

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

4 March 2011

Re: Exposure Draft on Hedge Accounting

Dear Sirs

The Roche Group has a turnover of CHF 47 bn. a year (EUR 34 bn.) derived from our worldwide healthcare business - pharmaceuticals and diagnostics - and employs over 80,000 worldwide. We have a market capitalisation (end 2010) of CHF 118 bn. (EUR 95 bn.) We have been preparing our consolidated financial statements according to IFRS/IAS since 1990 and therefore have a substantial interest in how these develop, so we appreciate this opportunity to give you input on this topic.

Certainly the Board deserves commendation for its efforts at reducing the current complexity of IAS 39 rules on hedge accounting and for re-directing guidance in the direction of better alignment with the economic reality of hedging activities. The proposed approach on hedge effectiveness, the removal of retrospective effectiveness testing and the possibility to apply hedge accounting to components of non-financial items and to net positions and risk components are considerable improvements in our view and should make hedging and risk-management activities more readily understandable for users. In fact, we would have wished the Board to go even further in this direction as the Exposure Draft (ED) unfortunately still contains in our view too many "comfort-blanket" constraints which would limit achievement of the overall objective. As a consequence we are not yet clear on the extent to which it would now be worthwhile for us to undertake more hedge accounting than at present. We outline these areas in our detailed responses to the specific questions in the Appendix. However, our general reaction to the proposals in the ED is very positive.

We must nevertheless add the caveat "depending on the outcome of other work still being undertaken on financial instruments, especially portfolio/macro hedging": depending on this outcome, our views on the present ED looked at on a stand-alone basis may need to be modified.

Also, we believe that the ED could have been improved by investigating more fully the possibilities in respect of inflation risk as a hedged risk and the eligibility of other risks not affecting profit or loss but still subject to risk management strategies.

Finally, on disclosures, we would ask the Board to ensure that disclosure requirements arising on hedge accounting as well as on the other areas currently being worked on are carefully coordinated for a coherent revision of IFRS 7 – hopefully with more differentiation to prevent “over-disclosure” of immaterial items, which has been a problem for non-financial entities since the introduction of that standard.

Sincerely,

F. Hoffmann-La Roche AG

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Appendix – Responses to specific questions in the Exposure Drafts

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 very much support the proposed introduction of this objective as it is much better oriented to entities providing users with information which reflects the economic reality of hedge situations. If anything, we regret that the Board did not feel able to go even further in focusing more closely on this objective in setting the detailed requirements, rather than restricting it by anti-abuse constraints and thus lessening the relevance of the information provided. They are, nevertheless, a substantial improvement on IAS 39 rules.

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 very much welcome the proposed extension of the range of eligible hedging instruments to include non-derivative financial instruments. This would allow an entity to align its hedge accounting more closely to its risk management objectives.

Considering the objective of hedge accounting, we think that the nature of the hedging instrument should be much less important than the achievement of the risk management objective. We therefore regret that the IASB did not fundamentally reconsider the eligibility of financial instruments in categories other than fair value through profit or loss. We believe this decision may prevent an entity from portraying its risk management practice in its financial reporting. The Board should also have considered the possibility to further extend the range of eligible hedging instruments (e.g. equity investments designated as at fair value through other comprehensive income, financial instruments at amortised cost, disaggregation of non-derivative hedging instruments into components other than foreign currency risk). These exclusions would unfortunately prevent achievement of the objective in many cases.

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 with this proposed improvement as it would facilitate hedge accounting for entities that enter into transactions that give rise to a combination of different risks. It would thus allow hedge accounting to be more closely aligned to actual risk management practices.

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?

We welcome the general proposal to permit designation of cash flows or fair values of an item attributable to a specific risk or risks as hedged items irrespective of the nature of the item being hedged. This would eliminate a significant problem for companies that manage individual risk components separately and allow closer alignment of the accounting treatment to risks management practices. However, we do challenge the proposed rule in paragraph B18 that ‘inflation is not separately identifiable and reliably measurable and cannot be designated as a risk component of a financial instrument unless it is contractually specified.’ But why are inflation components so unique? Surely the principle of “separately identifiable and reliably measurable” should be a sufficient criterion.

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 agree with the proposal as it would help to align accounting better with many companies’ risk management strategies.

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 warmly welcome the proposals to lessen the bureaucratic burden currently associated with hedge accounting under IAS 39, though we would have hoped that the Board could have gone further in this direction. For instance, the proposed rules for demonstrating effectiveness would still involve companies in an administrative burden, and we think that, once a hedging relationship has been documented, requiring further assessment would be unnecessary given that any ineffectiveness is in any case measured and accounted for. Perhaps an approach could be considered whereby an assessment is only necessary when internal and/or external indicators suggest that the hedge may no longer be effective.

That said, the removal of the 80 to 125 per cent bright line test for assessing and measuring hedge effectiveness would certainly be a significant step towards introducing flexibility and abolishing unnecessarily restrictive requirements that currently discourage entities from applying hedge accounting. The elimination of this requirement would simplify implementation of hedge accounting and align it more closely to an entity’s risk management strategy. The elimination of the retrospective test should also facilitate the

application of hedge accounting as it would prevent de-designation in situations where minor price changes cause a hedge to be retrospectively ineffective.

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 broadly agree with the proposed general concept of ‘rebalancing’ hedge relationships as it would appear to allow the entity to reflect changes that occur in a hedging relationship from a risk management perspective. It would avoid frequent discontinuation and restarting of hedge relationships when the risk management objective remains the same. However, we have yet to form a clear view on how practical, complex and costly the implementation of the concept would be for us in practice, and we would certainly find a little more application guidance and/or illustrative examples useful.

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?

While we understand that the concept of re-balancing would obviate the need to discontinue hedge accounting in many cases where the criteria for its application are still fulfilled, we find it somewhat difficult to understand why the Board felt it necessary to introduce this bureaucratic restriction.

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?

We find the final presentation proposed – namely with any ineffectiveness shown in profit or loss – sensible, but we find the two-step approach to getting there would create extra work and extra confusion without providing any significant useful additional information which could not be even more easily provided as a disclosure. The prime focus of both preparers and users is the income statement, so grossing up the accounting entries in OCI would be likely to just increase operational complexity for no benefit from the preparers’ perspective. We believe that presenting the transfer of ineffectiveness on a separate line in other comprehensive income, as we understand the board is proposing, will not be relevant for assessing how effective an entity is with regard to its fair value hedge programme.

As far as the statement of financial position is concerned, we find that the proposal not to adjust the hedged item for the gain or loss associated with the risk being hedged but to show it as a separate line for each balance sheet position affected would be likely, in many circumstances, to clutter up the statement and reduce its understandability. Consequently, we recommend the Board to permit greater flexibility to take account of the individual situation of the entity, so that – for instance – such adjustments could be included in the statement netted with the position affected but split out in the notes, or all collected on one line in the statement and analysed in the notes if the statement itself would otherwise lose clarity because of the number of items, some of which might not be material.

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?

While acknowledging that the Board is here trying to resolve an important practical issue, we feel that the proposal would introduce additional complexity and build additional rules around the consequences of accounting for options. To implement this proposal many preparers would need to change systems, which may not currently separate the intrinsic and time values of options. Also, it would lead to an artificial split of the fair value of the option, which is not consistent with the prevailing valuation models adopted for pricing these instruments.

We would support a more principle-based approach that would consider the issue of systematic ineffectiveness in the light of the greater flexibility of the new ‘objective-based’ effectiveness assessment that the Board is proposing.

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?

It is somewhat difficult to respond to this question without an understanding of the Board's direction on portfolio/macro hedging. We understand that these deliberations represent an intermediate steps toward the development of a model for portfolio hedges. However, until we gain a better understanding of the Board's direction in respect of macro hedging, we will not be able to comment on these proposals in full.

Some restrictions will be maintained in the general hedging model for closed groups of hedged items, the rationale for which is not always clear. Field-testing of the effects of the proposals should be undertaken. Otherwise, the Board risks replacing one set of complex, rule-based, requirements with another set of complex requirements.

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?

We agree with the proposals in the ED on the presentation in the income statement of the effects of hedge accounting for group of items, particularly with the proposal to present on a net basis in a separate line in the income statement the gains or losses from the hedging instrument when it is designated in a hedge relationship of a net position of offsetting items that affect different lines of that statement. This would avoid artificial grossing up of gains or losses.

On the ED proposal relating to the presentation in the statement of financial position of the effects of fair value hedge accounting for group of items, we believe a more situative, judgmental approach is more desirable, as described in our response to Q. 9.

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 have some reservations about the extent and contents of the proposed disclosures. We would like to request that, before finalising these proposals and others on financial instruments, the Board consider the following:

- In many areas, particularly with forward-looking information, entities may be competitively disadvantaged by having to reveal such extensive details on their risk management positions and policies;
- A thorough review of the impacts of the proposals on IFRS 7 should be undertaken, so that the whole can be revised in a coordinated and coherent fashion;
- Field-testing whether the proposed disclosures meet the information needs of users at a reasonable cost would be highly desirable.

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?

The proposals do not appear to us to go far enough in addressing some of the practical problems related to the 'own use' exception. We therefore urge the IASB to further investigate this issue with affected entities before finalising the proposals.

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 understand the Board's doubts about permitting credit risk as a risk which can be hedged. However, the proposed objective of the hedge accounting is to represent the effect of an entity's risk management activities, and it appears that many entities – particularly financial institutions – do indeed hedge this risk. Consequently, *as the hedging relationship would in any case have to meet the general requirements for qualification*, including the risk being separately identifiable and reliably measurable, and is consistent with the risk management activities, we see no valid reason for making an arbitrary exception. Preparers and users would in any case generally prefer information which is approximately right to information which is precisely wrong, and if the credit risk is measured in a congruent manner for both hedged item and hedging instrument the fact that ineffectiveness would find its way into profit or loss should prevent material distortions. Furthermore, we find the Board's argument about not wishing to create complexity could be used against many of the other proposals in this ED.

Question 16

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

We believe that all aspects of the revisions to the reporting of financial instruments must be introduced simultaneously. Also, given that many of the aspects – including macro-hedging – are not even clear yet and that for many entities the system changes involved in the overall revision would be very significant, a latest mandatory date of January 1, 2015 would be the earliest practical effective date for many entities.

On the proposed transitional requirements, we agree that prospective application is appropriate, considering that retrospective application would often require the application of hindsight and that providing the necessary documentation to support the hedging relationships would often be extremely difficult.

