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Exposure Draft ED/2010/13 'Hedge Accounting'

March 4th, 2011

Dear Sir David,

We are writing to comment on the IASB Exposure Draft ED/2010/9 'Hedge Accounting' (herein referred to as 'the ED'). We highly appreciate the opportunity to comment on the ED. Our detailed comments on the questions raised in the ED are included in the appendix to this letter.

First of all, we highly appreciate the IASB developing a more principle-based standard on hedge accounting, thereby facilitating a closer alignment of risk management practice and hedge accounting. The latter is especially true for the suggested provisions allowing preparers to designate aggregated exposures or components of non-financial positions as hedged items and treating the time value of options designated as hedging instruments in an economically correct manner. From our point of view, finalising those and other proposals of the ED would be very beneficial to preparers and users of financial statements alike, particularly with regard to the financial reporting of non-financial institutions.

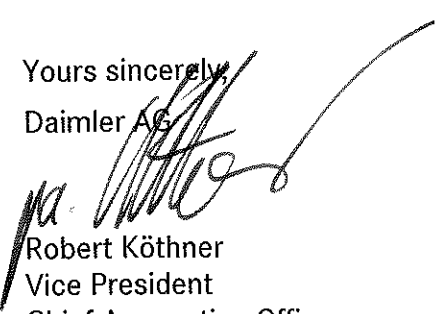
However, our major concern is that certain proposed disclosure requirements would oblige entities to disclose highly sensitive information, especially those with regard to the amount, timing and uncertainty of future cash flows as stated in paragraphs 40(b) and 45-48 of the ED. Therefore, we urge the IASB not to enact those disclosure requirements in the final standard (see our answer to Question 13).

Furthermore, we would like to point out certain issues of the ED which in our view are not clearly explained by the proposed standard, e.g. the notion of 'rebalancing' (see our answer to Question 7) and the proposed modifications to the own use exemption, which could result in mandatorily applying derivative accounting to certain contracts which are otherwise excluded from the scope of IAS 39 and IFRS 9, respectively (see our answer to Question 14).


We would have appreciated a contemporaneous deliberation of the accounting rules for financial instruments at least for all the aspects in the given project. Therefore, we will comment on the issue of groups as hedged items when the suggested provisions concerning portfolio hedge accounting are published in their entirety.

Yours sincerely,

Daimler AG



Robert Köthner
Vice President
Chief Accounting Officer



Dr. Friedrich Siener
Director

IASB questions

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?*

We agree with the general direction of the Exposure Draft that the objective of hedge accounting should be to represent the result of an entity's risk management activities in the financial statements. However, we ask the IASB to clarify that the application of hedge accounting is not limited to risk management activities that reduce the overall risk position, e.g. based on the VaR measure. Moreover, we were pleased to find that prior considerations of making hedge accounting mandatory for all hedges conducted by an entity's risk management have been reconsidered and that hedge accounting remains an accounting choice.

We believe that this choice assists in reflecting a more consistent view of an entity's hedging activities in the financial statements. However, we think, as outlined below, that certain of the proposed provisions will potentially produce a lot more complexity and will be very burdensome for preparers if the IASB does not explicitly facilitate their application.

In particular, the proposed obligation to rebalance designated hedging relationships under certain circumstances will cause preparers to fundamentally adjust hedge accounting systems, which we reject due to the costs that will be incurred for such adjustments (see our answer to Question 7).

Finally, we question the restriction within the proposed hedge accounting objective that all designated exposures within hedge accounting are restricted to those 'that could affect profit or loss' (paragraph 1 of the ED). As there could be a need to hedge equity investments measured at fair value through other comprehensive income, we ask the IASB to reconsider prohibiting such instruments from hedge accounting designation as this would produce an accounting mismatch that is not in line with the entity's risk management practices.

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?*

Basically, we welcome the extension of possibilities to designate non-derivative financial assets and non-derivative financial liabilities as hedging instruments also for risks other than foreign currency exposures.

We believe that such an extension results in an approach to hedge accounting which is more consistent with the proposed objective of hedge accounting, more closely aligning hedge accounting and risk management.

On the other hand, we have concerns about excluding non-derivative financial assets and non-derivative financial liabilities which are not designated as at fair value through profit or loss, although the IASB regards the use of such instruments as hedging instruments as being limited.

We think that this restriction might, in some cases, not be in line with the entity's risk management activities and thus produces a conceptual inconsistency with the proposed objective of hedge accounting. This problem is not solved by applying the fair value option to designate instruments as at fair value through profit or loss at initial recognition to be able to use them as hedging instruments because such designation is irrevocable. Although the application of the fair value option would initially be in accordance with the entity's risk management strategy, it is not possible to revoke such application subsequently if there is a change in the entity's risk management strategy. On the other hand, according to the proposed provisions, hedging relationships for which hedge accounting is applied have to be discontinued mandatorily if they are not in line with the risk management objective.

We also ask the IASB to think about further ways to disaggregate non-derivative financial instruments and non-derivative financial liabilities to allow components of those instruments to be designated as eligible hedging instruments.

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?

Yes, we agree with the proposal to designate aggregated exposures consisting of another exposure and a derivative as a hedged item because risk management strategies can also include synthetic exposures.

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?

Yes, we agree with and highly appreciate the proposal to allow preparers to designate changes in the fair value or cashflows attributable to a risk component of non-financial positions as a hedged item.

As current risk management practice is hedging components of non-financial positions with the same quality and efficiency as it does for financial positions, in our view it is a logical step to accommodate hedge accounting with current risk management practice.

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 that the IASB proposes to extend the eligibility of a layer component of a nominal amount to be designated as a hedged item not only for forecast transactions but also for existing transactions. This provides preparers with the possibility to better align hedge accounting and risk management practice.

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?

We fully agree with the removal of the 80 to 125 per cent bright line test as well as with the abolishment of the obligation to quantitatively carry out retrospective hedge effectiveness testing.

There is no conceptual reason why a hedge that is 79% effective should be excluded from hedge accounting compared to a hedge that is 80% effective, especially when risk management considers hedges to be economically effective when the hedging instrument and the hedged item offset, for instance, only by 70%. Furthermore, entities have to bear the consequences of setting up hedge accounting for hedging relationships that are expected to produce significant ineffectiveness by accordingly creating volatility in profit or loss, which also has to be separately disclosed in the notes according to IFRS 7.24.

Therefore, it is also obvious that the entity's internal risk management strategy shall be the main source for identifying the adequate quantitative or qualitative method to assess hedge effectiveness as outlined in paragraph B38 of the ED.

In this regard, when looking at paragraph 34 which states that '... when the critical terms [...] of the hedging instrument and the hedged item match [...] it might be possible for an entity to conclude [...] that the hedge ineffectiveness, if any, would not be expected to produce a biased result', we think that applying the 'critical-terms-match' method when the critical terms exactly match would be in line with this provision, although paragraph B32 of the ED states that an 'entity shall assess at the inception of the hedging relationship and on an ongoing basis whether a hedging relationship meets the hedge effectiveness requirements'. Paragraph BC88 of the ED confirms our understanding. To clarify this issue, we ask the IASB to permit the application of the 'critical-terms-match' method explicitly in the standard or the Application Guidance, as this would be also in line with an entity's risk management.

Currently, it is the prevailing opinion among preparers, users and auditors to permit the application of the hypothetical derivative method only for testing effectiveness in cash flow hedges, but not for fair value hedges. Because paragraphs B44-B45 do not explicitly state that calculating changes of the hedged item for the purpose of measuring hedge ineffectiveness by using a hypothetical derivative is solely applicable for cash flow hedges, one could think that the IASB does not see the necessity to exempt fair value hedges from using a hypothetical derivative. Therefore, we ask the IASB to clarify this issue and permit the use of hypothetical derivatives also for fair value hedges.

From a preparer perspective, we miss guidance on the relationship between the consequences of ineffectiveness on the one hand and the necessity to rebalance a hedging relationship on the other hand. If the elimination of the retrospective effectiveness testing in terms of a qualification criteria on the one side is accompanied by a great burden for preparers by forcing entities to rebalance hedging relationships for hedge accounting purposes on the other side, we do not see the benefit of the new rules. As outlined in our answer to Question 7, rebalancing would – depending on how the IASB interprets the notion of rebalancing – imply that entities applying hedge accounting may be forced to adjust their hedge accounting systems fundamentally and carry out continuing adjustments of hedge documentations possibly on a frequent basis. These adjustments will require significant efforts and disproportionately increase costs to maintain hedge accounting.

We believe it is important that the proposals on effectiveness testing, rebalancing and prohibiting voluntary dedesignation of designated hedging relationships are evaluated in conjunction because of the existing interdependencies of these topics.

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?

Regarded in conjunction with the proposed abolishment of the 80 to 125 per cent effectiveness corridor and the proposed prohibition of voluntary dedesignation of designated hedging relationships, rebalancing seems to be the right answer for those situations in which entities are currently forced – due to a current or expected failure of the effectiveness corridor of 80 to 125 per cent – to discontinue or proactively dedesignate hedging relationships within hedge accounting and possibly re-designate the affected hedging instrument(s) and hedged item(s) in a new hedging relationship with an adjusted hedge ratio. The adjusted hedging relationship is then regarded as a continuing hedging relationship. But from our point of view, the main question that remains open at this point is the relationship between any arising ineffectiveness and the concept of rebalancing.

Looking at the implications that rebalancing has for preparers with respect to maintaining hedge accounting systems and preparing hedge documentation, there might be an imbalance between the benefits of continuing existing hedging relationships within hedge accounting without discontinuation and the subsequent restart and the costs induced by frequently adjusting the hedge ratios of all the designated hedging relationships of an entity, thus adding new complexity.

The question if there is any such imbalance depends on the IASB's view when entities should be obliged to rebalance designated hedging relationships.

According to paragraph B50 of the ED, preparers should decide whether to rebalance a designated hedging relationship by analysing 'the sources of hedge ineffectiveness that it expected to affect the hedging relationship during its term' and evaluating 'whether changes in the extent of offset are:

- (a) fluctuations around the hedge ratio that remains valid (ie continues to appropriately reflect the relationship between the hedging instrument and the hedged item); or
- (b) an indication that the hedge ratio no longer appropriately reflects the relationship between the hedging instrument and the hedged item.'

In doing so, an entity shall perform 'this evaluation against the objective of the hedge effectiveness assessment, ie whether the hedge ratio still ensures that the hedging relationship will produce an unbiased result and minimise expected hedge ineffectiveness' (paragraph B50 of the ED). The IASB states that this assessment requires judgement.

Thus, as the definition and requirements of rebalancing a hedging relationship are apparently unclear, it is crucial to discuss and understand the meaning of rebalancing. In this regard, paragraph B51 of the ED states that:

'Fluctuation around a constant hedge ratio (and hence the related hedge ineffectiveness) cannot be minimised by adjusting the hedge ratio in response to each particular outcome. Hence, in such circumstances, the change in the extent of offset is a matter of measuring and recognising hedge ineffectiveness but not of adjusting the hedge ratio, ie it does not result in rebalancing.'

On the other side paragraph B52 of the ED states:

'Conversely, if changes in the extent of offset indicate that the fluctuation is around a hedge ratio that is different from the hedge ratio currently used for that hedging relationship, or that there is a trend leading away from that hedge ratio, hedge ineffectiveness can be minimised by adjusting the hedge ratio whereas retaining the hedge ratio would increasingly produce a biased result and hedge ineffectiveness. Hence, in such circumstances, the change in the extent of offset is a matter of adjusting the hedge ratio and therefore requires rebalancing the hedging relationship.'

But especially when there are hedging relationships that will last over a considerable time period it is almost impossible to predict whether 'there is a trend leading away from the hedge ratio' that is currently applied within a certain designated hedging relationship.

Moreover, considering the proposal in paragraph 19 in conjunction with B29 of the ED, that a hedging relationship meets the hedge effectiveness requirements only, if among other things

'the hedging relationship will produce an unbiased result and minimise expected hedge ineffectiveness', we question if this principle is adequate to be applied to certain hedges that are common in risk management practice. If for example a 5Y-fix-rate bond issue is hedged using a 5Y-6M receiver interest rate swap, semi-annually paying float leg, there will be a correlation between the change in fair value related to the hedged risk of the bond and the changes in fair value of the floating leg of the swap which changes over the life-time of the hedge. Based on the requirements of B50-52 an entity might be obliged to rebalance the hedge relation. We think that this requirement (interpretation) will produce a lot more complexity and will be very burdensome for the preparers without providing additional information. We therefore ask the IASB to especially clarify the rebalancing requirements for such 1:1 fair value hedges. Note: if the hypothetical derivative method can also be applied to fair value hedges, the implications of the float leg regarding hedge ineffectiveness would be eliminated and no rebalancing would be necessary (see also our answer to Question 6).

Therefore, we urge the IASB to deliberate again on the notion of rebalancing. We propose that entities should be able to decide based on their risk management strategy for each hedging relationship when any rebalancing should be carried out. As entities always have to bear the consequences of having to recognise any arising ineffectiveness in profit or loss and already have to separately disclose the relevant amounts of ineffectiveness according to IFRS 7.24 in the notes, we see no reason to prescribe any obligation to rebalance designated hedging relationships on the basis of a diffuse principle as set out in paragraphs 51-52 of the ED. We believe that the proposed provisions on rebalancing could result in new complexity in the application of hedge accounting as the need will arise to conduct and document a lot of additional assessments that are not part of the risk monitoring procedures.

Therefore, the IASB should leave the decision to rebalance solely on the basis of an entity's risk management. That should be clearly stated in the final standard. An additional issue is to avoid cumbersome discussions with auditors and enforcement.

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?

Yes, we agree.

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 9(a)

No we do not agree. While we welcome the IASB's decision not to pursue its initial proposal to substitute the current fair value hedge mechanics with cash flow hedge mechanics as outlined in paragraph BC120 of the ED, we question that the proposed fair value hedge mechanics will provide additional value in comparison to the current IAS 39 mechanics.

According to paragraph 26 of the ED, the hedging gains and losses on the hedging instrument as well as on the hedged item would have to be recognised in other comprehensive income (OCI), but only the effective portion of those gains and losses shall remain in OCI while the ineffective portion would have to be transferred to profit or loss immediately (paragraph 26(c) of the ED).

The effective portions of the hedging gains and losses in OCI – which will perfectly offset – do not provide relevant information for users of the financial statements. Therefore we do not see the benefit of such an aggregated presentation in OCI.

Notwithstanding the fact that complexity in presenting information about hedge accounting to users will not be reduced by this proposal, we also believe that it will only introduce additional complexity to preparers, who would be required to adjust hedge accounting systems to reorganise the recognition of hedging gains and losses for all fair value hedges.

Accordingly, we urge the IASB to remain the current mechanics for fair value hedge accounting in IAS 39 unadjusted.

ad 9(b)

We question whether it is necessary that for each individual hedged item the 'separate line item shall be presented next to the line item that includes the hedged asset or liability' (paragraph 26(b) of the ED). We believe that such an approach would significantly distort the face of the statement of financial position.

Therefore, we ask the IASB to deliberate on showing on the face of the statement of financial position *one* single net amount for all fair value hedge adjustments relating to all the hedged items and requiring preparers to explain its composition in the notes (see also our answer to Question 13 below).

ad 9(c)

We agree that linked presentation should not be allowed for fair value hedges. We believe that presenting hedging instruments and hedged items in such a manner would confuse users of financial statements and impair comparability between entities.

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 (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?

We highly appreciate the proposed changes to account for the time value of options as this is currently a significant practical issue.

The proposals to account for the time value component in accordance with the nature of the hedged item – either transaction related or time period related – will allow entities to account for the time value component of designated option contracts in an economically correct manner, thus matching with corresponding profit or loss effects of the hedged item and therefore avoiding artificial volatility in profit or loss.

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?

As the IASB announced that it will issue another Exposure Draft on dynamic portfolio hedge accounting around mid-2011, we are not able to comment on any of the proposals of the ED for groups of items as hedged items as we believe that there might be interdependencies arising between the two Exposure Drafts which cannot be anticipated at present.

Nevertheless, we ask the IASB to deliberate on allowing hedge accounting to be applied to a portfolio of FX revenues which is managed on a portfolio basis using adequate FX basket options.

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 refer to our answer to Question 11.

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?

No, we do not agree with the proposed disclosure requirements.

Amount, timing and uncertainty of future cash flows

Most notably, we reject the proposals outlined in paragraphs 40(b) and 45-48 of the ED concerning the amount, timing and uncertainty of future cash flows. Paragraph 46 of the ED states that entities 'shall provide a breakdown that discloses, for each subsequent period that the hedging relationship is expected to affect profit or loss, the following:

(a) the monetary amount or other quantity (eg tonnes, cubic metres) to which the entity is exposed for each particular risk (for hedges of groups of items, an entity shall explain the risk exposure in the context of a group or net position);

(b) the amount or quantity of the risk exposure being hedged; and

(c) in quantitative terms, how hedging changes the exposure (ie the exposure profile after hedging such as the average rate at which the entity has hedged that exposure).'

As those disclosures should be made 'for each subsequent period' and are therefore of a strong prognostic character, we entirely reject the current proposal to present such extremely sensitive information (e.g. estimates of the amounts of expected hedged items or disclosing hedge ratios), which would give competitors extensive insights into certain critical estimates.

Risk management strategy

Regarding paragraphs 40(a) and 44 of the ED concerning the disclosure of the risk management strategy, we believe that it is useful for users of financial statements to receive information about the exposures to which preparers are applying hedge accounting and to which they are not. For us, such disclosure requirements would be acceptable as far as the past and the current exposures are concerned. But if paragraph 44 of the ED would imply that entities should disclose an explanation of their future risk management strategy this is not acceptable from our point of view due to the concerns raised above relating to the disclosure of estimates.

Effects of hedge accounting on the primary financial statements

The IASB regards the proposed disclosures in paragraphs 40(c) and 49-52 of the ED concerning the effects of hedge accounting on the primary financial statements as a 'link between the hedge accounting information included in the primary financial statements and the hedge accounting information that is not included in the primary financial statements' (paragraph BC190 of the ED).

We believe that such a disaggregated presentation of the relevant information as illustrated in paragraph IE1-IE3 of the ED, which shows the effects of specific amounts resulting from applying hedge accounting relating to hedging instruments and hedged items on the level of type of hedge and hedged risk exposures, could be useful for instance to explain the composition of the single net amount for fair value hedges, as proposed in our answer to Question 9 above.

We urge the IASB to reconsider the proposed disclosures in the ED. As already stated above, the disclosure requirements especially with regard to the amount, timing and uncertainty of future cash flows are not acceptable.

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?

No, we do not agree with the proposal to amend paragraph 8 of IAS 32 and paragraph 5 of IAS 39 concerning the own use exemption.

From our point of view it is not clear whether the proposed provisions imply an obligation to account for any own use contracts as derivative financial instruments if a 'fair value-based risk management strategy' is pursued or imply an accounting choice to account for own use contracts as derivatives, if this is also in line with the entity managing them on a fair value basis.

We explicitly reject the first interpretation.

In paragraphs BC212-BC213 of the ED, the IASB states that an accounting mismatch can arise between a commodity contract for which the own use exemption has to be applied and therefore is excluded from the scope of IAS 39 on the one side and a derivative, which is entered into to hedge changes in the fair value or cashflow exposure arising from the commodity contract on the other side. As hedge accounting does not seem to be adequate to eliminate such accounting mismatches due to the associated efforts, especially when there is a large volume of commodity contracts hedged dynamically on a net basis, the IASB argues that fair value accounting seems the best way to do so.

First of all, as hedge accounting is not an obligation but an accounting choice, we believe that this principle should be the same with eliminating accounting mismatches as outlined above by applying fair value accounting to own use contracts.

Secondly, mandatorily applying fair value accounting to own use contracts that are indeed managed on a fair value basis by default could in turn create new accounting mismatches and thus increase profit or loss volatility, if for instance they are managed together with other positions which are on the other hand excluded from the scope of IAS 39 and thus fair value accounting may not be applicable.

For these reasons, we urge the IASB to make derivative accounting not mandatory but optional for those contracts for which otherwise the own use exemption has to be applied.

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?

No, we do not agree that introducing an alternative to applying hedge accounting for credit risk would under all circumstances add unnecessary complexity to accounting for financial instruments.

First of all, we believe that prohibiting the application of hedge accounting for credit risk using credit derivatives cannot be justified if the hedged risk component in fact meets the requirements in paragraph 18(a) of the ED to be ‘separately identifiable and reliably measurable’ and this is also in line with an entity’s risk management.

The IASB argues that ‘it is operationally difficult (if not impossible) to isolate and measure the credit risk component of a financial item as a component that meets the eligibility criteria for hedged items’ – even for financial institutions hedging credit risk using credit derivatives like credit default swaps – because the ‘spread between the risk-free rate and the market interest rate incorporates credit risk, liquidity risk, funding risk and any other unidentified risk component and margin elements’ (paragraph IN46 of the ED). Notwithstanding the fact that this may often be the case in practice, we ask the IASB to leave the hedge accounting provisions principle-based as far as it is possible in accordance with the requirements in paragraph 18(a) of the ED.

But for instances where hedge accounting cannot be achieved when hedging credit risk, we encourage the IASB to further deliberate on developing an approach that allows applying fair value hedge accounting to hedges of credit risk similar to the fair value option.

Question 16

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

We support an effective date of January 1st, 2015 with earlier application permitted for all phases of IFRS 9 and other new IFRSs the IASB is currently developing as also outlined in our comment letter on the IASB's Request for Views on *Effective Dates and Transition Methods*.

We support prospective application of the proposed hedge accounting requirements as outlined in paragraph 53 of the ED.