

International Accounting Standards Board
30 Cannon Street
London
EC4M 6XH

7 March 2011

Dear Sirs

Exposure Draft 2010/13 *Hedge Accounting*

Barclays is a UK-based financial services group, with a large international presence predominantly in Europe, the USA, Africa and Asia. It is engaged primarily in banking, investment banking and investment management. In terms of market capitalisation, Barclays is one of the largest financial services companies in the world. Barclays has been involved in banking for over 300 years and operates in over 50 countries with more than 156,000 employees.

We are strongly supportive of converged IFRS and US GAAP requirements for hedge accounting. After careful consideration of the proposals in the International Accounting Standards Board's ('IASB' or 'the Board') Exposure Draft *Hedge Accounting* ('ED'), we believe that overall the proposals are an improvement on current IFRS or US GAAP hedge accounting requirements, or the more limited changes on hedge accounting that the US Financial Accounting Standards Board ('FASB') have proposed in their recent due process documents.

We are supportive of the Board's aim in the ED to more closely align risk management activities and the financial reporting of those activities. We believe this will result in our financial statements being of greater relevance to our investors.

We do however have concerns about how some of the proposals might be applied in practice, as we believe the guidance in some important areas is unclear. How to make the link between risk management and the proposed accounting operational is a consistent theme in our response – especially in the context of effectiveness assessment, rebalancing/discontinuation and disclosures. We believe that how this link is applied is fundamental, both in terms of making the proposals operational but also to ensure that accounting does not end up driving risk management – which would be both contrary to the objective set out in the proposals and undesirable. In particular:

- **We believe that limiting hedge accounting to exposures to particular risks that only affect profit or loss limits the usefulness of information to investors** as it does not allow us to represent our risk management practices (which are not limited to items that affect profit or loss) in our financial reporting. This limitation contradicts the objective of the ED to more closely align hedge accounting and risk management.
- **We consider that the rebalancing proposals are confusing and complicated.** We believe that rebalancing should not be made mandatory if it is not part of the risk management objective of entities. Many entities consider that, from an operational perspective, if a hedge performs

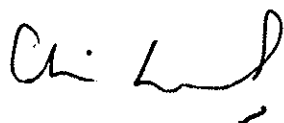
appropriately, rebalancing is unnecessary. Rebalancing and de-designation are interlinked. For Barclays, which has extensive hedging activities, de-designation is important in making hedge accounting operational. Prohibiting de-designation will result in a major operational burden, and may result in us being unable to apply hedge accounting in a cost-effective way. Such an outcome will not meet the Board's objective of improving the relevance of financial statements to investors, and will increase the demand from our investors for non-GAAP information about risk management activities.

- **We do not believe it appropriate for the eventual standard to prohibit hedge accounting for credit risk and inflation risk.** The proposals indicate that if a risk is separately identifiable and reliably measurable it should be eligible for hedge accounting. This includes non-financial items. This principle has worked well in practice for financial items – and has resulted in the appropriate recognition and measurement of ineffectiveness, but further changes are necessary. If an entity can separately identify and reliably measure a risk component, and the entity is hedging that risk, it should not be prevented from applying hedge accounting to that risk component.
- **We believe that the Board needs to address the hedging of credit.** For financial institutions, the hedging of credit risk is an important activity that our investors want to understand. The application of IAS 39 *Financial Instruments: Recognition and Measurement* to credit risk hedging activities does not result in useful information for our investors. Of the three alternatives described in the ED, we consider Alternative 3 to be an improvement on current practice. However, we believe that the Board should also consider an approach whereby a specific exception for credit is made to the normal identification approach for components, which would be less incongruous to the overall hedge accounting approach than the three alternatives described and more representative of the way that credit is hedged.

We understand the reasons behind the Board's decision to develop general hedging proposals separately from the macro hedging proposals. We believe that the Board should finalise the general hedging proposals and not necessarily wait until the macro hedging deliberations are complete. We do however urge the Board to develop the proposals on macro hedging as a matter of urgency and to consider our responses to this ED in those deliberations. We note the comments from the Board and IASB staff that the proposals set out in the ED do not necessarily determine, or restrict, the approach taken on macro hedging. We also believe that the Board may need to reconsider aspects of the general hedging model (for example, rebalancing and discontinuation) once macro hedging is completed.

We trust that the Board find our comments useful. If you would like to discuss our response in more detail, then please contact Gavin Francis (Gavin.Francis@Barclays.com) at 1 Churchill Place London E14 5HP.

Yours faithfully,



Appendix 1

Responses to detailed questions

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 are generally supportive of the Board's proposed objective to more closely align hedge accounting to risk management activities, and the financial reporting of those activities (paragraph BC14(a) of the ED). By more closely aligning the use of derivatives and other hedging instruments with the financial reporting for those instruments, we believe that the financial statements will provide more useful information to our investors. However, we do have some operational concerns, which we note in responses to many of the Questions below.

We also believe that limiting hedge accounting to exposures to particular risks that could affect only *profit or loss* limits the usefulness of information to investors. We agree that hedge accounting is modification of the normal recognition and measurement requirements. However, the use of financial instruments in hedging risk exposures is not limited to items that might affect profit or loss, and such a limitation is also inconsistent with the Board's long-stated objective of one performance statement that shows all income, expenses, gains and losses to users of financial statements. Hence maintaining such a restriction will inevitably impair the usefulness of financial statement information about performance to investors.

We address our concerns about the application and the scope of the proposals in turn below:

1 Application of the proposed objective

Background

While we agree with the closer alignment between risks management and financial reporting, we believe that *how* the proposed objective might be applied in practice is unclear, and inappropriate application of the objective may actually result in the accounting driving the articulation and development of risk management, which we believe to be the opposite of the intended outcome of the proposals.

How to make operational the link between risk management and the accounting is a common theme through our response – whether it is with regard to effectiveness assessment, rebalancing, discontinuation or disclosures.

We believe that this is the most pervasive and important issue that the Board needs to consider and address for these proposals to be successful both from an operational viewpoint, but also to result in more useful information being provided to investors.

Risk management

At Barclays, risk management objectives and policies are set at Board or Board Risk Committee level. A key example for the Group is interest rate risk. The risk management objective is to align the interest rate flows across the group, between assets and funding to mitigate the interest rate risk that arises from term structure of interest rates and basis risk, allowing for volume, liquidity and timing constraints.

To maximise efficiency, interest rate risk generated by customer portfolios or market transactions is transferred internally between business units, aggregated, netted and ultimately moved to a business unit which will transact hedging trades (usually interest rate swaps) with the external market. The risk management objective and policy is set at a high level, and the policy does not necessarily set out how the objective should be achieved or how the policy should be executed.

Hedge accounting is sometimes applied at transaction level, but is most commonly applied at portfolio, business or even a higher level by selecting hedging instruments and hedged items from the total pool of interest rate based products across the bank – such as issued debt instruments, inter-bank debt, customer loans and deposits or interest rate swaps. Through this process hedge accounting relationships are created that match the net risk of the instruments giving rise to the accounting mismatch so as to minimise (within efficiency based tolerances) income statement volatility to reflect in the financial statements, as far as possible, our economic risk management strategy.

Aligning risk management and hedge accounting

The ED is drafted mainly in the context of relationships between individual hedged items and hedging instruments. For an entity with limited risk exposures and limited risk management activities, linking a risk management objective with individual hedging relationships is probably appropriate and readily operational.

However, for a complex entity such as Barclays the very high volumes of transactions create the need to measure and manage risk exposures on an aggregated basis. Hedge accounting should also be applied on an aggregated basis for operational reasons and because that approach would best capture our risk management objective and approach. Risk management structures are influenced by both the size of the entity and the risk exposure and transactions of the entity. Therefore, in order for the hedging proposals to be applicable to all industries and to remain operational, they need to be aligned to the level at which risk management exposures are aggregated, measured and reported to senior management.

Applying the risk management objective in this way will also ensure consistency with the approach for determining the appropriate level at which the 'business model' criteria should be applied in IFRS 9 *Financial Instruments*, and will also aid an entity's discussion of financial risks and its management of them under the requirements of IFRS 7 *Financial Instruments: Disclosures*.

Risk management vs. hedge accounting approaches

The fair value and cash flow hedge accounting approaches exist to address particular types of recognition and/or measurement mismatches that are created by the financial reporting framework, in particular the mismatch between items held at fair value through profit or loss and those held at amortised cost. Therefore, the ED (like IAS 39) assumes the entity is either hedging exposures to changes in fair value or the potential variability of future cash flows. However, this is a hedge *accounting*, not a risk management approach.

As noted above, a key objective of our risk management policy is to mitigate interest rate risk.

Today, we apply hedge accounting to our interest rate risk management activities mainly by using the cash flow hedge accounting approach, with a limited amount of fair value hedge accounting where this is operationally simpler to apply. We make limited use of the portfolio hedge accounting model as it does not offer us significant operational benefits. The decision to apply cash flow hedge accounting is as much for operational reasons as for any other reason, although in some situations the hedge accounting approach

used is dictated by economic hedges of fixed rate liabilities (such as core deposits) being ineligible to be designated as hedged items for accounting purposes.

Forcing a risk management objective to fit to a particular type of hedge accounting approach may result in an entity trying to modify its risk management strategy to achieve a particular hedge accounting mechanism. That is, risk management policy becoming subsidiary to hedge accounting – an outcome that is contrary to the objective in the proposals.

Our overall concern is that the proposed objective will be applied by trying to link an overall risk objective policy with a particular type of hedge accounting mechanism, on a transaction by transaction basis. We do not believe this to be an appropriate application that will provide useful information to investors, or an application that is operational.

2 Scope of the proposals

We believe that limiting hedge accounting requirements to exposures to particular risks that could affect only *profit or loss* limits the usefulness of information to investors. Financial instruments used to hedge risk exposures are not limited to items that might affect profit or loss, and hence contradicts the objective of the ED - to more closely align hedge accounting and risk management. Such a limitation is also an exception to the overall principle-based approach taken by the proposals and is inconsistent with the Board's long-stated objective of a single performance statement that presents all income, expenses, gains and losses to users of financial statements.

Use of financial instruments to hedge exposures

Our risk management activities are not restricted to those items that affect profit or loss. Specifically, we use financial instruments to hedge the foreign exchange risk we face on equity investments whose fair value changes would, under IFRS 9 *Financial Instruments*, be recognised in Other Comprehensive Income with no recycling to profit or loss permitted.

We also undertake economic risk management in common with many other banks, to protect our regulatory capital position; this therefore includes items (as in the case above) that might be recognised in Other Comprehensive Income. Similarly, many non-financial companies may hedge to protect their balance sheet positions to ensure compliance with borrowing covenants or similar restrictions.

The consequences of limiting hedge accounting to risks that could affect profit or loss

The consequences of the limitation in the ED are that the derivatives used to hedge the FX or other risk will be measured at fair value through profit or loss. However, movements in the fair value of the hedged item will be recognised in other comprehensive income. This creates meaningless “noise” in our income statement that does not provide useful information to financial statement users as it does not represent our risk management approach. This will result in demand for pro-forma (non-GAAP) information by investors and undermine the value of the financial statements.

Continuous Income Statement

The decision to restrict hedge accounting to items affecting profit or loss is in conflict with the Board's vision that the statement of comprehensive income be considered as a continuous performance statement. We believe that by applying different principles to items recognised in profit or loss from those recognised in Other Comprehensive Income obstructs this vision. Furthermore, we do not believe it is appropriate to be

making such exceptions until the Board determine the accounting principles that underlie other comprehensive income.

Hedge accounting mechanics of permitting hedging of Fair value through Other Comprehensive Income

We understand the Board's main concerns related to the practical issues that would occur in the matching of the fair value of the hedged item and the hedging instrument and the recognition of hedge ineffectiveness (see paragraph BC 23 of the ED).

We support the second alternative presented in the Basis of Conclusions (see paragraph BC 25), namely that ineffectiveness should be presented in profit or loss, consistent with hedge accounting principles. We also believe that presenting all hedge ineffectiveness in the same place in the financial statements will provide the most useful information to our investors.

We recognise that this contradicts the prohibition of reclassifying to profit or loss gains or loss on equity instruments accounted for at fair value through Other Comprehensive Income but believe that this would be an appropriate exception as is the case of dividends received on these investments.

More specifically, in relation to foreign exchange risk, we manage the foreign exchange risk of strategic investments in a similar way to our hedges of net investments and would support a consistent approach, whereby ineffectiveness is recognised in profit and loss.

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?

Although the situations in which a non-derivative financial instrument measured at fair value through profit or loss will be used as a hedging instrument appear to be limited, we support this proposal as long as it is consistent with an entity's risk management strategy.

We are concerned that allowing non-derivative financial instruments measured at fair value through profit or loss as hedging instruments could be abused, as it could override the fair value option to measure a financial instrument at fair value through profit or loss. Nevertheless, to align hedge accounting with risk management, designation as a hedging instrument may provide more useful information to investors. Any use of a non-derivative financial instrument measured at fair value through profit or loss as a hedging instrument should, of course, be supported by documentation and effectiveness assessment testing, and the Board may wish to consider whether additional disclosure is warranted.

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 derivative may be designated as a hedged item. Some entities often enter into transactions that give rise to different risks, and it may be that their risk management strategy is to hedge these risks independently. To maintain the objective of the exposure draft (to achieve a closer alignment between hedge accounting and risk

management) it is important that aggregated exposures of a derivative and a non-derivative be eligible to be designated as a hedged item.

However, we believe that additional guidance is required. Where risk management calls for frequent changes in the hedging relationship by layering derivatives on derivatives (for example, switching from floating interest rate to fixed rate, and vice-versa, to target a funding mix) significant complexity arises from the interactions between the different hedge accounting mechanisms. We believe it necessary that the Board consider this issue in greater detail and provide application guidance to avoid diversity arising in practice.

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 consider that the current principles in IAS 39 generally work well in practice for most financial items, although there is scope for improvement. This includes the appropriate measurement of hedge effectiveness, and the recognition of hedge ineffectiveness. We therefore welcome the Board's decision to extend the eligibility to non-financial items.

However, we do not consider it is appropriate to make explicit exceptions in the case of inflation and credit risk. This proposal not only retreats to the current situation where there is inconsistent treatment between financial and non-financial items (given that there are no proposed explicit exceptions for non-financial items) but also undermines the general principle to base hedge accounting on an entity's risk management objective. If an entity has identified a non-contractually specified inflation component or a credit risk component that can be reliably measured, and it is hedging this risk from risk management perspective, then the entity should not be precluded from applying hedge accounting to such a risk component.

In response to the Alternative View, we believe that the criteria that a risk must be separately identifiable and measurable has and will continue to result in ineffectiveness being appropriately calculated and recognised, as long as there are appropriate guidelines stipulating that the movement in the hedged risk component cannot simply be equal to the movement in the hedging instrument (e.g. such as an assumption that a credit default swap price simply mirrors the credit component of a loan). To be eligible, an entity must be able to demonstrate the different elements and inputs that contribute to the price and movement of the hedged component.

Given the continuing evolution of financial markets, we believe the Board should maintain the fundamental principle of separately identifiable and reliably measurable risk components, without explicitly prohibiting items such as inflation or credit risk. This will provide the necessary flexibility to enable the current accounting standards framework to prevail into the future.

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?**

We support the ability to designate a layer of the nominal amount of an item as a hedged item, if that approach is consistent with the entity's risk management. This approach is similar to that used for cash flow hedges today to address uncertainty regarding hedged items and, as is noted in the basis for conclusions, similar uncertainty exists for fair value hedges in some situations. The proposed approach therefore better reflects the approach often used in risk management to address such uncertainty.

- (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?**

The proposals noted above may be helpful with entities with few hedging relationships, or for hedging relationships of non-financial items. As noted in the ED, when considering individual items, a prepayment option whose fair value changes in response to the hedged risk would result in ineffectiveness being misrepresented. However, the proposals are unlikely to provide any significant relief from either an operational perspective, or from the point of view of aligning hedge accounting with risk management, for entities that undertake significant hedging activities based around portfolios of financial assets, because of the restriction regarding prepayment options.

In such situations, the effect of prepayment options are modelled and managed by risk management in the context of the total portfolio, and not in the context of each individual asset. This approach permits the benefits of greater certainty about likely prepayments arising from a portfolio assessment. We believe that a workable solution for both fair value and cash flow hedging should be to allow for the hedging of bottom layers within the portfolio hedge accounting model. In such situations, to reflect risk management, prepayments should be taken from the top layer, allowing the bottom layer to remain "intact". We therefore urge the IASB to develop proposals for portfolio hedge accounting as a matter of urgency.

We also do not agree with paragraph B23 of the ED – that a prepayment option is not an eligible hedged item in fair value hedge if the fair value of the option is affected by changes in the hedged risk. To reiterate our response to Question 4, we do not consider it appropriate to make explicit exceptions for eligible hedged items, in a principles-based standard. An entity that can separately identify and measure changes in value due to prepayment risk and interest rate risk should be able to exclude the prepayment option.

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?

Barclays supports the removal of the 80-125% "bright line" test to determine whether a hedging relationship qualifies for hedge accounting. We agree with the views expressed in paragraph BC 77 of the ED that the "bright line" assessment criteria is difficult and onerous to apply and that it does not reflect an entity's risk management strategy.

As all ineffectiveness is required to be measured and recognised in the period it occurs, arguably, there is no need for effectiveness assessment criteria, given a requirement that hedge accounting reflects an entity's risk management activities. However, on balance, we agree that requiring an effectiveness assessment (whether qualitative or quantitative) is a reasonable requirement to place on preparers to ensure the appropriate application of hedge accounting.

Hence we support inclusion of an effectiveness assessment, and we believe moving to an objective based approach will more closely align with an entity's risk management strategy and result in more useful information to our investors. We do not support simply moving the bright-line test (for example, to 'reasonably offset') that we have today, as that is inconsistent with the objective set out in the ED.

Effectiveness from a risk management perspective

We set out above the example of Barclays' interest rate risk management objective, i.e. , to align the interest rate flows across the group, between assets and funding, to mitigate the interest rate risk that arises from term structure of interest rates and basis risk, allowing for volume, liquidity and timing constraints. To maximise efficiency, interest rate risk generated by customer portfolios or market transactions is transferred internally between business units, aggregated, netted and ultimately moved to a business unit which transacts hedging trades, usually interest rate swaps, with the external market.

For risk management purposes, Barclays has set tolerances for economic ineffectiveness arising from interest rate risk exposures. These tolerances, which reflect the cost of hedging and other practical constraints, do not result in an expectation of, or actual realisation of, 100% effectiveness either economically or from an accounting perspective.

Applications of the proposals in the ED

In order to meet the hedge effectiveness requirements in the exposure draft, an entity must ensure that the hedging relationship is both unbiased and minimise expected hedge ineffectiveness (paragraph 19(c) and B29 of the ED).

We believe that the use of the terms 'unbiased' and 'minimise' should be reconsidered. Some view the use of such terms as implying 100%, or close to 100%, effectiveness. We understand that this was not the Board's intention, and such an interpretation would not reflect the practical or operational realities of risk management.

The term 'minimise' also implies that constant rebalancing of hedging relationships should be undertaken. Once again, we understand that this was not the Board's intention, and of course, it does not reflect how risk management operates. Rebalancing should follow the approach taken by risk management, with all ineffectiveness reported. An entity should be permitted to proactively rebalance. This should not be restricted only to adjustments to effect a change in the hedge ratio as implied in the exposure draft, and on the other hand, rebalancing should not be made mandatory.

We agree that the effectiveness assessment requirements should extend past identifying accidental offset. In practice, a robust risk management framework would preclude such a hedge relationship from being entered into from the outset. However, we agree that it is necessary to provide guidance around accidental offset.

We recommend that the Board clarifies the proposal that all potential sources of hedge ineffectiveness should be identified and documented at designation and on an ongoing basis (paragraph 19) b) of the ED). We assume it was not the intention for this to be an open ended search. It would be more appropriate for an entity to consider and document the main sources of potential ineffectiveness.

Paragraph B 42 also requires an entity to consider the time value of money when measuring hedge ineffectiveness. When considering the offset between the intrinsic values of the hedged item and hedging

instrument, we consider this to be too prescriptive and therefore ask the Board to clarify that they do not intend to change established market practice.

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 consider the proposals put forward in the ED (paragraphs B46- B60) to be confusing, complex and we are concerned about how they will be interpreted and applied.

Our main concern regards whether rebalancing is mandatory, if the hedging relationship fails to meet the hedge effectiveness assessment. As we mentioned in our response to Question 6 we believe that rebalancing should follow the approach taken by risk management, and should be neither mandatory nor restricted to adjustments that change the hedge ratio.

The proposed guidance focuses on rebalancing in the context of hedge ratios. However, in the context of interest rate risk for Barclays, the hedge ratio is simply not relevant. It will always be 100%, or close to 100%. It is unclear when reading the rebalancing proposals (paragraphs B46- B60) if rebalancing is restricted to only adjustments to effect a change in the hedge ratio. We assume this was not the intention and we urge the Board to reconsider the rebalancing rules and how they envisage rebalancing to be interpreted and applied in practice (see further explanation below).

Finally the rebalancing proposals have the potential to become unduly complex, especially in a banking context where risk exposures can change on a daily basis. A hedge accounting model that only allows for rebalancing could result in a substantial number of layers of separate hedge accounting relationships, which become very difficult to manage operationally. Thus rebalancing should also be supported by an ability to discontinue hedge accounting on a voluntary basis, to allow reasonable flexibility for an entity to discontinue hedge accounting relationships and replace with new hedge accounting relationships in line with their own risk management strategy.

This would also be consistent with the original objective of the exposure draft to simplify hedge accounting.

Rebalancing from a risk management perspective

As noted above, Barclays' overall interest rate risk management objective is to mitigate interest rate risk arising from the term structure of interest rate and basis risk. To maximise efficiency, interest rate risk generated by customer portfolios or market transactions is transferred internally between business units, aggregated, netted and ultimately moved to a business unit which transacts hedging trades (usually interest rate swaps) with the external market.

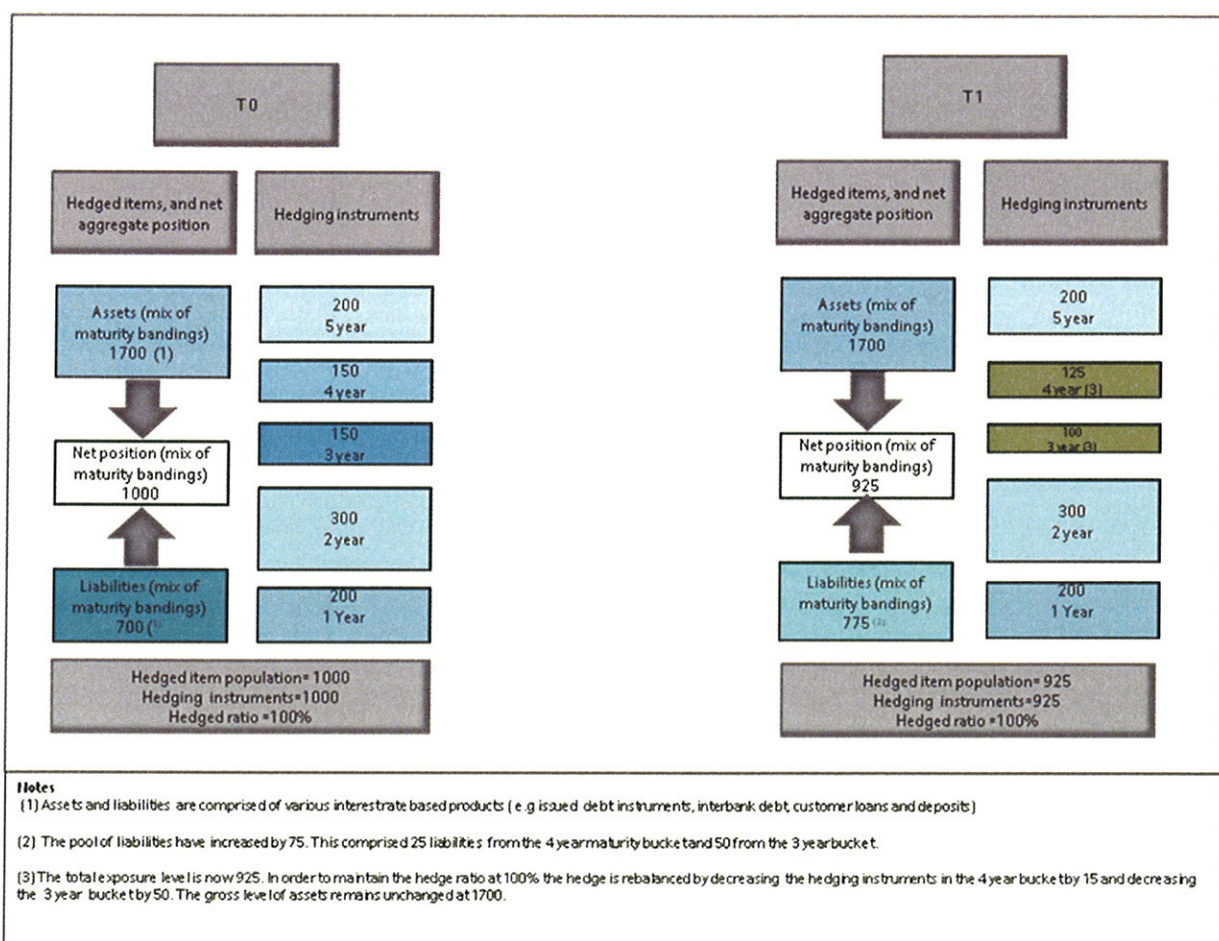
Risk is managed in all business units across the Group to be within set limits per business unit, based on risk appetite.

Hedge accounting may be applied at transaction level, but is far more commonly applied at portfolio, business or at an even higher level by selecting hedging instruments and hedged items from the total pool of interest rate based products across the bank (e.g. issued debt instruments, inter-bank debt, customer loans and deposits, interest rate swaps) to create hedge accounting arrangements that match the net risk of the instruments giving rise to the accounting mismatch so as to minimise (within efficiency based tolerances) the income statement volatility.

One common strategy, in order to most easily match the hedge arrangements with the net risk position, is to create a number of hedge accounting arrangements to match the different risk maturities within the net position. As the overall position increases, new hedge accounting arrangements are designated. If the overall position reduces, existing hedge accounting arrangements may be de-designated (or, potentially re-designated in a smaller amount). These changes are undertaken on a daily or monthly basis. Several hundred hedging relationships are managed by this process.

This approach to de-designation is the method we use to make hedge accounting operational under IAS 39.

This has been illustrated in the diagram below.



Application of the proposals in the ED

It is not clear whether our risk management strategy as illustrated above would be achievable under the ED through rebalancing or partial discontinuation. We would strongly support a hedge accounting model that allows us to respond to a change in our gross liabilities by adjusting the hedging relationship down to the new exposure level (CU925), whilst maintaining a constant hedge ratio. A model that allowed us to simply reduce the level of hedging instrument in the relevant time bucket (as illustrated in the diagram) would represent a considerable improvement to the current hedge accounting rules under IAS 39. It would also allow us to easily reflect our risk management techniques in the financial statements, whilst simultaneously reducing the operational burden

Link to objective of the ED

To reiterate our primary concern, as expressed in our response to Question 1, the level at which the hedge can be rebalanced is crucially important. In instances where the hedge relationships exist at the net risk level, as we describe above, to require re-balancing to be based on changes in the hedge relationship at the portfolio level would be operationally impossible. We urge the Board to consider our example provided above and devise a rebalancing approach (and/or a de-designation approach) that can be applied not only at the transaction or portfolio level but also to a net exposure of items giving rise to interest rate risk.

It would be helpful if guidance to this effect was included to demonstrate how the objective of representing the effects of an entity's risk management activities in the financial statements can be applied at a number of levels depending upon the risk management approach taken by it.

We would also recommend that the Board revisit the proposals on re-balancing and discontinuation after completing deliberations on macro hedging.

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 support the overall objective of the hedge accounting proposals to align hedge accounting to risk management. However in order to achieve this objective, the Board should allow an entity to voluntarily revoke a hedging relationship, without restriction, should the entity no longer wish to pursue hedge accounting. We do not agree with the Board's logic (set out in BC117) that, if an entity initially qualified to use hedge accounting in accordance with its risk management objective, it is arbitrary and unjustifiable to voluntarily discontinue hedge accounting. This has no conceptual merit given that it is optional to apply hedge accounting in the first instance.

The Board should also be aware of the operational complexities that would occur if hedge accounting cannot be discontinued on a voluntary basis. As we mentioned in our response to Question 7, the

rebalancing proposals have the potential to become unduly complex, especially in a banking environment with risk exposures that can change on a daily basis. A hedge accounting model that only allows for rebalancing could result in a substantial number of layers of separate hedging relationships, which becomes very difficult to manage operationally. Thus rebalancing should also be supported by an ability to discontinue hedge accounting on a voluntary basis, to allow reasonable flexibility for an entity to discontinue hedge accounting relationships and replace with new hedge accounting relationships in line with their own risk management strategy. This would also be consistent with the original objective of the exposure draft to simplify hedge accounting.

Under paragraph 64 of the ED, a hedging relationship can only be discontinued in its entirety when the hedge relationship no longer meets the risk management objective and strategy e.g. the entity no longer pursues that risk management objective and strategy. The ED is not clear as to what constitutes a change in risk management objective and strategy and interpretations could differ.

Discontinuation from a risk management perspective

In our response to Question 7, we described our risk management objective and strategy regarding hedging and current use of the hedging de-designation rules under IAS 39. The risk management objective for interest rate risk is to align the interest rate flows across the Barclays Group (between assets and funding) to mitigate the interest rate risk that arises from term structure of interest rates and basis risk.

To maximise efficiency, interest rate risk generated by customer portfolios or market transactions is transferred internally between business units, aggregated, netted and ultimately moved to a business unit which transacts hedging trades (usually interest rate swaps) with the external market.

Hedge accounting is sometimes applied at transaction level, but is most commonly applied at portfolio, business or even higher level by selecting hedging instruments and hedged items from the total pool of interest rate based products across the bank (e.g. issued debt instruments, inter-bank debt, customer loans and deposits, interest rate swaps) to create hedge accounting arrangements that match the net risk of the instruments giving rise to the accounting mismatch so as to minimise (within efficiency based tolerances) the income statement volatility.

A common strategy, in order to most easily match the hedge arrangements with the net risk position, is to create a number of hedge accounting arrangements to match the different risk maturities within the net position. As the overall position increases, new hedge accounting arrangements are designated. If the overall position reduces, existing hedge accounting arrangements may be de-designated (and potentially re-designated in a smaller amount). These changes are undertaken on a frequency that varies from daily to monthly. Several hundred hedging relationships are managed by this process. (See diagram in our response to Question 7)

In the instance that the net exposure being hedged has reduced - through for example, an increase in gross liabilities or a decrease in gross assets - the hedge no longer meets our risk management objective for interest rate risk; our objective is to align the interest rate flows across the group (between assets and funding) to mitigate the interest rate risk that arises from term structure of interest rates and basis risk. Therefore our hedging strategy is altered to match the new exposure level, by changing the hedge relationships and hedging instruments so they match the new net exposure level, by de-designating existing hedge relationships. We believe use of de-designation in this manner would be permitted under the proposals set out in the exposure draft, as de-designation is clearly used to ensure the total portfolio of hedge accounting arrangements are aligned with the risk management strategy.

Link to re-balancing proposals

We set out in our response to Question 7 that is unclear when an entity is applying re-balancing or partial discontinuation. We ask the Board to consider whether paragraph B65 would be more appropriate under the rebalancing proposals and we ask for further guidance as to when either rebalancing or partial discontinuation is relevant.

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?**

We support the Board's proposals 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 and loss. We acknowledge that the presentation in other comprehensive income would result in a net nil position, but that the proposed recognition and presentation approach will allow investors to see in one location in comprehensive income the hedge accounting effects, as well as highlighting ineffectiveness recorded in profit or loss.

- (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?**

We believe that the proposals to present gains or losses on hedged items in separate line items in the statement of financial position will, for an entity such as Barclays that applies hedge accounting to many line items, result in a highly cluttered and confusing statement for investors, reducing their ability to comprehend the statement of financial position.

A requirement to add an additional line item under each of the current line items to present the impact of fair value hedging would almost double the number of line items we currently have. The Board needs to ensure that use of the statement of financial position is limited to the most relevant and decision-useful information; we are not convinced that the proposals would result in that. However, we agree with the objective to improve the ability of investors to understand the composition of the carrying amounts of assets and liabilities that are, or have been, in fair value hedge accounting relationships - especially because we receive questions from our investors about changes in the carrying amounts of assets and liabilities arising from fair value hedging adjustments.

We believe this objective can be met, whilst maintaining a simple and concise statement of financial position through two alternative approaches, which we urge the Board to consider.

Our preference would be to continue with the approach in IAS 39 and adjust the carrying amount of the hedged item for the gains or loss associated with the risk being hedged. This approach will provide transparency for investors, although the carrying amounts of assets and liabilities in the statement of financial position will continue to be a combination of an amortised cost and fair value hedge accounting adjustments. This presentation should therefore be accompanied by note disclosure that disaggregates the balance sheet value into amortised cost and fair value adjustment for the risk being hedged.

An alternative approach would be similar to that allowed under the macro hedging model under IAS 39 (paragraph 89A) whereby a single separate line representing the aggregate of all fair value hedge adjustments of the hedge items is shown a) within assets if the hedge item is an asset or b) within liabilities if the hedged item is a liability. This would then be supported by a note which disaggregated the single line item into hedged items, showing the gains or losses on the hedging relationship. The disadvantage of this approach is that the balance sheet item created is difficult to explain, requiring the user to refer to a disclosure to understand the impact of hedging on the individual balance sheet items, hence our preference is for the first approach.

- (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 agree that linked presentation should not be allowed for fair value hedges. Linked presentation is not permitted in IFRS and, we believe, would raise many additional issues that the Board would need to address regarding when it would be required or permitted. We also note that an entity can, if it so wishes, present disclosures to help investors understand the relationship between hedging instruments and hedged items.

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 are supportive of the Board's proposals for accounting for the time value component of an option. However the proposals would result in hedge accounting for options becoming far more complex. An alternative might be to permit all time value amounts to be transferred to profit or loss on some rational basis, with appropriate disclosure, rather than requiring different treatment for transaction related hedged items from period related hedged items. We also believe that the Board should continue to allow an entity the choice of recognising the time value of the option as a derivative at fair value through profit or loss, as is permitted under IAS 39, so that accounting complexity created by the proposals may be averted.

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?

We agree with the proposals for groups of items and, in particular, the proposals on layer components of a group of hedged items. This conforms with the overall objective of the proposals, namely, to align hedge accounting with risk management.

However, it is difficult to consider the impact and applicability of these proposals in isolation without understanding the Board's proposals for portfolio hedge accounting. The proposed restrictions for eligibility of hedging a bottom layer, specifically the restriction contemplated in paragraph 36 (a) of the ED, may result in these proposals being of limited use in a banking environment. We believe that a workable solution for hedging of bottom layers within the macro hedging model should be developed. Partial prepayments can be removed from the top layer, not affected the bottom layer, and prepayments occurring in excess of the top layer would lead to ineffectiveness. As noted previously, this would reflect the risk management approach taken by many financial institutions.

We note that the paragraph 34 (c) only allows cash flow hedging for groups of hedged items when the profit or loss is affected in the same reporting period. We believe this will significantly disadvantage more regular reporters (for example quarterly reporters) as compared to annual reporters. We urge the Board to reconsider this and either provide some relief in this regard or restrict the use of cash flow hedging only if group of hedge items affect profit or loss in different years.

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 understand the Board's approach to presenting hedge accounting adjustments in a separate line item when a group of offsetting risk positions are being hedged. However, we note that if multiple derivatives are used to hedge the offsetting positions on a gross basis, while the economic effect is identical to hedging on a net basis, the presentation of the hedge accounting adjustments will be different. It therefore seems the presentation will depend on whether derivatives are designated separately to emulate a net position, or a single derivative is designated for the net position. We do not believe that this will always result in the appropriate presentation. We believe that application guidance is necessary to ensure consistent presentation for transactions with the same economic outcome.

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 are supportive of the proposed disclosures in paragraphs 40-44 of the exposure draft. We appreciate the Board's effort to reduce unnecessary duplication and "clutter" by allowing cross referencing both within the annual report and to other published statements.

As mentioned in our response to Question 1, we consider that in order to maintain the link to risk management, disclosure should be closely aligned and influenced by an entity's risk management activities. The disclosure proposals put forward in paragraphs 40-44 would be more appropriately supported by quantitative disclosure that presents information in a similar way to how the information is aggregated, measured and reported to senior management.

Our more specific comments relating to particular disclosure comments are as follows:

- The disclosure proposed in paragraph 46 (c) is a good example of potential divergence from the overall objective to align hedge accounting with risk management. We would not consider average strike price to be a useful risk management tool and considering the volume of derivatives we enter into on a daily basis, we believe that it would be almost impossible for us to obtain information about average rates and then disclose this information in a meaningful way.

We do not see the need to disclose this level of detail, which could reveal commercially sensitive information about Barclays hedging strategy with little value to most financial statement users, given the time lag between year end and subsequent publication of financial statements.

- Regarding the disclosures under paragraph 46 (a) (read with 46(b)), it is not clear whether an entity should disclose all its risk exposures (including categories of risk exposures to which hedge accounting is not applied to), or only those categories of risk exposures to which an entity applies hedge accounting. Paragraph 46 (b) of the ED seems to suggest the former – although we believe that was not the intention of the Board (as evidenced in paragraph 44). If disclosures of all risk categories were required, such disclosures would certainly be extensive.

As we mentioned in our response to Question 5, we believe it is potentially onerous to disclose a description of all sources of potential hedge ineffectiveness and it will only result in boilerplate disclosure. We suggest the board clarify that it was not the intention for this to be a comprehensive search. It would be more appropriate for an entity to consider and document all the principal expected sources of ineffectiveness.

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?

Generally we support amendments that would make it easier for entities to present financial information about their risk management activities in a meaningful way without imposing unduly onerous requirements.

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 BC 226–BC 246 should the Board develop further and what changes to that alternative would you recommend and why?

We are very supportive of a principles-based standard which aligns hedge accounting to an entity's risk management policy. While it is perceived to be operationally difficult, we do not agree with the statement that hedge accounting for credit risk is not possible, and neither do we agree with the statement that it would add unnecessary complexity to account for hedges that make use of credit derivatives. As financial markets evolve, hedging accounting needs to be "future-proof".

Barclays, as many other financial institutions, makes extensive use of credit derivatives to manage the credit risk inherent in many of its financial assets, which currently leads to significant income statement volatility. We believe this volatility to be spurious.

Moreover we believe the criteria requiring separately identifying and measuring a risk component as a hedged item is sufficiently robust and that it is not appropriate to exclude certain risk components such as inflation and credit risk. An entity that can separately identify and measure credit risk for the purpose of their own risk management activities should also not be precluded from applying hedge accounting if they meet the necessary criteria. In this context, however, it may be helpful to add application guidance to dispel any notion that the credit default swap price is simply equal to the credit risk component in the financial asset.

We agree that it is operationally difficult to isolate and measure the credit risk components of a financial asset in order to meet the eligibility criteria for hedged items, but this in itself is not sufficient to simply prohibit hedge accounting for credit risk. After all, this is the case for other components as well.

Should the Board continue with its approach to credit hedging, of the three alternatives considered by the Board we consider Alternative 3 to be a significant improvement on current practice and the preferred option. A significant portion of our economic hedges of credit risk are in relation to loan commitments, which are out of the scope of IAS 39, so that we are unable to use the fair value option in IAS 39. Hedging strategies for loans and loan commitments are also entered into subsequent to initial recognition when there are indications of financial difficulty (although not necessarily impairment). The fair value option in IAS 39 is therefore not a helpful accounting solution reflective of our credit hedging risk management approach.

We also consider the second alternative approach put forward in the basis of conclusions to be an improvement on IAS 39, and this could be a reasonable compromise between accounting complexity and reflection of risk management activities. However, the profit or loss impact that occurs when the financial asset is re-measured to fair value will not provide useful information as it does not reflect any credit related event and will be counter-intuitive to investors; credit protection is often taken out when the fair value of the asset is falling even though the asset might not be impaired - so at the point when the risk is actually reduced the entity is required to take an immediate loss in the profit or loss in order to apply the fair value option. This is counter-intuitive and therefore this option may not be widely used in practice.

The first alternative approach is not useful in reflecting risk management of credit risk, because of the restriction that it must be applied at initial recognition.

Therefore, despite the operational complexity of the third alternative, we believe this to be the superior approach. We agree that transparent disclosure such as that prescribed in the BC 244 would be useful.

We believe that the Board could also consider an approach which is less dramatic than the 3 alternatives described whereby a specific exception is made to the normal identification approach for components.

We would also support a solution that can also apply when index-linked hedging instruments (such as ITRAXX) are used, rather than name specific credit derivatives. The solutions proposed in the basis of conclusion unfortunately only facilitate name specific credit derivatives, while index linked credit derivatives are often used to hedge a portfolio of items, or in conjunction with name specific contracts. This does not seem to have been considered by the Board at all in its deliberations.

Question 16

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

In line with our response to the Board's request for views on Effective Dates and Transition Methods we would support an effective date of 1 January 2015 for all projects currently under consideration, with voluntary early adoption permitted.

We would also welcome the release of two separate standards for micro and macro hedging so we can adopt these proposals as soon as available. However, it would be useful to understand the Board's proposals on macro hedging before we adopt micro hedging to minimise any resultant costs or system changes.