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President

Sir David Tweedie
Chairman
International Accounting Standards Board
First Floor, 30 Cannon Street
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Dear Sir David,

I am writing to provide you with the Eurosystem's comments on the Exposure Draft on Financial Instruments: Hedge Accounting. With regard to the proposed amendments, we would like to highlight the following issues:

First, the Eurosystem strongly supports sound and high quality accounting standards, given their potential impact on financial stability. Against this background, we are generally supportive of the proposed new principles-based hedge accounting model that aims to better align financial reporting and the entity's risk management activities. At the same time, we welcome the proposed simplifications in various areas, such as assessing hedge effectiveness.

Second, we note that important hedging activities are not entirely covered by the proposed "general" hedging model. We would thus urge the IASB to develop a suitable model for macro hedging given the importance of this issue for the banking industry. The new model for macro hedging should strive to resolve the remaining EU carve-out relating to hedge accounting. Under the final standard for financial instruments (IFRS 9) all internationally active banks should be able to adequately reflect in financial reporting the effects of sound risk management practices, including portfolio hedging of core deposits against interest rate risk.

Third, we note that the proposal places great emphasis on adequate representation of "risk management activities" and introduces a series of other new terms and principles. In order to mitigate possible unintended consequences, we believe that the precise nature of the "risk management activities" that hedge accounting is supposed to represent should be better defined – first of all by clearly stating that the reference is made to risk management activities which are aimed at reducing or offsetting the impact of risk exposures in profit or loss (or OCI) - and some of the terms and concepts (such as "effectiveness testing" and "rebalancing of a hedging relationship") be clarified.

Fourth, we do not believe that hedge accounting should generally be restricted to risks that affect profit or loss only. The failure of representing risk mitigating activities in relation to equity instruments that are measured at fair value through other comprehensive income (i.e. "strategic equity investments") would not achieve the stated objective of the hedge accounting proposal, which is to represent in the financial statements the effect of prevailing sound risk management activities. We understand this issue arises from the prohibition in IFRS 9 to transfer realised gains or losses from other comprehensive income to profit or loss, as mentioned in my letter regarding IFRS 9 (Financial Instruments: Classification and Measurement), dated 18 December 2009. In this context, we would encourage the IASB to continue its current work on the conceptual differences between items to be presented in other comprehensive income and those in profit or loss, as indicated in the May 2010 Exposure Draft: *Presentation of Items of Other Comprehensive Income*.

Fifth, the current piecemeal approach taken for the revision of the accounting standard for financial instruments calls for a comprehensive impact assessment and outreach program with stakeholders on the impact of all proposals, taking into account their interactions. The results of this assessment may highlight areas where changes or refinements are needed. Looking forward, it would be important that an opportunity for such changes to be introduced is provided before the complete standard is finalised. In addition, we stress the importance of performing a post implementation review to analyse the real impact of the new standard.

Finally, on convergence, we are concerned about the continuing divergence of the general approaches with regard to accounting for financial instruments. Given that any hedge accounting proposal is inextricably linked with the respective classification and measurement approach, we strongly urge the FASB and the IASB to increase their efforts with a view to responding to the G20 request for accounting convergence by the end of 2011.

Against this background, I would invite the IASB to consider the above issues in the finalisation of the standard on financial instruments (IFRS 9).

Yours sincerely,



cc.: Mr. Jonathan Faull - Director General DG Internal Market and Services - European Commission
Mr. Nout Wellink – Chairman - Basel Committee on Banking Supervision