

## EXECUTIVE BOARD

P. Flynn  
Chief Financial Officer

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

Subject

**IFRS Exposure Draft “Hedge accounting”**

Date

9 March 2011

Dear Sir David,

We have read the proposals contained in the Exposure Draft (“ED”) “Hedge accounting”. We would like to thank you for the opportunity to comment on these proposals. In this letter we provide the comments on behalf of ING Group, a world-wide financial services organisation focusing on banking, investments, life insurance and retirement services.

**1. Summary and conclusion**

We have, in prior years, consistently expressed our opinion that hedge accounting under IAS 39 is unnecessarily complex, rule-based and not aligned with well-established risk management practices. Therefore, we very much welcome the initiative to simplify the requirements for hedge accounting and to better align these with risk management practices.

We fully agree with the proposed principle-based objective to put the entity’s risk management in a more prominent position. We furthermore believe that the proposals as presented in the ED will generally improve hedge accounting for individual assets and liabilities.

However, we strongly regret that the ED does not address macro hedges for open portfolios, which is key in order to properly reflect common risk management practices of retail banks, as evidenced by the existing EU carve-out. We are of the opinion that a revision of the requirements for hedge accounting can only be finalised in its entirety, i.e. including macro hedging. We are furthermore concerned that certain conclusions in the ED, such as the prohibition to include prepayment risk in hedging the bottom layer of a net position and the continued prohibition of sub-Libor hedging are setting a precedent for macro hedging that will not be acceptable to the banking industry.

Amstelveenseweg 500, 1081 KL Amsterdam, The Netherlands  
P.O.Box 810, 1000 AV Amsterdam  
T +31 20 5415424 F +31 20 5418570  
E [patrick.flynn@ing.com](mailto:patrick.flynn@ing.com)

ING Groep N.V., registered office Amsterdam  
Trade Register no. 33231073 Amsterdam

## 2. Our main concern: Limited scope of the ED - Macro hedging

The scope of the current ED is limited to hedging individual items and groups of items that are part of a closed portfolio. Given the importance of macro hedging to financial institutions, the exclusion of groups of items that are part of an open portfolio is a major concern. There is a strong interrelation between the general hedge accounting model and the macro hedging model and, therefore, we believe that the IASB should not finalise the ED without including macro hedging. We are supportive of the “bottom layer approach” that is proposed in the ED and we believe that this approach, if properly introduced into the macro hedging model, could result in an improved and acceptable model. However, we are concerned that the ED does not allow including prepayment risk in the bottom layer;— it would be detrimental if this prohibition would be carried forward to the macro hedging model.

## 3. Improvements in the ED compared to current IAS 39

We welcome the following improvements compared to the current requirements in IAS 39:

- the basic principle that hedge accounting should reflect risk management practices;
- the more principle-based requirements for effectiveness testing and the deletion of the artificial 80% and 125% effectiveness boundaries;
- the deletion of the prohibition that derivatives cannot be hedged items;
- the improvements in hedge accounting when options are used as hedging instruments;
- the recognition that the bottom layer of a net position can be designated as hedged item.

## 4. Areas where the ED needs clarification

The following areas in the ED need clarification or field testing before these can be finalised:

- We support the proposals in the ED to remove the 80-125% effectiveness boundaries. The main issue in practice is that these are artificial boundaries without any period of “repair” if a boundary is temporarily exceeded. The ED introduces new effectiveness requirements, such as the requirement to “minimise ineffectiveness”, which are not clearly defined. Although we support “minimising effectiveness” as a principle, we believe that the final standard should clarify that it is not intended to be interpreted in practice as a new “bright line”.
- The ED introduces a new concept of “rebalancing” rather than the current de-designation and re-designation; although we see the conceptual rationale for rebalancing, it represents a significant change in practice which has not been sufficiently tested, and, therefore, may cause unintended consequences. We believe that it would be premature to prohibit voluntary de-designation until rebalancing has proven to be a valid replacement.

## 5. Areas of the ED on which we have significant concerns

We have identified a number of proposals in the ED on which we disagree:



- the exclusion of macro hedging of the scope of this ED, as explained in section 2 above;
- the continued prohibition to apply hedge accounting to inflation risk and credit risk;
- the prohibition to include prepayment options in the bottom layer hedge of a net position;
- the continued prohibition to hedge a benchmark component in a sub-LIBOR interest rate;
- the presentation changes for fair value hedge accounting, which are operationally significant but do not result in more meaningful presentation or disclosure.

## 6. Implementation efforts and timing

We believe that the proposal on hedge accounting makes it easier to achieve hedge accounting and therefore current hedge relationships should be able to continue. It is our expectation that this proposal in itself will have limited challenges on implementation. However, as explained above, we strongly believe that a final standard should also address macro hedging.

Furthermore, under the requirements in the ED, the implementation of hedge accounting will also require the implementation of the other phases of IFRS 9. The implementation of this standard as a whole will have a significant impact on our organisation and will require significant effort and time. As a result, we strongly believe that the proposed effective date of 1 January 2013 is not realistic. In our opinion, the entire IFRS 9 (including hedge accounting and the other phases) should not be effective before 2015 and should also continue to provide an exemption for restating comparative figures at this later implementation date.

Our responses to the specific questions raised in the ED are included in the Appendix. As we believe that our main concerns as expressed above are significantly more important than some of the detailed questions, we have not commented in detail on some of the questions raised in the ED.

We are available to discuss these comments further with you and/or your staff.

Yours truly,



Appendix: Responses to questions raised in the ED

**APPENDIX: RESPONSES TO QUESTIONS RAISED IN THE ED****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?**

We agree with the objective of aligning hedge accounting with risk management, resulting in consistency between financial reporting and risk management. The IASB should reconsider its approach to OCI items as the rules in the proposal prohibit inclusion of these items in a hedge accounting relation. The entity's risk management may well include hedging of such instruments.

**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 support the extension of the eligible hedging instruments with this new class and would like to encourage the Board to consider the possibility to further extend the range of eligible hedging instruments if and when that provides more alignment with risk management.

**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 agree that an aggregated exposure that is a combination of another exposure and a derivative may be designated 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 (i.e. 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?**

We 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. In this context we do not understand why it is not allowed under the proposals in the ED to hedge sub-Libor, inflation and/or credit risk components.

**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?**

We welcome the fact that an entity is allowed to designate a layer of the nominal amount of an item as the hedged item, as this is common practice in risk management in certain areas. However, we strongly disagree with the fact that a contract that includes a prepayment option is not eligible to be designated as a hedged item in this respect. We fail to see the rationale why the existence of a prepayment option would prohibit hedge accounting in this respect.

#### **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?**

We support the proposals in the ED to remove the 80-125% effectiveness boundaries. The main issue in practice is that these are artificial boundaries without any period of "repair" if a boundary is temporarily exceeded. The ED introduces new effectiveness requirements, such as the requirement to "minimise ineffectiveness", which are not clearly defined. Although we support "minimising effectiveness" as a principle, we believe that the final standard should clarify that it is not intended to be interpreted in practice as a new "bright line".

#### **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?**

We agree with the concept of rebalancing the hedging relationship as a method of adjusting the hedge relation in order to maintain an effective hedge in line with risk management. However, rebalancing is a new concept that will require a more in-depth analysis and substantive field testing to ensure the concept does not introduce unintended consequences.

**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?**

We conceptually agree that hedge accounting should be discontinued only when the hedging relationship (or part of a hedging relationship) ceases to meet the qualifying criteria and that it should not be permitted to discontinue hedge accounting for a hedging relationship that still meets the risk management objective and strategy, and that continues to meet the qualifying criteria. However, we refer to our response on Question 8 and reiterate our concern that it has not been appropriately tested in practice whether rebalancing is a proper replacement of the current de-and re-designation.

**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?**

No. The proposal to recognise the gain or loss on the hedging instrument in other comprehensive income does not have any benefits compared to the current accounting for fair value hedges, whilst introducing several operational complexities. Furthermore, we have reservations that the proposed treatment results in an increase in better decision-relevant information for users of our financial statements.

We also do not see a benefit in requiring linked presentation because the clarity and usefulness of this information would improve.



### 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 (e.g. 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 (i.e. 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?

We agree with the proposal to accumulate the change in fair value of the option's time value in other comprehensive income. The different treatment for transferring transaction-related and time period-related hedged items to the income statement create additional complexity which can be avoided if only one method is applied.

### 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?**

No. We believe that items in a group that contain a prepayment option should not be scoped out as a layer component. We fail to see the rationale of the requirement to identify gross amounts in order to be able to collectively designate the items as a group as this seems to conflict with the principle based approach of the ED.

Furthermore, especially in this area, the linkage between hedge accounting for closed and open portfolios is eminent and, therefore, we are of the opinion that this ED can only be finalised after incorporating macro hedging for open portfolios.

### 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 (e.g. 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?**

We agree with the proposal on the income statement presentation for a hedge of a group of items with offsetting risk 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?**
- (b) **What other disclosures do you believe would provide useful information (whether in addition to or instead of the proposed disclosures) and why?**

We support principle-based disclosures with respect to hedge accounting in order to provide the users of the financial statements adequate information to allow them to understand the risk management strategy and the hedge accounting applied. However, the required information seems extensive and will require further balancing and/or integration with IFRS 7.

### 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?**

We welcome the proposal to expand the hedge accounting possibilities in accordance with the notion of the entity's risk management principle.

### 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?**
- (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?**

We welcome the efforts to address the current difficulties in applying hedge accounting for credit risk. However, we believe that the right solution should be to enable hedge accounting for credit risk in a principle-based manner, rather than finding suboptimal other alternatives.

### Question 16

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

We support prospective application of the proposals. We believe that the entire IFRS 9, including hedge accounting and the other phases, should have a mandatory effective date not before 2015, with an exemption for restating comparative figures.

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