draft. We also recognize the extensive outreach programme undertaken by the IASB in constructing this Exposure Draft and expect this process will be rewarded by an overall positive response. Reval feels this is a significant step forward in the providing users with useful information on the risk management activities of the reporting entity.

Reval's responses recommend the Board reconsider the guidance summarized in the points below:

- Remove the disallowance of voluntary de-designation as long as it is part of the risk management strategy – a valid technique to align accounting outcomes currently employed across many organizations.
- Ensure that zero cost option structures qualify for the new guidance for option time value under Para 33. Such instruments are common hedging tools and should be treated in the same manner as purchased options.
- Remove the restriction on net position hedging for cash flow hedges if the impact to profit and loss occurs in different periods. We feel this restriction will disqualify nearly all net position hedging, and therefore result in hedge designations inconsistent with the risk management policy, which is the issue as highlighted in Para B73.
- Change the guidance in Para B75 to allow for gross up reporting when hedging net positions as this is a more meaningful representation to users of the impact of net hedging.
- Change some of the more sensitive disclosure requirements to voluntary application rather than mandatory since they would present a higher burden for those entities that elect hedge accounting over those that do not.

In general, we support the principled approach used by the IASB in constructing this Exposure Draft. However, many of the questions we address in our response are intended to seek clarifications where we feel there is confusion or the potential for inconsistent application of the principle provided.

Specifically, Reval feels the final draft should provide further guidance on:

- The nature of hedge effectiveness objectives and the use of boundaries
- Circumstances where non-contractual component risk can be assessed as separately identifiable and reliably measurable
- The possible treatment of derivatives as hedged items within multiple hedge relationships or where they include optionality – for example, a purchased FX option
- How hypothetical derivatives could now be applied within fair value hedge relationships

Finally, we are concerned that some of the changes in this Exposure Draft represent a departure from US GAAP as well the proposed US Exposure Draft for financial instruments ASC 815. The recent FASB Discussion Paper seeks to get feedback from the FASB's constituents on the proposed IASB changes. We encourage the IASB to actively educate these constituents on the drivers and benefits of this Exposure Draft. A positive response from the FASB Discussion Paper for the IASB's proposal will be critical in moving back towards the convergence we all seek between IFRS and US GAAP.

Regards,



Blaik Wilson
Vice Chairman
Hedge Accounting Technical Taskforce
Reval.com, Inc.

Attachment: Reval responses to IASB's ED/2010/13

Reval responses to IASB's ED/2010/13

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?

Across our client base, Reval has seen the frustrations that have resulted from reporting under the current IAS 39 guidance. We often encounter instances where negative accounting outcomes prevent companies from implementing sound economic hedging strategies. In turn, we have also seen companies employ highly synthetic and complex accounting strategies to achieve hedge accounting that bear little resemblance to actual hedging strategies themselves. As such, a principle that looks to align accounting and risk management outcomes in the financial statements is a welcomed cornerstone to revising the guidance under hedge accounting.

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?

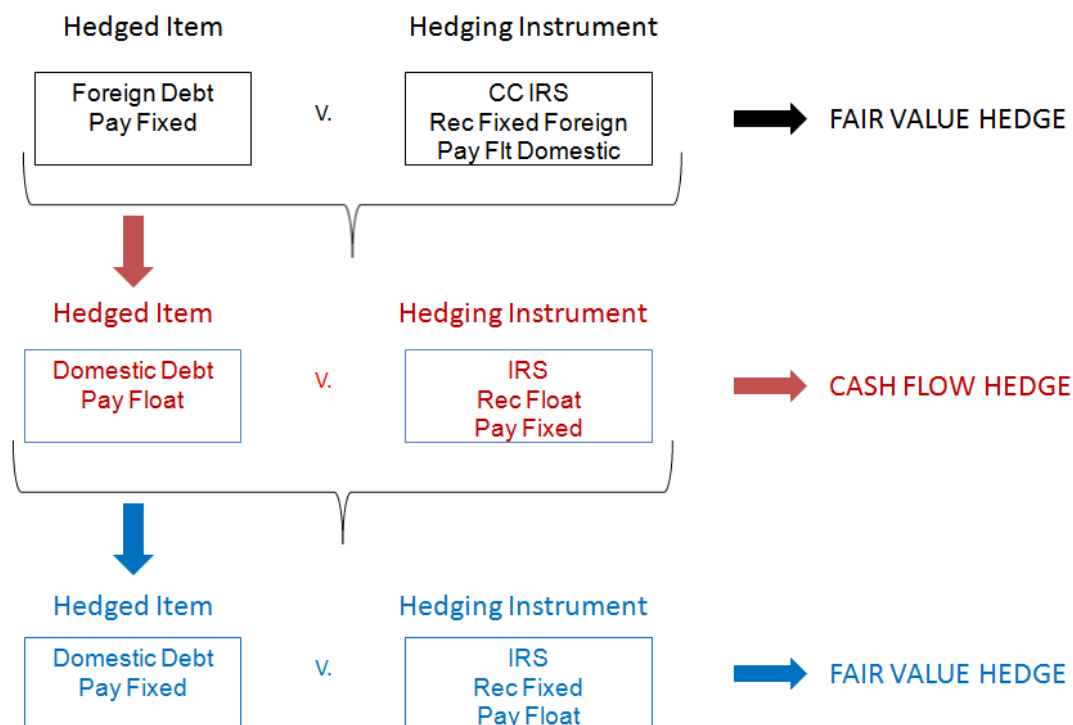
Reval agrees with this treatment given that hedge accounting will only be applicable if it is consistent with the risk management objectives of the entity.

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?

Reval agrees that the guidance should accept designation of exposures alongside derivatives as a hedged item in certain instances. These instances include the two examples provided by the Board in Para B9. However, the principle outlined by the Board in Para 15 is stated in such broad terms that it will enable very wide application well beyond the specific, valid examples the Board has identified in B9.

Consider a risk management objective that actively manages fixed v. floating debt levels on foreign currency debt already converted to domestic level. As shown the graphic below, organisations could designate multiple hedge relationships, each embedded with derivatives that have previously been designated in other hedge relationships, including other types of hedge relationships.



This layered effect could be repeated on and on, resulting in derivatives such as the original cross currency interest rate swap participating in multiple, simultaneous hedge relationships – each relationship contributing to separate line items on the balance sheet and profit and loss. Potentially, this could lead to extremely complex reconciliations and obscure the transparency the IASB are seeking in this new Exposure Draft. We envisage that option-based derivatives may also be used as hedged items and seek further clarity on how intrinsic and time value is expected to be treated in these instances by the Board.

Reval recommends the IASB further explore the application of derivatives as hedged items. Particularly, the IASB should consider what limitations around the application of this standard would be appropriate and offer further guidance on how the accounting framework will accommodate such layered accounting strategies.

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?

Reval agrees with separate designation of component risk and, in particular, supports the change to allow for such designation for non-financial items in certain circumstances. Where a component risk is contractually specified, identifying component risk should be relatively straight-forward to apply. We seek further clarity on what represents a component risk for commodities when it is not contractually specified. For instance, must it be a physical component of an exposure or simply a price component? Must an historical contractual relationship exist or is this only one indicator? Reval suggests the IASB provide further guidance here.

Reval asks the IASB to reconsider paragraph B18, which prohibits the designation of an inflation component unless it is contractually specified. We believe that the new guidance in Para 18 should be applied to inflation risks alone and question whether the specific rule implied in B18 is now inconsistent with this principle.

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?

Reval agrees that an entity should be allowed to apply layered designation as this is in line with the risk management approach of many organisations.

(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?

Reval agrees that a prepayment option could impact the fair value of a hedged item as a whole and, as such, no individual layered approach should be allowable.

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?

Reval understands the Board's desire to align effectiveness with risk management, but there is very little clarity provided in the Exposure Draft on what constitutes a hedge effectiveness objective. As such, we could see a very wide range of objectives applied for identical hedging strategies, which would result in different accounting results and loss of the comparability the IASB is seeking.

Reval recommends that all hedge effectiveness objectives include boundaries that each entity defines, given their expectation within their risk management policy. Such boundaries will also show sufficient levels of correlation to achieve other than accidental offset as required in the Exposure Draft. This will allow companies to monitor their assessments against those boundaries and provide a consistent approach to identifying any bias in a hedge relationship. Such boundaries should be included in the disclosure requirements under the Exposure Draft so that users of financial statements can compare results across different entities.

We agree with the requirement to expect other than accidental offset, but it would only be applicable in a very small number of instances in our experience.

We also seek clarity on Paragraph B44, which addresses the use of hypothetical derivatives in the assessment and measurement process. Under IAS 39 and US GAAP, hypothetical derivatives are not allowed to be used in fair value hedge relationships. Para B44 implies that hypothetical derivatives are not specific to any hedge relationship type. The most typical fair value hedge relationships across our client base are fixed rate debt being swapped to floating. Reval seeks further clarity on how a hypothetical derivative would replicate the fair value changes of the hedged item in this instance as required by the standard. As such, Reval would request further guidance in this area.

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?***

Reval agrees that rebalancing is reflective of risk management strategies that adjust hedging levels to mitigate changes in the underlying exposure or market conditions. We feel this requirement will become clearer once the IASB provides greater clarification on the hedge assessment objective we highlighted in our response to Question 6.

- 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?***

Reval agrees that the ability to proactively rebalance a hedge relationship allows companies to reflect their risk management decisions.

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?***

Reval believes that Paragraph 24 is consistent with the overall aim of aligning the risk management objective of an organisation with the accounting objectives. This is an improvement to IAS 39, which does not allow rebalancing of an existing hedge relationship that still meets the risk management objective and strategy on the basis of which it qualified for hedge accounting.

- 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?***

Reval believes that the removal of the current voluntary revocation in paragraph 91 (c) of IAS 39 of an existing hedge relationship is inappropriate in instances where voluntary de-designation is designed to meet risk management objectives. For example, companies often hedge forecasted foreign currency cash flows into cash flow hedges. At the time those forecasted cash flows are invoiced, and hence recognised on balance sheet, such entities will voluntarily de-designate these hedge relationships so that future mark-to-market movements on the hedging instrument offset the mark-to-market movements on the newly recognised asset or liability.

An alternative approach is to extend the current rules around partial discontinuation to full discontinuation if it is consistent with the risk management objectives. With this approach, the provision of Paragraph 24 can remain, as Reval supports the concept that the voluntary de-designation should be prohibited if it still meets the risk management objective.

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 recognised 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?**

Reval agrees with these proposals as they will avoid a mixed measurement model for the hedged item, at the same time, provide useful information by providing greater transparency and comparability as the effects of risk management activities and all hedge accounting activities would be presented in the same place. However, this guidance is very different from the current and proposed US guidance, which requires the recycling of fair values through net income rather than OCI for fair value hedges.

- (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?**

Reval recognises that presenting the gain or loss on the hedged item attributable to the hedged risk as a separate line item in the statement of financial position will preserve the amortised cost basis of the hedged item, thereby avoiding a mixed measurement model for the hedged item and improving transparency in the statement of financial position

- (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?**

Reval agrees with BC 128 and believes that disclosures about hedging would be a better alternative to provide information that allows users of financial statements to assess the relevance of the information for their own analysis, rather than through linked presentation.

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?**

Yes, Reval agrees 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 as the treatment reflects the economics as a cost of hedging.

- 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, Reval agrees for the same reasons as given above.

- 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, Reval agrees as they would be consistent with aligning the risk management policy and the accounting framework as one would expect the actual option would have critical terms that perfectly match the hedged item.

Reval would like confirmation that the guidance within Para 33 applies to zero cost structures, which are not net written options. Zero cost structures, such as collars, are very common across our client base, and clients would expect consistent accounting outcomes between these structures and options in which a premium is paid.

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?

Yes, Reval does agree as it bridges the current gap in the IAS 39 hedge accounting model and the actual risk management practices. The removal of the similarity testing to reflect the economics of what happens in practice, so that the change in fair value of individual hedged items need not be proportional to that of the group, is a great leap forward.

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 recognised 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?

Managing exposures on a net basis is a common approach, and Reval commends the IASB in allowing such designations as hedged items within a group. However, the restriction embodied in Para 34 c will prevent most entities from being able to take advantage of the net position designation because, in practice, many net exposures could potentially fall within different reporting periods. In addition, at the time of hedging, many entities could not predict which reporting period a hedged item will impact P&L, and this uncertainty would be another reason to not employ net position hedge accounting.

For example, if a EUR entity has sales in USD and purchases raw parts in China (denominated in USD), it may elect to hedge the net USD exposure for risk management purposes. The purchases are manufactured into finished goods, and only when they are sold do they impact profit or loss. Therefore, even though the cash flow dates are aligned for risk management, the impact to profit and loss could be very different for the offsetting hedged items. This is a common scenario across our client base, and under Para 34 c, net position designation would not be allowed. Reval feels that this is inconsistent with the risk management principle of aligning accounting and risk management outcomes. As such, this restriction will result in the same issues highlighted in Para B73, which is clearly not the intention of the IASB.

In addition, Reval disagrees with paragraphs B75 and B76, which disallow the gross up of individual line items or deferral of value changes to match later recognition of other hedged items. We feel that recognising the impact of net position hedging in the individual line items of the offsetting hedged items is more reflective of the risk management objectives and more useful for users of financial statements. We understand that the IASB staff did

consider in some detail the approach suggested by Reval above and request that the IASB reconsider allowing for gross up reporting for net positions.

Question 13

- a) Do you agree with the proposed disclosure requirements? Why or why not? If not, what changes do you recommend and why?***

We believe more field research is required, and the adoption of these disclosures in isolation to IFRS 7 would not be consistent with disclosures developed on a uniform basis and would lead to less transparency in financial statements. Our clients would also be concerned that some of the disclosures include sensitive information such as forecasted exposures and the average rate of current hedge positions. By making such disclosures mandatory, this Exposure Draft could potentially punish those entities looking to hedge account, because if a company does not apply hedge accounting, such disclosures are unnecessary. Reval recommends that such sensitive disclosures be voluntary, not mandatory under the standard.

- b) What other disclosures do you believe would provide useful information (whether in addition to or instead of the proposed disclosures) and why?***

As mentioned in our response to Question 6, Reval recommends the details around the hedge effectiveness objective be disclosed as well as the relevant boundaries for effectiveness in each hedging strategy over the reporting period.

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?

Reval agrees with the proposal that derivative accounting should apply to own use contracts. This is a solution to removing accounting mismatches that apply to own use commodity derivative contracts currently outside the scope of IAS 39

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 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 as it is clearly inconsistent with the principle-based standard-setting philosophy that the IASB is committed to.

- 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?***

Reval believes that this should be considered with the framework of Fair Value Measurement project.

Question 16

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

Reval believes earlier application should be permitted, provided that all existing IFRS 9 requirements have already been adopted or will be adopted together with the new hedge accounting requirements.

We also agree that hedging relationships that qualified for hedge accounting in accordance with IAS 39 also qualify for hedge accounting in accordance with the criteria of this ED and shall be regarded as continuing hedging relationships.