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Group Chief Accounting Officer

Sir David Tweedie
Chairman
International Accounting Standards Board
30 Cannon Street
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9 March 2011

Dear Sir David

ED/2010/13 Hedge Accounting

We welcome the opportunity to provide comments on the IASB's Exposure Draft 'Hedge Accounting' ('the ED') and thank the Board for enabling us to participate in this project.

HSBC is one of the largest banking and financial services organisations in the world, with assets of US\$2,455 billion at 31 December 2010. Headquartered in London, HSBC serves customers worldwide from more than 7,500 offices in 87 countries and territories in six geographical regions. HSBC's businesses encompass a very broad range of financial services and products, including personal financial services, commercial banking, global banking and markets, private banking, asset management and insurance.

We agree with the Board that the current hedge accounting requirements are overly complex and do not reflect risk management practices, and support the efforts of the Board to develop a new standard, as part of their commitment to work towards high quality international accounting standards.

We welcome many of the proposals, although we consider that the proposals have not gone far enough in realising their stated objectives. We welcome in particular those proposals which remove arbitrary distinctions, for example, permitting the designation of risk components in non-financial instruments, and allowing the designation as a hedged item of aggregated exposures, including those which contain a derivative. We support the removal of the bright-line thresholds for determining hedge effectiveness, which will prevent the failure of hedge accounting that can result from crossing these thresholds, and the general principles of rebalancing hedging relationships, which may allow closer alignment with risk management strategies. While the proposals will make it easier to apply hedge accounting, we believe that many institutions will retain some form of bright line testing for operational purposes.

Notwithstanding the improvements outlined above, we believe that the proposals have not gone far enough to address the concerns of the financial services industry. In particular we have the following concerns:

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- **Achievement of the stated objective** - we agree with the stated objectives of hedge accounting. If risk management and hedge accounting are to be aligned, then it would be logical that all major risk management strategies which use financial instruments to manage risk exposures should be capable of being reflected in hedge accounting. However, hedge accounting for certain risk management strategies used extensively by banks are prohibited, undermining the validity of the proposals for financial institutions. It is important that the next phase of this project on portfolio hedge accounting fully considers the accounting consequences of the main risk management strategies used by financial institutions. These include the behavioural risk management of core deposit portfolios and the mechanism by which banks make risk transfers when managing financial risks.
- **Granularity of Risk Management Strategy** – the ED appears to envisage that an entity's risk management activities would interact with hedge accounting at a very granular level, such that it would be possible to identify requirements to rebalance and/or terminate hedge accounting relationships by referring to the entity's risk management strategy. In practice, risk management strategies of financial institutions are not formulated at such a granular level, and due to the volume of hedge accounting transactions entered into on a regular basis it would be difficult to see how such a granular approach could be documented and operationalised. In addition it is unclear how the interaction of risk management activities at different levels of an entity would be incorporated into this framework particularly as risk is usually passed through different parts of the entity using internal deals.
- **Prepayment options within layers** - we fully support the proposal to permit hedge accounting for layers of transactions, and agree that for the hedging of individual transactions, a layer including a prepayment option should not be eligible as a hedged item if the option's fair value is affected by changes in the interest rate which the entity wishes to hedge. However in practice the relationship between prepayments and interest movements is not direct due to the influence of several factors. At a portfolio level, we believe that it is possible to use evidence and experience to designate a layer for hedge accounting purposes, in order to represent an effective risk management strategy.
- **Hedge effectiveness criteria** – the stated objective of hedge accounting is to represent in the financial statements the effect of an entity's risk management activities that use financial instruments to manage exposures arising from particular risks that could affect profit or loss. However the stated objective of hedge effectiveness assessment is to ensure that the hedging relationship will produce an unbiased result and minimise expected hedge ineffectiveness. We believe that there is a contradiction between the two objectives, as it appears that it would be possible for a hedge relationship to satisfy the risk management objective, yet if a better hedge were theoretically available, it would potentially fail the stated hedge effectiveness criteria. We would therefore expect preparers to require further guidance on the concept of designating hedge relationships to 'minimise expected hedge ineffectiveness'. We agree with the concept of reducing ineffectiveness, provided a

reasonable tolerance can be set, so that a hedge does not have to be constantly rebalanced for accounting purposes when no rebalancing is required for risk management purposes.

- **Discontinuation** - we believe that an entity should be permitted to discontinue hedge accounting for a hedge relationship which still meets the risk management objective and strategy on the basis of which it qualified for hedge accounting. The proposed prohibition is not consistent with how risks are managed in banks, is internally inconsistent with the principle that the entity should seek to rebalance hedging transactions to minimise ineffectiveness, and is inconsistent with the stated objective.
- **Hedge accounting for the credit risk component of a transaction** – given that using credit derivatives for economic hedging of credit risk is a valid and widespread risk management strategy, we believe that a principle-based standard should not prohibit hedge accounting for such a strategy. A method should be identified to isolate the credit risk component so that hedge accounting may be applied.

Our responses to the questions set out in the ED are provided in the Appendix. As always, we would be pleased to discuss our comments and concerns in more detail if this would be helpful.

Yours sincerely





Appendix: Questions for respondents

Question 1: Objective

Do you agree with the proposed objective of hedge accounting? Why or why not? If not, what changes do you recommend and why?

We agree in principle with the objective of hedge accounting. This approach aims to convey the context of hedging instruments in order to allow insight into their purpose and effect.

However, we believe that the proposals only achieve this to a limited extent, with significant areas not addressed. Some of the matters which need to be considered in order for the objective to be achievable are as follows:

- Appropriate level for application of the objective: risk management within financial institutions is generally carried out at a higher level than the transaction level (for example, at portfolio level). To align risk management with accounting at the transaction level would be operationally burdensome. For example a mechanism used extensively in financial institutions involves the use of internal derivatives by entities to hedge items in a held to collect model on a transaction by transaction basis. The hedges are transacted with an internal trading entity which in turn manages its exposures on a portfolio basis along with other trading instruments. Under the new proposals, as under the current rules of IAS 39, such internal derivatives cannot be designated as hedges. However, under the current rules of IAS 39, external derivatives from the trading book can be identified and designated, an activity which is undertaken solely to achieve hedge accounting, and not as a result of a documented risk management strategy of either entity. Given that this is a typical mechanism for cost effective risk management in financial institutions, clarification is required as to the level at which the hedge accounting objective introduced in the ED should be applied. The application of the objective of hedge effectiveness and rebalancing requirements would also need to be considered in this context.
- Aligning hedge accounting with risk management: risk management and hedge accounting can be better aligned if all main risk management techniques are recognised within the hedge accounting model. Further consideration should be given to the following areas:
 - Portfolios of core deposits are risk managed according to their behavioural characteristics. A key characteristic of such portfolios is that their expected lives extend beyond their contractual demand dates, thereby effectively preventing them from being designated in hedging relationships. The risk management of core deposits is a significant area of risk management for many banks. Therefore, risk management

strategy and hedge accounting are not aligned in this important instance, contrary to the stated objective.

- Credit derivatives are widely used to hedge credit risk, yet no mechanism is in place to enable hedge accounting for risk management strategies involving these instruments.
- Hedging the bottom layer of a portfolio of pre-payable assets.
- Hedges of items that are fair valued through OCI, for example foreign exchange hedges of strategic equity investments.

Until these issues are resolved, risk management and hedge accounting will not be aligned, therefore the objective cannot be fully achieved. Further, such a situation will result in the continued use of proxy hedge designations to reflect the actual risk management strategy, and therefore financial accounting procedures will not reflect the true risk management activities of the entity. We look forward to the Board addressing some of these issues as part of the portfolio hedging phase of hedge accounting.

We wish to point out that macro cash flow hedge accounting will still be a key component of banks' risk management strategies, and any related guidance in IAS 39 should be retained.

Question 2: Non-derivatives as hedging instruments

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?

Where an instrument is valued at fair value, and movements in the fair value can be used to hedge a risk exposure, we agree that it is appropriate that this instrument can be used as a hedging instrument, for example, using a loan asset to hedge a debt issuance.

We expect there would be limited situations in which such a scenario would arise, however support the proposal to include these exposures in the scope of hedge accounting.

Question 3: Derivative as hedged item

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 that it should be possible to designate as a hedged item an aggregate exposure which includes a derivative. If an exposure creates a risk which is being economically

hedged, we agree that there should be no artificial restriction which prevents this from being designated as part of a hedge relationship.

Question 4: Risk components

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 (i.e. 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 agree that it should be possible to designate a risk component as a hedged item, irrespective of whether the hedged item is a financial instrument or a non-financial instrument (unlike in IAS 39 where this is only permitted for financial instruments). This removes the arbitrary distinction between treatment of risks within financial instruments and non-financial instruments.

We believe that it is inconsistent with a principle based standard to explicitly prohibit the representation in the financial statements of valid risk management strategies including those involving credit risk and, where appropriate, inflation.

One of our main concerns is the explicit prohibition to designate the credit risk component in a hedge accounting relationship based on the conclusion drawn in the ED that this component is not separately identifiable and reliably measurable (see our response to question 15).

Question 5: Layers

(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?

IAS 39 permits designation of layers for anticipated transactions. However, as there is uncertainty for both anticipated and existing transactions, we agree with the proposal that the ability to hedge layers should apply to all transactions. Given the nature of certain transactions, it is often appropriate to hedge layers rather than the whole transaction, so as to minimise ineffectiveness.

(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?

We agree that for a single transaction 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 interest rate which the entity wishes to hedge. Where a prepayment option exists within a contract, it can be viewed as an instrument and a separate prepayment option. As both the values of the instrument and the prepayment option are likely to be affected by changing interest rates, then it cannot be said that the interest rate risk of the instrument is separately identifiable.

However, where the transaction is part of a portfolio (either open or closed) we believe that it is possible to use evidence and experience to designate a layer as part of an effective risk management strategy. Although there would appear to be a strong causal link between interest rates and prepayments, in reality we believe that the correlation is not direct because there are other factors to consider. Whilst interest rates influence prepayments to a certain extent, investors may wait for rates to fall before prepaying, and often prepay as rates begin to rise. Other factors which affect the level of prepayments include unpredictable customer behaviour and the impact of early repayment penalties. This approach could not be applied to a single transaction, as it is based on the expected probability of repayment of a number of financial instruments in a portfolio, whereas an individual financial instrument will either be repaid in its entirety or not prepaid, and so an expected repayment percentage could not be designated as a layer.

Question 6: Hedge effectiveness

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 support the removal of a bright line threshold for hedge effectiveness. The bright line was arbitrary and therefore did not provide a meaningful link between hedge accounting and risk management strategies. We also agree that requiring 'other than accidental offset' strengthens the risk management objective. However, we believe that the hedge effectiveness assessment objective could have the unintended consequence of being interpreted as a high threshold which could result in risk management strategies not being reflected in hedge designations. The objective of minimising ineffectiveness may not align to the risk management objective of the entity which aims to manage risk in a cost effective manner.

For example, if an entity can achieve a reasonable level of effectiveness with a certain hedging instrument in line with its risk management strategy, it should not be required to

pay for a significantly more expensive hedge to minimise hedge ineffectiveness. Further, if the best available hedge could achieve effectiveness of 90%, it is unclear whether this would meet the ED's hedge effectiveness objective.

The objective of hedge effectiveness assessment should be to reflect the execution of the risk management strategy without permitting the designation of hedges which involve an accidental offset. We therefore believe that inclusion of concepts such as 'unbiased' hedging and the minimisation of expected ineffectiveness could be misunderstood and will lead to increased complexity. If the Board believes that such concepts are necessary, detailed application guidance would be required.

Question 7: Rebalancing

(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?

We agree that where the risk management objective has not changed, it is appropriate for rebalancing to be permitted, without the need for dedesignation and redesignation of hedging instruments, to align hedge accounting with risk management policies. We do not agree that rebalancing should be made mandatory unless as indicated in our response to question 6, it reflects the way risk is managed in practice.

We agree that if the risk management objective has changed, it is appropriate to dedesignate the original hedge, however this requirement should be applied within a reasonable tolerance level, and should not require entering into a disproportionate amount of rebalancing.

In addition, further guidance would be useful on the level at which rebalancing is appropriate. Rebalancing would usually be done at a portfolio level, so even if certain hedges within the portfolio were individually ineffective, if the portfolio as a whole was effective, it should not be necessary to enter into equal and offsetting instruments to artificially balance each transaction individually, as this would not be in line with risk management strategy.

(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?

Consistent with the above response, we agree that if ineffectiveness is expected, it is appropriate to be able to rebalance proactively, if to do so were to align the hedge designation with execution of the risk management policy. However, in order for this to be applied in a cost effective manner, a reasonable tolerance must be set, for example, if a minimal amount of ineffectiveness is expected, it should not require a rebalancing, where this is within an entity's tolerance levels for risk management.

Question 8: Discontinuation

(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?

We support the proposal that hedge accounting should be prospectively discontinued when the hedge relationship ceases to meet the qualifying criteria (subject to any rebalancing). We therefore support the requirement to discontinue hedge accounting when the objective is no longer met. However we do not agree that hedge accounting should only be discontinued when the criteria are not met – this is discussed further in the response to question 8b.

We would like further clarification of how a hedge relationship is discontinued. Although we understand that if an instrument is sold, this constitutes the cessation of a hedge relationship, it is not clear whether or not a risk transfer (for example to another trading desk) would constitute the cessation of a relationship, or if this relationship would continue to exist until the instrument was sold externally. It is more consistent with risk management practice if an internal transfer was to qualify as a cessation of a hedging relationship.

(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 do not agree that an entity should not be permitted to discontinue hedge accounting for a hedge relationship which still meets the risk management objective and strategy on the basis of which it qualified for hedge accounting. Given hedge accounting is voluntary

and that it is permitted to designate a hedge relationship after the initial recognition of the financial instruments being hedged, it is not consistent to prohibit voluntary dedesignation. Further, we believe the ability to de-designate is necessary, given the complexities in representing risk management strategies in hedge accounting relationships (see our response to question 1).

Strong governance is very important, and we have our own internal procedures to prevent discontinuing hedge relationships without an appropriate reason. However, we have situations where we want to dedesignate, when the risk management criteria are still met. For example, in the case of dynamic hedging, where a pool of instruments is used, different instruments may need to be purchased/sold to maintain the hedge (note this is different to rebalancing as not just volumes of instruments are changed, but the instruments themselves). Removal of the option to voluntarily dedesignate would remove our ability to control the hedges in the most cost effective manner. We believe that it is the role of an entity's governance to ensure that the ability to dedesignate is not being abused.

Question 9: Fair value hedges

(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?

We do not support the proposal that the effective portion of a fair value hedge should be recognised in other comprehensive income. We appreciate that conceptually, this would mean an alignment with cash flow hedging; however, it would cause significant changes to systems to change the posting geography and, also some manual invention would be required to move the ineffective portion to profit or loss, as in most organisations, posting and effectiveness testing are two separate processes. This seems an unnecessary amount of change to systems, given there would be no overall change to the reported profit or loss.

(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?

We do not agree that the gain or loss on a hedged item should be presented as a separate item in the statement of financial position. Although we appreciate that this would eliminate the 'mixed model' measurement of the items in the hedge relationship, it would increase the number of line items on the balance sheet (to what extent, would depend on the disaggregation required). As these items themselves would not represent true assets/liabilities, it is not clear that the complexity of the mixed measurement approach is adequately resolved.

The current practice of adjusting the hedged item is a concept generally well understood by users and a separate line item would only increase operational complexity, without any improvement in information.

(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?

We understand that a linked presentation would show the gross amount of related items on the balance sheet, but the net of these would be included in assets or liabilities as appropriate. We agree that linked presentation should not be allowed for fair value hedges. This might be appropriate for SMEs or corporates with a limited number of hedges, but for a financial institution with a significant number of hedges, this would not be appropriate, as it would introduce further complexity to the balance sheet, and the presentation of aggregated gross and net amounts would be difficult to understand. We agree that it is most appropriate not to use linked presentation, but to describe and explain the hedge relationships in the disclosures, rather than trying to do this by means of a form of the balance sheet presentation.

Question 10: Time value of options

(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?

We agree that for transaction related hedges, the change in the fair value should be reclassified from other comprehensive income in accordance with general requirements, for example, recognising the gains/losses on the hedge of a forecast transaction when that transaction actually occurs.

This proposal is more attractive than the current practice of taking time value immediately into profit or loss, as it more closely reflects risk management practice and reduces income statement volatility.

(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?

We agree that for period related hedges, the change in the fair value should be reclassified from other comprehensive income on a rational basis, for example, recognising the

gains/losses relating to time value over the life of hedged item, thereby absorbing the gains/losses over the period appropriate to the instrument.

(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?

We agree that the accounting for the time value should only apply to the extent that the time value relates to the hedged item. Given that hedge accounting should only be applied to an identifiable and measurable risk, it makes sense that only the time value in respect of that specific risk should be subject to the requirements.

Question 11: Groups

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 that is consistent with other requirements that the components of a group should qualify individually for hedge accounting.

We are also supportive of the removal of the criterion that the fair value of all items in the group must move proportionally to the total. This means that hedge accounting can be applied to a wider population of groups, and as not all elements in an economically hedged group move proportionately.

We understand the reason for the inclusion of criterion (c), that for the purposes of cash flow accounting, any offsetting cash flows must affect profit or loss in the same period. However an entity which reports on a quarterly basis may be disadvantaged by not being able to hedge the net position, while an entity which reports on an annual basis has a better chance of demonstrating that the offsetting cash flows being hedged occur in the same period.

Currently we believe the hedge designation could work under IAS 39 by designating a portion of the gross exposure rather than the net exposure, and it would be helpful if the Board would confirm in guidance that this approach would be consistent with the principles of hedge accounting.

Question 12: Groups of items with offsetting risk positions

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 agree with the proposal. This is because it would not be meaningful to gross up gains/losses to attribute these to gross offsetting positions, as this would lead to the presentation of gains/losses which had not actually occurred, as a mechanism for presenting the net position. It makes sense therefore to present such gains and losses on a separate line.

Question 13: Disclosures

(a) Do you agree with the proposed disclosure requirements? Why or why not? If not, what changes do you recommend and why?

We agree that hedge accounting disclosures are important for the users of the accounts. We appreciate that the objective of the requirements (to disclose information about risk management strategy and how this is applied, how hedging activities affect future cash flows and the effect of hedge accounting on the primary financial statements) is to present information to help users understand the reasons for hedging and the impact of these strategies. However, we believe that the proposed disclosure requirements, which should be split by risk category, are too detailed to be useful to users of the accounts of large financial institutions.

To apply the disclosure requirements to all hedges, split by risk category, would be an extremely time consuming process, requiring a huge amount of additional work which would be unlikely to provide additional clarity to users.

(b) What other disclosures do you believe would provide useful information (whether in addition to or instead of the proposed disclosures) and why?

Currently we disclose the reasons for entering into hedges, the nominal contract amounts for the main hedge types and high level quantitative disclosure on the main hedge types, across the main risk components. We believe that current disclosures are adequate and appropriate. Given the volume of hedge accounting relationships, it is important not to over burden the user of financial statements with unnecessary detail and thereby reduce transparency.

In smaller entities, with fewer hedges, users may want more detail to understand how individually material transactions may affect the business. In a large bank, users are more

interested in the use of financial instruments within the context of risk management strategies, and would not benefit from more granular disclosure.

Question 14: Own use exception

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 it makes sense to allow entities to apply derivative accounting to contracts which form part of an entity's requirements for its own usage. If this is not permitted, the accounting outcome may not be consistent with the entity's risk management strategy.

Question 15: Alternative accounting

(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?

While we appreciate the efforts of the staff and the Board in pursuing the three alternatives we believe that a credit hedging solution within the hedge accounting framework is preferable. This would also avoid the ED being unduly prescriptive in disallowing credit risk components, which is inconsistent with a principle based standard. Preparers should be permitted the flexibility to designate credit risk if it meets the risk component criteria of being separately identifiable and reliably measurable.

Further, we acknowledge the practical difficulties in isolating credit risk in certain scenarios and believe that the new standard could address the issue with a pragmatic solution. This could be achieved, for example, by allowing a practical expedient to the eligibility criteria to permit credit risk to be identified and measured as the residual non-market risk component in the overall fair value of the hedged item. While the residual would include other factors like liquidity or funding risk, it is a practical representation of the entity's risk management strategy, would result in reduced income statement volatility and would represent unbiased measurement of all ineffectiveness arising from the hedged and un-hedged components of the non-market risk. While this is not the perfect solution, it may be one of the practical ways to address the industry's long standing requirement for a workable credit hedging solution. Fundamental to this and other solutions within the hedge accounting framework is the need for the standard to take a practical approach to the 'separately identifiable and reliably measurable' criteria in order to meet the

objectives of reducing complexity and eliminating unnecessary barriers to hedge accounting.

(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?

If the Board decided to develop one of the three solutions, we feel alternative 3 would most accurately reflect the effects of risk management, be less susceptible to earnings management and reduce the accounting mismatch. In order to make it more operational we suggest that the guidelines for the amortisation of the measurement change adjustment be consistent for loan commitments and loans.

Question 16: Transition

Do you agree with the proposed transition requirements? Why or why not? If not, what changes do you recommend and why?

Subject to the outcome of the consultation on transition and effective dates, we agree with the proposed transition requirements, to apply for annual periods beginning on or after 1 January 2013 with earlier application permitted, as long as all existing IFRS 9 requirements have been adopted. We also support the proposal that the new requirements should be applied prospectively to all hedging relationships.

We agree that it is appropriate to provide significant lead time for implementation, given that proposals could create additional work for entities, in particular in respect of the new fair value hedge accounting proposals. In addition, the increased disclosure requirements and the creation of separate line items to show the gain/loss arising from fair value hedges and for hedges of groups will change how the data is gathered, and therefore take time to implement.