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Accounting Standards Committee of Germany

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Sir David Tweedie
Chairman of the
International Accounting Standards Board
30 Cannon Street
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Berlin, 10 March 2011

Dear David,

IASB Exposure Draft ED/2010/13 "Hedge Accounting"

On behalf of the German Accounting Standards Board (GASB) I am writing to comment on the IASB Exposure Draft ED/2010/13 "Hedge Accounting" (herein referred to as 'ED'). We appreciate the opportunity to comment on the ED. Further, we decided to also comment on some issues related to open portfolio hedge accounting that still are under discussion and are not part of this ED. We like to note, though, that our evaluation may change when the supplementary proposals on open portfolio hedge accounting are published and changes to the current proposals are suggested.

The GASB is strongly in favour of making several kinds of items, which are commonly hedged in practice, eligible for designation as hedged items (such as components, groups and net positions) and, in particular, treating financial and non-financial items alike. We also support amending the effectiveness assessment requirement, i.e. relaxing the retrospective effectiveness testing and removing the existing bright line for the percentage of effectiveness.

However, the GASB does not fully support the proposed objective. We agree that the financial statements of an entity should represent the extent and effects of its risk management activities, but we rather see it as a subordinated principle to be followed whenever possible than as the objective – since we do not believe that risk management and hedge accounting can ever be fully aligned, given their different objectives, methodologies and techniques. In addition, we believe that the new hedge accounting objective is not in line with certain requirements of the hedge accounting model, or vice versa. Hence, either the objective should be modified, which we would prefer (details are set out in our answer on question 1), or essential elements of the hedge accounting requirements otherwise be amended in order to better align those with the proposed objective.

Further, the GASB has serious concerns about the appropriateness of making the accounting for commodity supply contracts dependent on an entity's risk management. We understand the motivations but do not believe that such a change in scope, which might be important for many non-financial entities, should be introduced as part of the hedge accounting phase of the project. Rather, it seems more appropriate if discussing and eventually amending the scope provisions (and the own use scope exemption, in particular) was part of the final review of the whole financial instruments' project. In addition, it is unclear whether derivative accounting for commodity supply contracts, as newly proposed, applies mandatorily or voluntarily.

Please find our detailed comments on the ED´s questions in the appendix to this letter.

If you would like to discuss our comments further, please do not hesitate to contact me.

Yours sincerely,

Liesel Knorr
President

Appendix – Answers to the questions of the exposure draft

> **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 seriously doubt that the stated objective and the proposed requirements of the hedge accounting model are in conformity with each other. As long as certain risk management activities cannot be reflected in the financial statements, e.g. internal hedges, or some instruments are not eligible for hedge accounting, e.g. those measured at FV through OCI or core deposit liabilities, the proposed objective is not fully achievable by applying hedge accounting.

The IASB discussed two possible objectives, one considering the entity's risk management being the starting point for further considerations (BC14(a)), the other making the accounting the starting point (BC14(b)). The IASB considers the objective as currently proposed to be a combination of the two objectives (BC16). We do not think that this conclusion is appropriate, because the wording in ED.1 rather suggests a risk management focused objective ("The objective of hedge accounting *is to represent* in the financial statements the effect of an entity's risk management activities […]"; emphasis added). Though, we would be very supportive of bringing both starting points closer together if the accounting view was the higher ranking objective and the risk management view was a subordinated principle. Thus, we propose the following rationale:

Hedge accounting may be applied only under the condition that an accounting mismatch occurs. An accounting mismatch occurs if the accounting – i.e. recognition (or non-recognition), measurement, or presentation of changes in fair value – for financial or non-financial items is different from how they are considered from a risk management's perspective. If such an accounting mismatch exists, an entity has an option to apply hedge accounting. When doing so, any designation for accounting purposes should be as much in line with the underlying risk management as possible, taking into account the existing boundaries of financial reporting. If an economic hedging relationship cannot be reflected identically in the financial statements, the designation for accounting purposes may deviate, but should still aim at producing an unbiased result and minimise expected ineffectiveness.

> **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 that non-derivative financial assets and liabilities are eligible hedging instruments, since these instruments are also used as hedging instruments by the entity's risk management.

Generally, we agree with derivatives and non-derivatives that are measured identically (at FVTPL) to be dealt with identically under hedge accounting. However, the population of eligible hedging instruments does not necessarily need to comprise all instruments that potentially may be used as hedging instruments within risk management but should be restricted to those instruments that potentially lead to accounting mismatches.

Further, we like to point out that ED.9 and B5 appear to be conflicting. B5 requires a designation of a non-derivative instrument in "its entirety", whereas ED.9 allows designating a percentage of the nominal of the hedging instrument. We ask the IASB to clarify the different wording or the meaning of "entirety" in order to avoid any misinterpretations.

Question 3

Do you agree that an **aggregated exposure** that is a combination of another exposure and a derivative may be designated as a hedged item? Why or why not? If not, what changes do you recommend and why?

We agree with aggregated exposures being eligible as a hedged item, but we wonder whether all aspects around the newly introduced notion of an "aggregated exposure" as a hedged item are clearly articulated and whether the existing examples are representative.

We are concerned that neither the notion of an aggregated exposure nor the examples provided in B9 make sufficiently clear as to how and when an aggregated exposure might be designated. In particular, it is not clear to us what distinguishes aggregated exposures from groups. We have learnt from conversation with the IASB staff that designating an aggregated exposure is meant to apply to hedging activities where (i) different risks (or other components) are managed separately, (ii) these risks are managed consecutively and/or for different time periods, and (iii) the risk exposure that is hedged subsequently to having hedged something else before cannot be quantified until the first hedge has actually been entered into. In our view, these characteristics do not yield from the pure wording of the ED and, thus, need further clarification.

In our view, designation of an aggregated exposure is not the only way of how hedge accounting can be applied in the particular circumstances noted above. We believe that it would also be possible to designate a single instrument or group of instruments as hedged item with two different hedging instruments. To our understanding, this leads to accounting outcomes that are different from those had an aggregated exposure been designated as hedged item. Further, we have learnt from IASB staff that designating an aggregated exposure includes the possibility of designating a hedging relationship "on top" (i.e. in a second step) of an existing hedging relationship (step 1). The "step 1" hedge is then considered as the aggregated exposure being designated under the "step 2" hedge, where the "step 1" hedge would remain in place. If that was the intention of the IASB, we suggest clarifying this issue as it does not appear to be clearly articulated in the ED.

As regards the alternative hedge accounting methods applicable, it seems unclear which of the two risk exposures would have to be designated first and which thereafter; maybe it is just an arbitrary matter. From an economic perspective both risk exposures are likely to be hedged individually without considering which one comes first or second. However, from an accounting point of view, designation of an aggregated exposure requires ordering the different hedging transactions – thereby possibly resulting in different accounting outcomes – which seems a questionable result.

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 consider the possibility of designating risk components as a hedged item to be an appropriate and necessary feature of any new hedge accounting model, should it bear any relation to what is done in risk management. We also agree with the IASB that separate identification and reliable measurement are appropriate conditions.

However, we wonder why the IASB mentions two specific risk factors and their potential ineligibility as a hedged risk component, being inflation risk (B18) and credit risk (IN46, BC220). With regard to both risk factors we are unsure whether they are outright exempt from ever being eligible as a designated risk component or whether the IASB merely believes that it was just too difficult to meet the “separately identifiable and reliably measurable” condition.

According to the proposals, inflation risk is excluded from being eligible if it is not contractually specified. It seems arbitrary to conclude that it can be designated in some cases (i.e. if contractually specified) while it cannot in other cases. We deem the principle in ED.18(a), which applies to any risk component, to be sufficient even in the case of inflation risk. Thus, in our view, there is no need for special guidance on this particular type of risk, hence, B18 should be deleted.

As regards credit risk it is important to note that this type of risk is often tracked by risk management and hedged with credit derivatives, especially in financial institutions. As is the case for other risk factors, it might not be easy to accomplish the “separately identifiable and reliably measurable” condition in certain situations. Though, it remains unclear whether the IASB considers the credit risk component to rarely meeting this condition when applying fair value hedge accounting or when applying cash flow hedge accounting or in both situations.

However, given long-standing practice it seems possible in modern risk management to measure the credit risk factor such that it allows for entering into hedging instruments granting at least partial offset (e.g. CDSs). This is particularly true when an entity hedges the credit risk of a single counterparty through the use of a single name credit derivative. In our view, there is no need to address the credit risk component. In cases where it is difficult to measure (or even to hedge) the credit risk component, hedge accounting requirements already include a general principle which applies to any risk component (see ED.18(a)). Further, risk management techniques advance further over the years, so it seems questionable why financial reporting should stop at a certain knowledge level rather than follow the advances made in risk management. Hence, we urge the IASB to refrain from drawing any final conclusions, which may or may not be justified today but not tomorrow, and to remain principles-based instead. As a consequence, we ask the IASB to modify or delete the relevant paragraphs within the BC.

Another reason why the IASB should re-consider the related BC paragraphs is that we consider the specific guidance why credit derivatives are inadequate for measuring the credit risk component (BC221) to be conflicting with the general guidance about hypothetical derivatives (B44, BC103). The latter explicitly permits measuring a risk component via a hypothetical derivative, for the purpose of expecting hedge effectiveness (ex ante) as well as measuring it (ex post).

Finally, we do not agree with the fact and the reasoning for not allowing sub-LIBOR hedges. Firstly, when considering instruments with variable interest payments below LIBOR (i.e. LIBOR minus x %), the IASB focuses (implicitly) on cash flow hedges (B25). We acknowledge that cash flow changes due to shifts in the benchmark interest rate are identical, irrespective of whether the entity designates the total cash flows (either LIBOR minus x % or LIBOR plus x %), or the inferior LIBOR only portion (if LIBOR plus x %) – whose designation is allowed –, or the superior LIBOR only portion (if LIBOR minus x %) – whose designation is not allowed. As the market interest rate hedged is always the same, we see no conceptual argument for disallowing hedge accounting in a scenario where the spread to LIBOR is negative. Additionally, we disagree with the IASB's statement that a sub-LIBOR instrument is deemed similar to a reverse floater (see BC73), because sub-LIBOR interest cash flows would increase if LIBOR increases, but the variable cash flows in a reverse floater behave inversely to a LIBOR shift. Secondly, in case of a fixed rate instrument with the fixed rate of x % representing an interest rate below LIBOR (B26), we deem it inappropriate to consider both being identical (see BC71), since in one case there is a cash flow risk resulting from changes to the benchmark interest, in the other there is a fair value risk. Hence, the rationale why hedge accounting is not allowed cannot be the same for both cases.

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?

Ad a) We agree with the eligibility of layers of a nominal amount.

Ad b) We do not agree that layer components including a prepayment option are not eligible. We are aware that groups of items often include prepayment options, which actually are taken into account in an entity's risk management activities. Since the ED does not allow for designating a layer component containing prepayment options in a fair value hedge of interest rate risk, this restriction seems too far reaching. We propose that, at least, if the layer to be designated is actually not exposed to prepayment risk – while the other (undesignated) part might be exposed – a designation should be allowed. In addition, there are also circumstances where the layer to be designated should comprise items with prepayment options, instead of excluding them entirely.

In other areas (e.g. lease contracts) prepayment or extension options are common. As we see it, proposals how to deal with such options need to be discussed and developed comprehensively. With regard to financial instruments, the potential designation of a layer of an item (or a layer of a group of items) including prepayment options should better be discussed in the context of hedging for open portfolios. We believe that any item including prepayment options should be equally eligible or not – regardless of whether it is in the context of groups under this ED or open portfolios under the additional ED still to come. In essence, whether this restriction is adequate or not depends on the outcome from the deliberations on open portfolios, which the IASB is still undertaking.

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?

In general, we agree with the modified requirements. In particular, we support relaxing the retrospective effectiveness testing requirements and removing the existing bright line for the percentage of effectiveness.

However, we have concerns in respect of the objective of hedge effectiveness assessment. As a designated hedging relationship shall produce an unbiased result and minimise expected ineffectiveness, we believe this implies a "target (effectiveness) result" for risk management which

shall be reproduced in the financial statements by adequately designating a hedge ratio. Upon assessing effectiveness one would compare the expected result of the hedge (for accounting purposes) with the actual result obtained by risk management in carrying out its strategy.

Having said this, we deem it essential to determine this “target”. We acknowledge that, in practice, hedges are not perfect, especially when a hedging instrument slightly deviates from a hedged item in terms of maturity, or payment dates, or risk components, or nominal. If an entity is to minimise expected ineffectiveness (of a designated hedging relationship), it also needs to determine the ineffectiveness of the underlying economic hedge. As a precondition, an entity needs to distinguish how much of the (partial) non-offset within this imperfect hedge is regarded as “intended to be unhedged” or as “intended to be hedged, but somewhat ineffective”. We believe the former should not be regarded as ineffectiveness and, hence, not be part of the designated component. The latter is considered as ineffectiveness and, hence, should be part of the designated component – with the consequence of being presented as ineffectiveness.

We doubt it is easy or non-arbitrary to draw this line. Even though the (sub-)objective of hedge effectiveness assessment provides a principle, which suggests the underlying risk management (and all related documentation) being the basis for the hedge designation, it remains difficult to draw this line as it does not affect solely the hedging relationship but the economic hedge behind. To conclude, as far as distinguishing between intentionally unhedged portions and accidentally unhedged portions remains unclear, it might be difficult to properly designate hedges that produce unbiased results or minimise expected ineffectiveness.

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?

Ad a) The GASB believes that rebalancing instead of de-designating a hedging relationship is a clear and sound principle. We deem it in line with the hedge accounting objective as proposed in the ED and also as proposed within our answer on question 1.

Ad b) It seems appropriate that an entity may proactively rebalance a hedging relationship when expecting to no longer meet the objective of effectiveness assessment.

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?

Ad a) Regarding mandatory discontinuation, we agree that a hedging relationship shall be discontinued if it ceases to meet the qualifying criteria. However, the notion of "after taking into account any rebalancing, if applicable" seems unclear. We wonder whether discontinuation would be required if rebalancing was not possible, or was not considered appropriate, or was not chosen by the entity. We would like to point out that there are four formal qualifying criteria (ED.19(a), (b), (c)(i), (c)(ii)), and meeting the objective of hedge effectiveness assessment is just one out of these four (ED.19(c)(i)). ED.23 requires that a hedge shall be rebalanced if it ceases to meet ED.19(c)(i) although risk management remains unchanged. ED.24 requires that a hedge shall be discontinued if it ceases to meet the qualifying criteria – which can be any of the four. Hence, in case the third criterion is not met, ED.23 (requiring rebalance) and ED.24 (requiring discontinuation) seem contradictory. We propose to improve the wording of ED.24.

Additionally, we consider IN25 and ED.23 to be inconsistent. IN25 (2nd sentence) proposes to voluntarily rebalance a hedge if it might cease to meet the "objective of hedge effectiveness" (one out of the four qualifying criteria), while ED.23 (2nd sentence) proposes the same if a hedge might cease to meet the "qualifying criteria" (any of the four). This makes unclear, whether voluntary proactive rebalancing is allowed under only one or under any criterion.

Ad b) In case all qualifying criteria are still met, we consider the exclusion of any voluntary de-designation to be in line with the above mentioned principle.

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?

Ad a) Some may consider it appropriate to recognise in other comprehensive income (OCI) any gains/losses from both the hedging instrument and the hedged item for both fair value hedges and cash flow hedges, as far as they represent the effective portion, if this was the only issue to be taken into account. However, achieving this identical treatment for both types of hedges comes along with huge efforts for implementing this modified accounting mechanism, while the outcome is a perfect offset which is the same in OCI or in profit or loss. For those cost-benefit reasons we oppose this proposal.

Ad b) We agree with presenting the gains/losses on the hedged item attributable to the hedged component as a separate line item. However, such line items should not be presented next to the related hedged item(s), but rather be aggregated into one single line item. A further disaggregation might be provided within the notes to the financial statements.

Ad c) We agree with rejecting linked presentation.

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?

Ad a) b) c) We agree that the designation of the intrinsic value component remains eligible. However, we neither agree with the time value being regarded as a protection premium, nor with the method of transferring gains/losses to OCI in order to avoid volatility, nor with the different accounting for transaction related vs. time period related hedges. Thus, we urge the IASB to require one single method. As the "deferral method" would not work with time period related hedges, and as it seems generally inadequate, we propose to retain the "amortisation method". After all, this would reduce additional complexity and the rules-based nature of these particular proposals.

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 consider the eligibility of groups of items as a hedged item to be useful, thereby covering additional risk management practices for which hedge accounting is not available today. We acknowledge that some of the hedging strategies that are referred to as "portfolio or macro hedging" are now covered by the proposals encompassing groups or net positions – i.e. closed portfolios –, although other portfolio hedging strategies – i.e. open portfolios – are still under discussion by the IASB.

However, the requirements for the special case of a nil net position do not seem technically sound. As hedge accounting requires designating both a hedged item and a hedging instrument, we cannot understand why something (a nil net position) may be designated without a hedging instrument. Moreover, it seems weird that selecting any bunch of assets/liabilities, which then constitutes a net nil position, simply results in all items being jointly measured at their hedged component with the result of a complete offset within this nil net position – as far as it results from the hedged component. As a consequence, determining a nil net position provides an option to measure components selectively (while excluding others). E.g., if we assumed a nil net position containing items that would never qualify for a hedging relationship under the general hedge accounting criteria, it seems that less criteria apply for a nil net position than for a hedge accounting relationship. Hence, some relationships could be determined as a nil net position even if they would *otherwise* qualify for hedge accounting or if they would *not* qualify for hedge accounting. In both cases, applying hedge accounting and meeting its conditions may be circumvented.

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 (e.g. 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 do not agree that hedging instruments' gains or losses should be presented separately from those of the hedged group's items. In case the items in the group affect different line items, it would be preferable if the effects of both the hedging instruments and the hedged items could be presented net – provided the hedging instruments' gain/loss can be split, which is generally possible in practice. If this is the case, an entity should be given the option to present it (net) in the same line item as the hedged items. In addition, showing these amounts separately from each other either on the face of the income statement or within the notes should be subject to application of IAS 1.

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?

Ad a) b) We do not agree with the proposed disclosures. As set out before, we are not convinced that the objective of hedge accounting relates solely to an entity's risk management activities that ought to be reflected in the financial statements. Hence, the disclosures which focus on the risk management are not appropriate.

We deem most disclosure requirements not relating to accounting issues but merely to risk management strategies or activities and its related expectations and assumptions. They may even be of forward-looking nature. Moreover, disclosures relating to hedge accounting should be restricted to hedged items or hedged risks.

Finally, from the ED it is not apparent how these disclosure requirements relate to IFRS 7 and whether, and to what extent, they will complement or replace IFRS 7 disclosure requirements. We urge the IASB to make sure these requirements are put into a clear context with already existing disclosures relating to financial instruments.

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, in certain situations, a fair value measurement of those contracts would be adequate and helpful for an entity otherwise forced to apply a more complex hedge accounting. However, we have the following concerns about the proposals.

The ED proposes that derivative accounting "would" apply to such contracts (BC218, 1st sentence). It remains unclear whether this is mandatory or voluntary. As outlined above we understand that the new proposal is intended to facilitate the accounting for these contracts but not to force preparers into a fair value measurement for these non-financial items. Accordingly, we believe that if the condition was fulfilled, a fair value measurement would be acceptable but should be optional. This is underlined by reference to any other unrecognised contract that will be settled in the future (e.g. firm commitments); those contracts *may* be designated under hedge accounting if this is in line with risk management. We urge the IASB to treat commodity supply contracts – which similarly are contracts to be settled in the future – the same optional way.

As outlined above, we could accept if these commodity supply contracts were measured at fair value voluntarily under the given condition(s). Nevertheless, the new proposal means expanding the scope of IAS 32/IFRS 9 which should be subject to more comprehensive considerations before finalising the IAS 39 replacement project. We consider other assets, e.g. inventories under IAS 2, being potential candidates for similar optional fair value accounting under the same condition. The issue is an "accounting mismatch" for measurement reasons between certain financial instruments and non-financial items. If it was deemed appropriate that the hedge accounting requirements should also apply to non-financial items, covering this issue in the hedge accounting section of IFRS 9 would be appropriate. However, if instead fair value measurement is deemed as the better solution (i.e. a suitable alternative to hedge accounting), we oppose to simply expanding the scope of the IFRS on Financial Instruments.

In addition, we consider the new criterion of "if that is in accordance with the entity's fair value-based risk management" (BC218, 1st sentence) not being sufficiently clear. The additional argument that applying derivative accounting would create a faithful presentation if an entity "manages its entire business on a fair value basis" (BC218, 2nd sentence) raises the question of whether a "fair value-based risk management" and a "business that is managed on a fair value basis" are distinct from each other, or depend on each other, or may (or may not) be congruent. We believe that due to the unclear wording related to this criterion it is difficult to determine whether the criterion is met.

Further, we think the wording of BC217 is unclear as to whether the new criterion, which applies additionally, is super- or subordinated to the current ones (type of settlement, i.e. net settlement, and purpose, i.e. own use).

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?

Ad a) b) We support the credit risk component being eligible as designated hedged item (see our answer on question 4). Hence, we would not support to modify the fair value option requirements as set out in BC226 et seq. Moreover, we agree with the argument that any change to the fair value option would add unnecessary complexity.

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 proposal to apply the hedge accounting requirements if all other existing IFRS 9 requirements were initially applied at the same time or have already been adopted. Further, we would agree if early application was allowed.

However, we do not agree with an initial mandatory application for periods beginning on or after 1 January 2013. Due to parts of IFRS 9 not being finalised yet, we are not in a position to propose an alternative date for initial mandatory application. However, we refer to our comments on the IASB's Request for views about "Effective Dates", where we propose initial application no sooner than 1 January 2015.

With regard to transition, we agree with a prospective application while existing hedging relationships should continue if they qualify for hedge accounting under the new requirements.