



*Spanish Banking Association*

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Sir David Tweedie  
Chairman  
IASB

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Asociación Española de Banca	
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**Subject:**      *Exposure Draft Hedge Accounting*

Dear Sir David,

The AEB<sup>1</sup> welcomes the efforts of the IASB to undertake a review and replacement of IAS 39 with the aim of simplifying the accounting for financial instruments.

In this sense, we are pleased to contact you to express our support for the FBE's position that will be sent to you about this subject, nevertheless we would like to stress some points relevant for the Spanish Banks we represent. Those points are as follows:

- We notice also that the proposed standard prohibits hedging for equity investments designated at fair value through other comprehensive income. From a risk management perspective, nothing precludes an institution to hedge such investment. So, this accounting prohibition conflicts obviously with the stated objective for hedge accounting. That means that the general objective designated from hedge accounting, to translate adequately in financial statements the risk management strategy of entity is not the basic principle supporting the whole text. BC 23 to BC 26 highlight some technicalities arisen from the decision not to recycle in P& L, the realized value of such investments, but in our view, they are not convincing to justify the de facto prohibition of hedging those securities. Furthermore, as BC 27 pinpoints that a forecast dividend from such investments could be an eligible hedged item, it is illogical to preclude from this status, the sum of the discounted forecast dividend, which is the recorded fair value of these securities.

<sup>1</sup> The Spanish Banking Association (AEB) is the voice of the Spanish banking sector representing and defending the collective interests of banks operating in Spain (94 member banks: 59 Spanish and 35 credit entities' branches of foreign banks operating in Spain), with total consolidated assets of € 2,110 billion as of December 2010 and 109,996 employees in Spain.



- With regard to the qualification for designation as hedged items (paragraphs 12-14), we would like to mention that the final standard should allow to qualify the forecast results of a subsidiary as a hedged item, doing so hedge accounting would be aligned with the entities risk management strategies and volatility in the P&L account due to the translation risk, would be avoided.

Many entities have subsidiaries in foreign countries whose operations are performed in a functional currency which differs from the parent company's functional currency. Regarding profit and loss, the annual results in local currencies of these entities are translated to the consolidated profit and loss account using the average exchange rate of the period (this is for practical reasons. However, if exchange rates fluctuate significantly the exchange rate of each transaction should be used).

Then, the variability of the exchange rate of the local currency in respect to the functional currency of the parent company, give rise to a foreign exchange risk exposure in the consolidated financial statements, and entities want to hedge this risk in the same reporting period, and sometimes even 2-3 years ahead.

According to paragraph 14, if a hedged item is a forecast transaction, that transaction must be highly probable. From our point of view, a portion of predicted revenues, normally those expected in the short term, will meet the "high probable" criterion. Additionally, 2-3 years forecast results in a retail banking business which is very stable and forecast results are based on historical information, could be also predictable with a high probable criterion. This hedging relationship will have to meet all the hedge effectiveness requirements according to paragraphs B27-B39.

- In terms of the hedge of "non foreign currency risk" of a firm commitment / highly probable forecast transaction, we advocate for a "look through approach" in order to allow the hedge accounting for other identified and measurable risks in a firm commitment / highly probable forecast transaction in order to improve the current hedging capability of the acquirer in a business combination when the transaction is on the due diligence period.

We suggest the Board to evaluate the opportunity to allow hedge accounting treatment not only for foreign currency risk, but also for the market risk originated by the assets or liabilities of the acquired company if these can be reliably identified and measured.

- Regarding to Prepayment options, the ED proposes that a layer component of a contract that includes a prepayment option is not eligible as a hedged item if the option's fair value is affected by changes in the hedge risk. On the contrary, and based on in our experience, we believe that allowing the accounting hedge could be reasonable in the following cases:



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*Pedro Pablo Villasanté*

- When the hedged item is a single financial instrument with an embedded prepayment option, whose financial performance comes from the aggregation of multiple options executed individually. This is the case issuing a liability whose notional – contractually - mimes the unamortized nominal amount of a group of individual credits. In that case, when the amount is large enough, its execution probability performance under a statistical approach could be measured and therefore could be easily hedged.
- When the hedged item is a liability with an embedded prepayment option that grants the issuer an unconditional right to cancel it.

Finally, we want to point out that the current uncertainty in the other areas of financial instrument accounting and the interaction of the different consultations makes it difficult to provide final comments. Therefore the views expressed in this letter may be subject to change as a more complete picture emerges on all of financial instrument accounting.

Yours sincerely,