

March 07, 2011

**International Accounting Standards Board**

30 Cannon Street  
London EC4M 6XH  
United Kingdom

Dear Board Members:

We appreciate the opportunity to comment on the Exposure Draft on Hedge Accounting (the "Exposure Draft") issued for exposure in December 2010. Mexican Banking Association<sup>1</sup> (ABM) is the organization that represents and defends the general interests of the associated banks (Banks) before public and private organizations, and facilitates communication between the Banks in building consensus on issues that require the establishment of standards that raise efficiency of the sector as a whole.

We support issuance of the Exposure Draft and the efforts of the International Accounting Standards Board (IASB) to simplify and set new hedge accounting requirements to reflect, in a better way, an entity's financial risk management activities. As financial institutions, we use derivatives and other financial instruments to manage economic risks and must often choose between volatility in earnings due to not allowed hedge accounting models and constraints and burdens inherent in the successful application of hedge accounting criteria. The Exposure Draft gives financial and non-financial institutions the flexibility to adopt the hedge accounting model that best reflect the way they manage their risks to the extent to which those activities are successful in meeting the entity's comprehensive risk management objectives.

Financial institutions are regulated by the Mexican National Banking and Securities Commission<sup>2</sup> (the "Commission") through the rules set forth in the General Provisions Applicable to Credit Institutions (the "Provisions"). The Provisions establish the requirements on risk management that the financial institutions must fulfill. Non-financial institutions have no rules on risk management established by any regulatory authority, only occasionally by their Board of Directors and Corporate Governance. For this reason, we suggest that you establish some guidelines on what constitutes an adequate risk management and developing of strategies and objectives according to the Exposure Draft to fulfill the requirements for the application of hedge accounting.

Set forth below you will find our responses to the questions included in the Exposure Draft.

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<sup>1</sup> Asociación de Bancos de México

<sup>2</sup> Comisión Nacional Bancaria y de Valores

**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 proposed objective of hedge accounting. This proposed objective will flexibility entities to adopt the hedge accounting model that best reflect the way they manage their risks to the extent to which those activities are successful in meeting the entity's risk management objectives.

As we comment, we suggest that the Board establishes some guidelines on what constitutes an adequate risk management function and how to develop strategies and objectives according to the Exposure Draft to fulfill the requirements for the application of hedge accounting for non-financial institutions.

**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 agree. A non-derivative financial asset and a non-derivative financial liability measured at fair value through profit or loss should be eligible hedging instruments.

**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. This would help entities to adjust the structures of hedges initially assembled, in the case that the conditions under which the hedge was set change in contrary way to the initial expectations, building the establishment of new hedge structures with a dynamic risk management.

We suggest that the Exposure Draft should be clearer, expand the wording of this section and include some examples or guidelines to users with the purpose that the preparers of financial information can apply and interpret this section in an appropriate way.

**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 agree 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. Doing so simplifies the establishment of clearly defined hedging structures identifying precisely the risk to be hedged. This risk should be according to objective of hedging in the risk management function.

**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 that an entity should be allowed to designate a layer of the nominal amount of an item as the hedged item. We also agree 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. A prepayment of the hedged item will lead to its derecognition and therefore the hedge should be terminated earlier.

**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 agree that the hedge effectiveness requirements need the hedge relationship be based on the financial risk management objectives and strategies and that at inception of the hedge, the hedging relationship be neutral, without a biased over or under hedging.

We believe that establishing a range in which the hedge can fluctuate is adequate for measuring the effectiveness and thus eliminate the subjectivity in terms of how efficient is the hedge, this would help preparers of financial information, and especially the auditors, have a better definition as to whether a hedge is effective or not.

**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 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. We consider that this rule indicates that this rebalancing of the hedge must be documented in an appropriate manner as part of the requirements for the rebalancing of the hedge.

We agree that 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 provided that the rebalancing is properly documented and go according to the clear objectives of the entity's risk management.

#### **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 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).

We also 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.

#### **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 recognized 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 agree that for a fair value hedge the gain or loss on the hedging instrument and the hedged item should be recognized in other comprehensive income with the ineffective portion of the gain or loss transferred to profit or loss.

We 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; this

way the amortized cost of the hedged item is not altered, giving clarity to the presentation of the financial position.

We agree that a linked presentation should not be allowed for fair value hedges

**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?

We 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).

We also 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.

Finally, we 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)

**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 criteria for the eligibility of groups of items as a hedged item.

**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 recognized 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 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 recognized in profit or loss should be presented in a separate line from those affected by the hedged items.

**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 agree with the proposed disclosure requirements.

We consider that sometimes the required disclosures become repetitive and can confuse the users of financial information.

**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 agree that 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

**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 agree that all three alternative accounting treatments to account for hedges of credit risk using credit derivatives would add unnecessary complexity to accounting for financial instruments.

**Question 16**

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



We agree with the proposed transition requirements that indicate the new hedge accounting rules should be applied prospectively.

We appreciate the opportunity to express our views in this letter. Should you have questions, please feel free to contact me at the following telephone number +52 55 5267 5271 or e-mail [glezreal@santander.com.mx](mailto:glezreal@santander.com.mx).

Sincerely,

**C.P. Jesús González del Real**  
Accounting Committee Coordinator  
Mexican Banking Association