

9 March 2011

International Accounting Standards Board
1st Floor 30 Cannon Street London EC4M
6XH United Kingdom

(By email: CommentLetters@iasb.org)

Dear Sir

RESPONSE TO EXPOSURE DRAFT ON HEDGE ACCOUNTING: ACCOUNTING FOR FX SWAPS

Introduction

DBS Bank is pleased to have the opportunity to comment on the *Hedge Accounting* exposure draft (ED) issued by the International Accounting Standards Board (IASB) in December 2010. While we have also participated in the industry- level response coordinated by the Singapore Accounting Standards Council (ASC), we hope to, in this submission, delineate in greater detail our proposed treatment of the interest element of a forward / swap contract. We make reference specifically to the deliberations set out in BC143 to BC155.

Summary of proposal

As outlined at BC143, IAS 39 presently allows an entity a choice of either (a) designating an option-type derivative as a hedging instrument in its entirety; or (b) separating the time value of the option and designating as the hedging instrument only the intrinsic value element. The fact that alternatives have been made available in this form suggests that the standards do contemplate the disaggregation of a derivative into component parts and the subsequent designation of one part as a hedging instrument. We urge the Board to consider extending this concept to other derivatives and consider its applicability to forward contracts below.

Current treatment inadequate

The utilisation of a funding swap as a hedging instrument is not uncommon for financial institutions in Asia and other emerging markets, where they deploy surplus funds in one currency into lendings of another currency through FX swaps. Specifically, DBS Bank has surplus local currency (SGD)-denominated deposits and

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one avenue of deployment is to swap them into USD via an FX swap, and then deploy them as USD assets (e.g. loans). Prior to the adoption of IAS 39, USD interest income was accrued on the USD loans, while what would effectively be USD interest expense, comprising the SGD deposit interest and the SGD-USD swap points, was accrued as interest expense. This treatment was reflective of the substance of the transactions, having been, as the Board has articulated in BC150, "determined on a rational basis to reflect principle-based standard-setting best".

Under IAS 39, the entire FX swap is treated as held for trading and accounted for as fair value through profit or loss (P&L), in the process generating unnecessary volatility. More fundamentally, the accrual of USD interest income and SGD interest expense resulted in a mismatch in the net interest margin that has been difficult to explain to our constituents. Together with the inherent difficulty of applying hedge accounting, the income statement was no longer representative of the economic hedge; we would venture that the current situation is another clear instance where the accounting treatment is disconnected from risk management.

Disaggregating forward/swap contracts

Taking guidance from the proposed treatment of the time value of an option, we suggest that the Board consider extending it to the interest element of a forward contract (e.g. the swap points in a funding swap). Our proposal is based on the following considerations drawn from the principles set out in BC144:

- Similar to the treatment of the time value of an option, the interest element of a forward contract can technically be separated from the spot price, as entities typically designate only the latter as a hedging instrument;
- The interest element can also be construed of as a cost of hedging.

In addition, in an extension of the concepts outlined in BC149 and BC150, we propose that the fair value on the hedging swap be recognised in other comprehensive income (OCI) at inception. Thereafter, the swap points can be amortised from OCI to the PStL on a rational basis over the hedged period, reflecting what are, in essence, hedging costs.

While not directly equivalent, this approach is also conceptually similar with the Board's views on expected credit losses, where such losses are to be allocated over the life of a financial asset on a time-proportional basis. The Board's primary objective, in this regard, is to reflect the underlying economics in a lending transaction by "maintaining a link between the pricing of the financial assets and the expected losses" (BC32 of Supplement to ED/2009/12 issued in January 2011). Similarly, we believe the amortisation of the swap points better captures the link between the interest margins earned and actual expenses incurred in the process.

DBS hopes that the comments provided are useful in assisting with the Board's consideration of our proposal. Should you require any further clarification, please contact me at sokhui@dbs.com. Thank you.

Yours faithfully



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CHIEF FINANCIAL OFFICER