

9 March 2011

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

Dear Sirs

ED/2010/13 – Hedge Accounting

IMA represents the asset management industry operating in the UK. Our members include independent fund managers, the investment arms of retail banks, life insurers and investment banks, and the managers of occupational pension schemes. They are responsible for the management of £3.4 trillion of assets, which are invested on behalf of clients globally. These include authorised investment funds, institutional funds (e.g. pensions and life funds), private client accounts and a wide range of pooled investment vehicles. In particular, the Annual IMA Asset Management Survey shows that in 2010 IMA members managed holdings amounting to just over 40% of the domestic equity market.

In managing assets for both retail and institutional investors, IMA members are major investors in companies whose securities are traded on regulated markets. Therefore, we have an interest in the standards governing how such companies prepare their financial statements as users.

IMA supports the Board's development of high quality accounting standards, and welcomes the exposure draft and the development of a revised approach to hedge accounting. Users have been concerned that the approach in IAS 39 'Financial Instruments: Recognition and Measurement' is too rules-based and complex, does not reflect an entity's risk management strategy, or give an indication as to whether any hedging meets that strategy. Thus we welcome proposals to replace this with a more principles-based approach by, for example, replacing the 80-125% rule with a less arbitrary approach to assessing hedge effectiveness. Our observations about particular aspects of the ED are set out below.

- **Convergence with US GAAP.** The FASB's proposals to revise accounting for financial instruments included limited changes to hedge accounting. We prefer the IASB's approach which considers hedge accounting more widely and includes non-financial instruments within its scope and would encourage the IASB to work with the FASB in achieving convergence in this area.

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- **Objective.** We welcome the ED's proposed objective as it will help ensure that an entity's accounting is better aligned with its risk management strategy. However, we are concerned that the proposed text of the objective may be too narrow in restricting it to the management of exposures that affect only "profit and loss" and not OCI or the Statement of Financial Position.
- **Flexibility.** We welcome the removal of certain of the artificial bases for hedging and recognition that it can be used to manage risks that are, for example, separately identifiable, grouped and net. However, too much flexibility can give rise to accounting arbitrage. We have not been able to assess how significant the risk of this is but note the concerns in the Alternative View and would like to see more worked examples so that we can better assess the impact of the proposals before the standard is finalised.
- **Inflation risk.** Inflation risk, unless contractually specified, will not be permitted to be hedged under the proposals. Inflation is an identifiable risk and if entities have hedging strategies that minimise it, then we consider it should be a hedgeable component under the standard.
- **Rebalancing and discontinuation.** The ED proposes that hedge accounting should only be discontinued when it no longer affects the risk management strategy. When a hedging relationship no longer meets the objective of the hedge effectiveness assessment but the risk management objective remains, then an entity is to rebalance the hedging relationship as opposed to discontinuing the hedge. Rebalancing is a new concept and we consider there should be further guidance on it.
- **Disclosures.** The fact that more risk components will be allowed to be hedged will increase complexity and a principles based approach will increase the amount of judgment applied. Both of these factors are likely to result in more disclosures and it is essential that preparers do not lose sight of the fact that users need to understand the overall risk management strategies employed – whether an item is disclosed as a separate line item in the statement of financial position or in the notes is largely irrelevant.

Moreover in paragraph 44 an entity should not only describe its risk management strategy for those risks it hedges but should do so for all risks - an entity that hedges should not have to provide more detailed disclosures. In this context, in the interests of producing a more cohesive framework, the IASB should consider disclosures in relation to financial instruments as a whole now that the phases in replacing IAS 39 are complete. This should involve a comprehensive review of IFRS 7 *'Financial Instruments: Disclosures'*.

- **Macro hedging.** The proposals only relate to general hedge accounting requirements in that we understand that requirements for portfolio hedge accounting – or macro hedging – are still being developed. We do not believe the IASB should finalise a standard on hedge accounting until it has developed proposals that address both general and macro hedging.

Please contact me if you would like clarification on any of the points in this letter or if you would like to discuss any issues further.

Yours faithfully

A handwritten signature in black ink, appearing to read 'Liz Murrall', with a long horizontal stroke extending to the right.

Liz Murrall
Director, Corporate Governance and Reporting