

9 March 2011

International Accounting Standards Board
30 Cannon Street
London EC4M 6
United Kingdom

Comment Letter on Exposure Draft (ED) – Hedge Accounting

Dear Sir / Madam,

SwissHoldings, the Swiss Federation of Industrial and Services Groups in Switzerland represents 53 Swiss groups, including most of the country's major industrial and commercial enterprises. We thank you for the opportunity to comment on the above mentioned exposure draft (the ED). Our response below has been prepared in conjunction with our member companies. We outline some general comments below and answer the specific questions of the ED in the annex.

GENERAL COMMENTS

SwissHoldings welcomes that the proposals of the ED on Hedge Accounting are driven by risk management practices as accounting follows the business and should reflect its activities. We consider several proposals as a fundamental change in hedge accounting. We support the proposal in the ED which relaxes several hedge accounting restrictions for non-financial service industry preparers and better aligns with their risk management operations. We also agree with the ED proposals to eliminate significant and unnecessary restrictions maintained in IAS 39 and makes hedge accounting more accessible and facilitate hedge accounting for certain additional transactions and circumstances.

SwissHoldings supports the following proposals made in the ED:

- a) The eligibility of non-derivative financial assets and liabilities as hedging instruments and the possibility to designate a combined exposure of a non-derivative instrument and a derivative as a hedged item;
- b) The several proposals to broaden the eligibility of risk components for the designation as the hedged item in a hedging relationship; and
- c) The hedge accounting by one single method for the different types of hedges.

From an industrial and service industry preparers' view, we are not especially exposed to all proposals addressed by the questions. Therefore, we do not express a distinct opinion in particular on your questions on the hedging of groups of items and the designation of a layer component which includes prepayment options. We would also like to state that generally it is difficult to comment on proposals without having all the proposed amendments available in a complete standard. Once all phases of the IAS 39 replacement project are exposed for commenting, we will have to reassess the entire body of accounting principles on financial instruments. So our views and comments cannot be considered as definite at this stage.

We have concerns on the introduction of additional complexity and would suggest that the Board reconsiders the proposals in the area of:

- a) The introduction of the concept of '*rebalancing*';
- b) The accounting and presentation of (in-)effectiveness in other comprehensive income; and
- c) The accounting treatment of the time value of options.

We also have reservations that hedge accounting per se is not being made available and applicable to all different risk types and that hedge accounting would be restricted to risks that impact profit or loss only.

Finally, we believe that the final standard needs more guidance and illustrative examples for the accounting of certain hedging transactions, especially for 'synthetic exposures' in respect of the treatment of the individual components of the hedging relationship for the combined exposure.

Below we further develop our views in our answers to your specific questions on the ED.

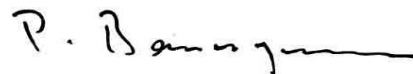
Yours sincerely

SwissHoldings

Federation of Industrial and Service Groups in Switzerland



Dr. Gottlieb A. Keller
Current Chair of SwissHoldings
(General Counsel Roche Holding AG)



Dr. Peter Baumgartner
Chair Executive Committee
SwissHoldings

cc SH Board

11-03-09-CL-ED-Hedge Accounting

ANNEXE

ANSWERS TO SPECIFIC QUESTIONS IN THE INVITATION TO COMMENT

QUESTIONS FOR RESPONDENTS – INVITATION TO COMMENT

Objective of hedge accounting

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?

SwissHoldings supports the ED's focus on an entity's risk management activities and agrees with the proposed objective to reflect in the financial statements the effects of these activities.

In principle, we agree with the Board's view in its Basis of Conclusion (BC) to use an objective that combines elements of risk management, financial reporting and accounting aspects. The objective also adequately assesses the presentation in the financial statements.

However in particular we do not agree that hedge accounting should be restricted to risks that affect only profit or loss. We consider that an entity should also be able to protect its other comprehensive income from fair value changes which arises for example from equity investments at fair value through other comprehensive income or the revaluation of emission rights. In practice, the reduction of fair value changes in other comprehensive income could certainly be part of an entity's risk management objectives, especially in the case of an entity with a low equity base and the need for compliance with certain debt covenants and ratios. We believe that this recognition anomaly where the fair value measurement effects of the equity investment would be reflected in other comprehensive income while the fair value measurement of the hedging instrument would be recognized in profit or loss should be mitigated by making hedge accounting also available for such items. In addition, the entity's risk management activities would also be better reflected in its financial statements. Therefore SwissHoldings suggests that the Board reconsiders the exclusion of risks that affect other comprehensive income from hedge accounting.

Instruments that qualify for designation as hedging instruments

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 a non-derivative financial asset or liability measured at fair value through profit or loss should be eligible hedging instruments. We consider that the ability to designate non-derivative financial instruments as hedging instruments will align hedge accounting further with risk management practice. Moreover, we believe that a difference arising from translation of intragroup monetary items in the consolidated financial statements should be eligible as a hedging instrument. Paragraph 17 of the ED allows such a difference to be eligible as a hedged item which is not consistent with paragraph 7 of the ED which does not permit it to be a hedging instrument. This would be useful when an entity is to hedge an acquisition or disposal in a foreign currency by designating a foreign currency intragroup monetary item as the hedging instrument.

Derivatives that qualify for designation as hedged items

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 that the aggregation of derivative financial instruments with another exposure may be designated as a hedged item for hedge accounting purposes. In addition, we would like to mention that the examples referred to paragraph B9 in the Application Guidance perfectly represent how entities assess and manage financial risks and reflect common risk management practices. It is therefore the right step to include aggregated exposures qualifying as hedged items in order to harmonize accounting principles closer with business and risk management approaches. However, the examples in paragraph B9 of the ED should clarify the accounting treatment for those derivatives which are part of the combined exposure. We would prefer that the Board consider enlarging the illustrative examples in this respect as well as providing more guidance.

Designation of risk components as hedged items

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 definitely concur with the proposal to allow the designation of risk components as hedged items regardless as to whether the risk derives from a financial or non-financial item, if the risk is separately identifiable and measurable. SwissHoldings considers the ability to designate a risk component as the hedged item in a hedging relationship which will qualify for hedge accounting as a required fundamental change in hedge accounting rules. We believe that this proposal will eliminate significant constraints in the application of hedge accounting for non-financial industry preparers, especially for those companies which are managing individual risk components they are exposed to due to their business activities.

In addition, we are of the opinion that certain risks, as a general principle, should not be excluded from their eligibility for hedge accounting. As commented in our answer to question 14, hedge accounting should not be limited for credit risk. But the same would hold true for inflation risk as well. The Board's argumentation of paragraph B18 is not completely clear to us and we think that inflation as a separate risk could be identified and measured. We would like to recommend that the Board should analyse this subject further in its field testing and outreach activities.

Designation of a layer component of the nominal amount

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?*

We welcome the continuation of the ability to designate a percentage component of a nominal amount as the hedged item. In addition, we support the introduction of a layer component that can be designated as the hedged item. We believe that further enlargement of components that can be designated as hedged items will make hedge accounting more operational in respect of actual hedging strategies.

Our member companies of the non-financial service industry have relatively limited experience with prepayment options in their usual business areas. Although we can follow the Board's argumentation as presented in paragraph BC69 of the Basis for Conclusion, we are not in a position to provide additional input on this point.

Hedge effectiveness requirements to qualify for hedge accounting

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 principle, SwissHoldings agrees that hedge effectiveness should be a qualifying criterion for applying hedge accounting. The uncertainties that will arise with this requirement relate more to how effectiveness should be determined and interpreted. The proposal in the ED does not determine a bright-line rule within which hedge effectiveness should remain in order to continue with the hedging relationship. We understand that in the absence of such parameters, management should determine what they consider to be an acceptable level of ineffectiveness which must be aligned and consistent with their risk management objective. However, we are concerned that the proposed guidance may reduce comparability among preparers due to different interpretations. In order to avoid interpretations, especially on the 'most optimal' hedge ratio to achieve excellent effectiveness, the ED should clarify that the hedge ratio should be assessed in order to minimise hedge ineffectiveness, but not – as we read now paragraph B30 – that the most ideal hedge ratio should be maintained from inception throughout the maturity of the hedging relationship.

But overall, we welcome the removal of the 80% to 125% hedge effectiveness test thresholds. All the more, so as the ED proposes to account immediately in profit or loss for any ineffectiveness. Consequently the effect of a hedging relationship where the fair value changes on the hedged item and those of the hedging instrument do not correlate perfectly are recognized directly in profit or loss regardless of the effectiveness ratio of the hedging relationship.

Rebalancing of a hedging relationship

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?*

We understand the Board's objective to limit the possibility of earnings management by ceasing the possibility to 'voluntarily' interrupt a hedging relationship. We also accept that risk management objectives should not change frequently. Therefore we agree with the approach to adjust primarily the hedging relationship rather than discontinue, restart and change the

relationship. The introduction of the concept of '*rebalancing*' allows entities to react to changes that might occur in a hedging relationship over time.

We agree inasmuch that the 'most optimal' hedge ratio is clarified as mentioned in our response to question 6 above. Without this clarification, paragraph B52 could require entities to rebalance just because the most optimal hedge ratio is no longer the one currently used. We agree with rebalancing but only when the hedge ineffectiveness is no longer aligned to the risk management strategy and not because the hedge ratio is no longer the 'most optimal'. Moreover, the level of ineffectiveness is anyway recorded to the income statement.

However we believe that the proposed approach will increase the complexity of hedge accounting. In addition, the '*rebalancing*' principle will introduce new processes in hedge accounting that are currently not operational. We recommend that the Board undertakes additional outreach activities and field testing on the application, feasibility and understanding of the '*rebalancing*' concept. We would suggest that '*rebalancing*' should not be mandatory, but should be optional in order to reduce ineffectiveness. We believe that optional '*rebalancing*' would reflect actual risk management activities.

Discontinuing hedge accounting

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?*

As mentioned in our answer to question 7 above, we support the proposals that an entity should not be permitted to terminate a hedging relationship when the qualifying criteria are still met such as the risk management objective still exists. However, since hedge accounting is not mandatory, why should an entity be forced to continue just because the economic hedge continues? It is important that the Board demonstrates its reasoning in the Basis for Conclusion.

The concept of '*rebalancing*' almost follows the risk management activities to adjust risk exposures with the respective hedging instruments. Therefore we agree that hedge accounting should be continued when an entity still manages the same risk through the use of the same hedging instruments.

Accounting for fair value hedges

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 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?*
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- 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 agree with the Board's view expressed in the paragraphs BC119 and BC120 of the ED to have a common accounting approach for both types of hedges (fair value and cash flow hedges).

Using the same reasons as discussed in our comment letter on the presentation of an entity's own credit risk (*ED on Fair Value Option for Financial Liabilities*), we do not agree with the introduction of the gross presentation method in other comprehensive income. We do not support the two-step approach for presentation purposes. The proposal to present the hedging effects in three lines (changes in the fair value of the hedged items and hedging instruments and the transfer of ineffectiveness to profit or loss) will unnecessarily increase the complexity for preparers from an operational point of view and we therefore believe that it would still be more appropriate to account for hedge effectiveness directly in other comprehensive income and the ineffective portion in profit or loss.

We believe that the result of the measurement of the hedged risk could be presented as a single separate line item in the statement of financial position, however, these items should not be presented as single items for each single risk next to the line items that are hedged in the statement of financial position. We believe that the introduction of a separate line item for the hedging gain or loss on the hedged item will substantially and unnecessarily increase the number of line items presented in the statement of financial position. The statement of financial position will be less clearly presented and it will become less decision-useful for users. Therefore SwissHoldings would like to propose to the Board to consider to present all gains or losses on the hedging relationships in one line item in the statement of financial position and to require disclosure of the hedges and related gains or losses as separate note.

Moreover, we do not support a linked presentation on the face of the statement of financial position. The risk management policy and strategy with its related operational activities employed should be described and disclosed in the notes to the financial statements. A linked presentation in the statement of financial position would reduce comparability among preparers and industries as the use of hedge accounting would differ significantly.

Accounting for the time value of options for cash flow and fair value hedges

Question 10

- a) *Do you agree that for transaction related hedge 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 (eg 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 (ie 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?*

SwissHoldings welcomes the proposal to defer an option's time value in other comprehensive income when an entity separates the intrinsic value and time value of an option contract and designates only the change in the intrinsic value as the hedging instrument. The separate

recognition of the time value in accordance with the hedged item or transaction better portrays how this value is considered for risk management purposes, since it is usually considered as a cost of obtaining hedge protection similar to an insurance premium.

We understand the argument for the reclassification of the option's time value accumulated in other comprehensive income as described in the paragraphs BC149 and BC150 of the ED. We would like however, to propose that the Board considers only one approach for the reclassification of an option's time value out of other comprehensive income due to practicality considerations and in order to further reduce complexity. For example, to amortise the original time value portion of the premium paid to profit or loss over the life of the option with subsequent changes in time value being accumulated to other comprehensive income.

In addition, we question whether the accounting approach for the time value should be isolated to options or whether, as a general principle, should be applicable to other derivative instruments such as foreign exchange forward contracts. We believe that it would be worthwhile for the Board undertake further appraisals of the extension of the accounting for the time value of options to other derivatives and present its view in the Basis for Conclusion.

Hedges of a group of items

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?

SwissHoldings supports the direction the Board is proposing to allow hedging of a group of items. We concur with the main principle that only a group that consists of items that individually are also eligible hedged items should qualify as a hedged item for hedge accounting purposes. Although as non-financial industry preparers, we will be rarely affected by the hedge accounting for hedges of financial instrument portfolios, we are not in a position to finally conclude on these proposals until the accounting approaches for macro hedging have been further developed.

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 (eg 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 proposed presentation in a separate line item in profit or loss because the result of the valuation of the hedging instrument derives from the already netted risk position and an expansion of the hedging instrument's gains or losses for allocation purposes would not fairly represent the actual financial situation.

Disclosures

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?

The effort required from preparers to compile the information for the proposed disclosure requirements will be dependent on an entity's risk management strategy, its exposure to different risks and in particular, its use of hedge accounting. We expect that non-financial industry preparers will increase their use of hedge accounting as a consequence of the proposals made in

this ED. As a result, the proposed disclosure requirements could become extensive. We believe that some requirements would not be necessary if the Board reconsiders to reduce further the complexity of the proposed approaches for the presentation and reclassification of hedge accounting effects in other comprehensive income. As commented in our answers to questions 9 and 10, we consider that the proposed accounting requirements should be simplified in particular those related to the models to recognise valuation changes in other comprehensive income.

In our opinion, the wording of the disclosures proposed in the ED should be clarified. In particular, we are concerned with:

- Paragraph 46(c), which mentions the average rate at which an exposure is hedged, would seem to require an entity to disclose sensitive information to others that may result in a competitive disadvantage. Such information could be used by competitors or market speculators to take positions in the market for the hedged item which adversely influences the operations of the entity and/or the position of the other market participants with whom the entity is transacting.
- The requirements in paragraph 40(b), 44(c) and 46(a) and (b) that effectively appear to require disclosure of forecasts to the extent of future expected transactions.

As those disclosures should be made 'for each subsequent period' and are therefore of a strong prognostic character, we entirely reject to present such extremely sensitive information (eg estimates of the amounts of expected hedged items or disclosing hedge ratios), which would give competitors extensive insights into certain critical estimates and exposures. We consider that an entity would put itself at a significant competitive disadvantage.

We propose that the disclosure requirements should be restricted to risk management policy hedges that are in place at the balance sheet date and information about hedges taken out during the reporting period. Disclosure of expectations about the extent of future transactions would amount to disclosure of budget information and goes against the principles of current accounting practices. In addition, such information always embeds estimation and uncertainties. This information is less reliable, and would provide speculators with the opportunity to flex the market prior to the transactions of the hedging instruments.

We also propose that the risk management policy disclosures within paragraph 40(a) be reworded to refer to a 'currently approved risk management policy' which would provide scope for adjustment of these practices, rather than implying a commitment by the entity to maintain current policies whatever significant market fluctuations may occur.

We are also concerned that the ability to cross-reference to non-audited information contained outside of the financial statements (paragraph 41 of the ED) would pose severe issues for auditors and their clients in determining the extent of information that is within the scope of the audit opinion.

We believe that the Board should undertake additional outreach activities in respect of disclosure requirements and we would welcome the preparation of disclosures that do not have the potential to harm an entity's future business.

Accounting alternatives to hedge accounting

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 understand and support the proposals that an entity should be allowed to fair value contracts that would otherwise meet the 'own use' scope exception, if that is in accordance with the entity's fair value-based risk management strategy and that in order to eliminate an accounting mismatch an entity applies hedge accounting. We are more concerned that the proposed amendment to paragraph 8 of the scope of IAS 32 could be interpreted in such a way that contracts linked to a market price or index, but where physical delivery for own use is intended (executory contracts), would also have to be valued at fair value. To make it crystal clear we suggest amending the ED by confirming that the 'own use' scope exception is still in force in Appendix C of the ED or by including the existing guidance on implementing IAS 39, Section A example A.1 to the Application Guidance of the ED.

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?*

As commented in our answer to question 1, SwissHoldings is of the opinion that hedge accounting should not be restricted to risks affecting profit or loss only. We have the same view for the qualification of categories of risk as also strengthened in our comments on question 4. We understand that the use of credit derivatives to manage credit risk is very common in the financial services industry. We believe that credit risk should not be excluded per se from the risks for which hedge accounting can be applied. As long as the common requirements for the qualification for hedge accounting are met, i.e. the risk is separately identifiable and measurable, hedge accounting should be permitted for the hedging of credit risk. We are not completely convinced that the alternative accounting treatments considered by the Board would add unnecessary complexity to the accounting for financial instruments in the absence of the possibility to apply hedge accounting for credit risk.

Effective date and transition

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 that hedge accounting of the revised standard can only be applied if all of the IFRS 9 requirements are in force or have been adopted. Furthermore early adoption before the effective date should be permitted. We also concur with the proposal to require a prospective application as previous hedge accounting had been undertaken under completely different circumstances. We are of the opinion that the effective date should be aligned with the Board's decision as a result of its recent request for views on *Effective Dates and Transition Methods*.