

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Stockholm 9 March 2011

Exposure Draft ED/2010/13 Hedge Accounting

Representing preparers' point of view, the Swedish Enterprise Accounting Group (SEAG) welcomes the opportunity to comment on the above-mentioned Exposure Draft (ED).

We are generally positive to the amendments proposed in the ED. We believe that the ED takes important steps towards producing appropriate accounting treatment of economically rationale risk hedging activities. We do, however, see some areas where further improvement is possible. In the appendix, we give our comments to the questions we have found especially important.

We are pleased to be at your service in case further clarification to our comments will be needed.

Yours sincerely,

CONFEDERATION OF SWEDISH ENTERPRISE

Dr Claes Norberg
Professor, Director Accountancy
Secretary of the Swedish Enterprise Accounting Group

The Swedish Enterprise Accounting Group (SEAG) represents around 40 international industrial and commercial groups, most of them listed. The largest SEAG companies are active through sales or production in more than 100 countries.

Total net turnover of SEAG companies: 245 billion EUR

Total assets of SEAG companies: 335 billion EUR

Total number of employees in SEAG companies: 950 000

Appendix

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?

Yes, we agree. The objective should be to represent in the financial statements the effect of an entity's risk management activities that use financial instruments to manage exposures. Hedge accounting should continue to be voluntary as proposed in the ED.

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?

We welcome the approach to extend the range of financial instruments to be subject to hedge accounting. By doing so, companies will have a better possibility to use hedge accounting if using instruments for their risk management objectives that are not subject to hedge accounting under the current IAS 39, such as non-derivative financial instruments for hedging anything else but foreign currency risk. We agree with the principle that it should not be the nature of the instrument that is decisive, but instead the type of risk management used.

Even though we understand the arguments of the Board when deciding not to allow hedge accounting for items revalued in OCI or equity, it is not evident to us that the decision is in line with the proposed objective described in question 1. If a company is engaged in hedge activities of items such as investments in equity at fair value through OCI or revaluation of emission rights etc in accordance with the company's risk management, we question why it should not be possible to allow hedge accounting for such activities. If keeping a restriction for such hedges in the proposed principle, the hedged item will be revalued over OCI and the hedge instrument over P/L.

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?

We understand that this change intends to eliminate some inconsistencies in the current IAS 39, which does not allow a derivative to be designated as a hedged item, and if so we agree that it should be possible to designate the combined exposure (ie synthetic exposure) as a hedged item.

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?

Yes, in our opinion, this is an important improvement of the existing rules. Furthermore in the application guidance B12 we believe that it would be useful to change the wording something less to e.g. a part of to avoid the misunderstanding that an entire item cannot include negative components or that components cannot be both negative and positive from time to time. We also suggest that the concept separately identifiable is clarified in more detail, or changed to merely identifiable, especially concerning none contractually specified risks.

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?*
- (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?*

- (a) We agree with the statement in a) above. We believe that this is a useful proposal that will enable hedge accounting to be more aligned with actual risk management practices.
- (b) It is not clear to us why it is necessary to specifically exclude the possibility to identify a layer component when a contract includes a prepayment option and where the prepayment option's fair value changes in response to the hedged risk. With a principle based approach it should be allowed to identify a layer component in all such cases where the prepayment option can be separately identified and reliably measured.

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?*
- (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?*

- (a) We support the proposal regarding rebalancing and the objective-based hedge effectiveness assessment. We believe that the current IAS 39 approach of discontinuing hedging relationship on rebalancing is inflexible and doesn't take into

account that rebalancing is part of the management of risks in the highly volatile and dynamic markets today. However, we believe that more guidance is required. It is not fully clear what is considered as unbiased result, minimum hedge ineffectiveness, and when rebalancing would be appropriate.

- (b) We agree with the proposal 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. We believe that such an approach is an important component of active risk management policy, and it is superior to a framework that requires companies to wait with the rebalancing until the ineffectiveness is a fact.

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?*
- (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?*

- (a) We agree with the proposals for discontinuation of hedge accounting for a hedging relationship. We believe that, relative to the current requirements in IAS 39, the proposals are more objective and dynamic because of the inclusion of the principles of new hedge effectiveness assessment and rebalancing. We believe that the proposals will more closely align hedge accounting with the risk management policies of entities.
- (b) We principally agree with the proposal 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. However, if the risk management policy contains added value strategies such as corridors discontinuing the hedge relationship can be in line with the risk management policy. In this case voluntary discontinuation should be allowed.

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?*
- (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?*

(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?

- (a) We agree with the suggestion to align the accounting of fair value hedges with the accounting of cash flow hedges. Our understanding is that the revaluation of the hedged item will be presented in the statement of the financial position and other comprehensive income and not in profit or loss. By this suggestion, both effects will be presented in other comprehensive income and volatility in profit or loss will decrease.
- (b) We do not 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. In order to keep the statement of financial position as informative as possible we believe it is important to keep it short. We therefore suggest presenting all other information in the notes to the financial statements.
- (c) We do agree that linked presentation should not be allowed for fair value hedges and we base our decision on the same principles as you mention in the Basis for Conclusions.

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?*
- (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?*
- (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?*

- (a) We agree that the change in the option time value should accumulate in OCI and be reclassified in accordance with general requirements¹. We are pleased to find an acceptance of the concept of options truly hedging the risk of an adverse market move at a cost/premium.
- (b) We agree based on the same as above.

¹ However, we would like to point out that the current framework lacks a general principle for recycling from OCI to P/L covering all applicable accounting areas. A general principle should be included and elaborated upon in the Conceptual Framework project and/or in the Financial Statement Presentation project.

- (c) We do not agree that there will be a need for a restrictive critical terms approach. If these are not efficient hedges according to the risk management policy, these would be disqualified for hedge accounting in its entirety. If the option is a hedge instrument in its entirety then the time value will impact P/L or B/S at the same time as the hedged item. If only the intrinsic value of the option is designated as a hedge then the changes on time value of the option will impact P/L over time.

We also want to stress that the separation of the intrinsic value and time value of an option is a theoretical split as the FX-option is an Option on a FX-Forward. For this purpose the forward FX-rate includes time value as well as being the basis for the valuation of the time value of the option.

Question 13

- (a) Do you agree with the proposed disclosure requirements? Why or why not? If not, what changes do you recommend and why?*
- (b) What other disclosures do you believe would provide useful information (whether in addition to or instead of the proposed disclosures) and why?*

We object to detailed disclosure requirements that risk limiting the entity's possibility to communicate the effects of its risk management activities in a clear and understandable way. Our experience is that when there are too many detailed requirements to fulfil, it gets difficult to keep "the thread" throughout the disclosures when having the ambition to tick off all requirements. We see a risk that the proposed detail level of the disclosures may be subject to "check-list" behaviour. Instead we believe that information will be more useful if there is room for the entity to prioritize among disclosures in order to emphasize on focus areas in the entity's risk management that is relevant to the reader of the financial report. Such an approach would also be in line with the overall objective of this Exposure Draft.

We are also concerned that the proposed disclosures may require information of prognostic character which can be deemed to be a forward looking statement. It is difficult to interpret the disclosure requirement concerning the amount, timing and uncertainty of future cash flows in any other way than as that entities will be forced to disclose forecasts, even those entities that normally don't communicate forecasts to the market. We strongly recommend the Board to revise the requirements and to clarify that the disclosure requirements should not force entities to disclose sensitive information about future flows that is not communicated elsewhere in the financial report.