

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

9 March 2011

Subject: Comment letter to the Exposure Draft ED/2010/13 "Hedge accounting"

Dear Sir/Madam,

We are grateful for the opportunity to comment the Exposure Draft Hedge accounting. We also participated on the meeting held in Lisbon in 1 of March, and in our opinion this approach of getting direct and personal feedback combined with the possibility to address comment letters is very useful in order to acknowledge corporate experience in the standards. In addition to the response to each of your question in the Exposure Draft, that we attached, we would like to summarize some of our main concerns.

We agree with the overall objectives of the exposure draft to align hedge accounting with the risk management activities, replacing the excessive rules-based under IAS39 to a more principles based. Sonae's attitude towards financial risk management is conservative and cautious, and Sonae does not enter into derivatives or other financial instruments that are unrelated to its operating business or for speculative purposes, however, many times under IAS 39, we experienced that for some derivatives, that are completely aligned with the above mentioned strategy it's very difficult or impossible to apply hedge accounting. Our principal risk is interest rate risk, since most of our debt is floating rate, and we aim, through the use of derivatives, to have a percentage of our exposure hedged, whilst at the same time minimizing the costs of such hedging activities (much like we do with insurance, where sometimes it is too expensive to cover extreme and unlikely scenarios), with simple instruments, but not always with Interest rate swaps, and as a matter of fact only interest rate swaps seemed to be considered "non –speculative" under current rules.

A large number of our hedging relationships are cash flows hedges of variable interest rate risk, and we only use plain vanilla derivatives, however only derivatives that fix interest rate (IRS) completely mitigate any negative impacts in the income statement. Many common simple derivatives (like options or a combination of options) that do not have, in our opinion, a speculative propose seem not to be completely effective under the current rules and thus introduce undesirable volatility in the income statement, which distorts reality. We also feel that the effectiveness tests requirements are excessive and for plain vanilla derivatives where critical terms match it shouldn't be necessary to perform any type of quantitative test, and only if there is any change in the terms of the hedged or hedging item, the documentation should be

reviewed. We hope that the new rules will introduce a clear simplification of the process of assessing the hedge effectiveness whilst maintaining the quality (and truthfulness) of accounting information.

Besides the simplification of the process of assessing the hedge effectiveness, we are not completely comfortable that the new rules will have enough flexibility in order to include derivatives that are solely entered with the aim of reducing risk (but at the same time, paying due attention to the effective costs of undertaking such hedges). There are some situations where we are not able to entirely understand the IASB point of view and it's not clear the treatment where there is not any cost for obtaining protection against a risk over a particular period of time, for example in a zero cost collar, or where we sell an option to subsidize the rate of a cap or swap (example cap with a Knock out, where the derivative would terminate in an extreme and unlikely scenario). Even when there is a written option it's only to reduce the "insurance premium", and the entity continues to obtain protection but only until a specific level. For this type of hedging relationships no ineffectiveness should exist since the hedging is completely aligned with a risk management oriented to obtain protection until a specific level, for an acceptable price. Under the current rules we have volatility in profit and losses associated to changes in the time value component of the market value of an option, which, when maintaining the derivative until the maturity, will have zero-sum in the end, which in our opinion transmits an incorrect perspective on the accounting statements of the company.

In relation to the requirements to disclosure information like projections of sales, purchase of commodities, or interest rates of debt, together with details of derivatives hedging some of these could potentially be very disadvantaging to companies against their competitors and their suppliers (for instance disclosing the credit spread or interest rate of each individual loan, to potential lenders, will in fact act as a floor to future deals, since potential Lenders will use that information to calibrate their proposals, which will be very detrimental to the company and its ability to keep credit spreads as low as possible), particularly if they don't have to report under IFRS. The entity should determine how much detail to disclose, and any additional information requirement should be consistent with the current standards avoiding more costs to produce these disclosures.

Thanks for the opportunity to comment and I trust that you will find this letter and the attached comments useful.



Yours sincerely

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Financial Director

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APPENDIX

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?

Overall, we support the proposed objective of establishing a link between hedge accounting and the entity's risk management activities. The internal risk management used should be reflected on the entity financial figures. A principals based as opposed to the existing rules based approach seems to be the right direction. Having said that we also believe that existing methodologies frequently do not reflect the true nature of hedging, and sometimes introduce a lot of volatility and fluctuations in the earnings and balance sheet of a company which distort usefulness of hedge accounting methodologies. Also, most of the times derivatives products which serve a true purpose in terms economic hedging are treated as "speculative" (since –in case of interest rate hedging - any instrument which is not a swap have an ineffectiveness component), which completely distorts the way they are reported.

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?

Yes we 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.

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?

Yes, we agree with the proposal to permit a combination of an exposure and a derivative to be designated as a hedged item, in order to comply with the hedge accounting principles which are focused on risk management activities. We support the decision to allow the designation of a synthetic exposure as a hedged item, and the possibility of designate a derivative as a hedged item. Hedging decisions should be based on the net exposure, allowing an exposure to be considered as a combination of another exposure and a derivative may result in a more economical hedging decision either because of the ability to use different counterparties for the same risk or by reducing the transaction amounts.

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?

Yes, we agree that risk component of financial or non-financial instruments to be eligible as hedged items, assuming that the risk components are separately identifiable and reliably measurable. However we consider that the restriction on paragraph 18 that inflation cannot be an eligible risk component unless contractually specified should be eliminated.

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?

- a) Yes, we agree that an entity should be allowed to designate a layer of the nominal amount of an item as the hedged item, as it contribute to the objective of establishing a link between hedge accounting and the entity's risk management activities, and allowing designation of layers will also minimize ineffectiveness. We consider that under this approach should be possible to designate a hedged based on a percentage basis of a risk being hedged, but also on a layered approach that allow for example designate as the hedged item a defined amount of a group of bonds issued by the entity.
- b) In principle we do not agree, we believe should be eligible until the prepayment (an if) the prepayment option is exercised.

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 totally support the Board's proposal to remove the 80-15 per cent bright line test, and the retrospective hedge effectiveness tests requirements, and the replacement to a more objective-based prospective hedge effectiveness assessment consistent with the objective of a hedge accounting that reflects the risk management strategy of the entity.

We believe that for plain vanilla derivatives where the critical terms match no quantitative test, should be necessary and no ineffectiveness should exist. Even for derivatives, like Swap's not at the money (where a initial mount is paid or received), or derivatives with written options, like zero cost

collar's, if the critical terms match no tests should be necessary, and no ineffectiveness should exist, as this derivatives are completely aligned with a risk management strategy of limit the exposure.

Question 7

(a) Do you agree that if the hedging relationship fails to meet the objective of the hedge effectiveness assessment an entity should be required to rebalance the hedging relationship, provided that the risk management objective for a hedging relationship remains the same? Why or why not? If not, what changes do you recommend and why?

(b) Do you agree that if an entity expects that a designated hedging relationship might fail to meet the objective of the hedge effectiveness assessment in the future, it may also proactively rebalance the hedge relationship? Why or why not? If not, what changes do you recommend and why?

We agree with the introduction of the concept of rebalancing the hedging relationship, as hedging is a dynamic process and assuming that the original risk management objective remains unchanged the maintenance of the initial hedging relationship should be possible. However the Board's should introduce further clarifications, and instead of mandatory rebalancing a voluntary decision of the entity it's probably a better solution.

We agree with the proposal to allow the entity voluntary rebalance the hedge relationship if it expects that a designated hedging relationship might fail to meet the objective of the hedge effectiveness assessment in the future.

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 disagree with prohibiting de-designation of a hedge relationship, as this is not aligned with typical treasury risk management practices. There are some situations where flexibility is needed and required to more closely align hedge accounting to the risk management strategy. For example when a entity enters into a cash flow hedge for forecast purchases on foreign currency, the aim of risk management strategy is to protect its cash flows, however hedge accounting would only be applied until the moment the invoices become on- balance, after which the entity get natural offset in the income statement of both hedged item and hedging instrument.

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?

Although we understand the reasons of these proposals we do not see what useful benefit it will provide users of the accounts and adds unnecessary complexity to other comprehensive income. The global impact on profit and loss remains the same, although there will be offsetting impacts in other comprehensive income that will still require explanation. The new rules should allow the entity, as is choice and accordingly to the option that pass on a better figure of the entity risk management, to present in the same line as the asset/liability on the face of the balance sheet with a separate disclosure in the relevant note to the accounts, and not as separate line item on the face of the balance sheet.

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 a transaction related hedged items the change in fair value of the option's time value is transferred from other comprehensive income to profit and loss on a matching basis when the underlying impacts profit and loss accounts. For period related hedged items we agree with the

principle proposed, however we think that more clarification on what amortization methods are acceptable on “a rational basis”, the correct period for amortization should be the entire life the underlying taking into account amortizations schedules.

Although, there are some situations that we are not able to completely understand the IASB point of view. It's not clear the treatment where there is no cost for obtaining protection against a risk over a particular period of time, for example in a zero cost collar, or where we sell an option to decrease the rate of a cap or swap (example cap with a Knock out, where the derivative would terminate in an extreme and unlikely scenario). In the above examples there isn't any premium paid or cash out, however the entity objective it's always the same “to protect themselves against the downside of an exposure (an adverse outcome) while retaining the upside, they have to compensate someone else for assuming the inverse asymmetrical position”. The entity does not desire to assume any speculative position but it's only defining the “insurance premium” that it wants to pay. Even if there is a written option when it used only to decrease the “insurance premium” and the entity continues to obtain protection but only until a specific level (much like in an insurance policy). For this type of hedging relationships there no ineffectiveness should exist since the hedging is completely aligned with a risk management oriented to obtain protection until a specific level, for an acceptable price. Under the current rules we have volatility in profit and losses associated to changes in the time value component of the market value of an option, which, when maintaining the derivative until the maturity, will generate a zero-sum at maturity which in our opinion transmits an incorrect perspective on the accounting statements of the company. This volatility in profit and losses besides misleading interpretation could also have impact in the fiscal costs of the company.

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 and support the proposal to permit hedge accounting for net positions.

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 believe that, in a net position hedge, a presentation model should be developed stating that all effects of hedge accounting should be presented in one single line in both the balance sheet and the income statement, and additional information should be provided in additional disclosures with the relevant information allowing users to have more information about the entity risk management strategy.

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 IASB's view that the disclosures should help users to understand the overall risk management strategies, and the rule that an entity should determine how much detail to disclose. However under IFRS7 there is already a significant number of information, so any additional information requirement should be consistent with the current standards avoiding more costs to produce these disclosures. We are also concerned that the requirements to disclosure information like projections of sales, purchase of commodities, or interest rates of debt, together with details of derivatives hedging could potentially disadvantaging companies against their competitors, (for instance disclosing the credit spread or interest rate of each individual loan, to potential lenders, will in fact act as a floor to future deals, since potential Lenders will use that information to calibrate their proposals, which will be very detrimental to the company and its ability to keep credit spreads as low as possible) particularly if they don't have to report under IFRS. We are also concerned with the resources required to provide all information, and due to the fact of the complexity of some of the disclosures that no standard software packages exist which enable to provide requested information, an thus complex bespoke solution (a lot of the time complex excel spreadsheets) need to be developed to comply with such disclosures. Effectiveness tests are particularly difficult (for non plan vanilla instruments) to perform.

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 with these 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 have not made any comment on this matter, as these as been included for financial institutions.

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 transitional requirements. Comparative disclosure should not be required and we support the provisions to ensure current qualifying hedging relationships could be moved to the proposed model.