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March 9, 2011

**COMMENTS ON EXPOSURE DRAFT ED/2010/13 AND
PROPOSAL TO CONSIDER A FUNDAMENTAL CHANGE TO HEDGE ACCOUNTING**

[NOTICE: This letter does not represent the views of the financial institution that I am employed by, but rather, the views of a financial professional with 16 years experience in developing risk management financial solutions to major European, Latin American and US companies. This letter is presented with the objective of constructively contributing to the ongoing process of improving and simplifying hedge accounting, a key factor affecting effective economic risk management, which can often have a material impact in the efficiency of businesses and by extrapolation also an impact in the efficiency of the global economy]

Dear Sir David,

Please accept my congratulations to the IASB for embarking in the project to improve and simplify hedge accounting in the midst of an intense convergence process to achieve a single set of high quality global accounting standards within in a relatively short time frame.

I share the general consensus on the need to improve and simplify hedge accounting and I fully support the objectives you indicated to the Council of the European Union on March 16, 2010:

- a. to establish a more principles based approach
- b. an approach that better reflects the economics of hedging transactions
- c. to ensure that issues identified are addressed to the fullest extent possible

In a perfect world a global accounting framework would provide the guidance with which to describe the financial position and performance of reporting entities, including those somewhat more complex transactions associated with sound and effective economic risk management. In practice and unfortunately, our hedge accounting framework is also

affecting risk management decisions and sometimes constrainng or limiting sound risk management, a factor which stresses the importance of achieving an improved hedge accounting framework as soon as this is feasibly possible. As such, I was very pleased to read in the introduction of IFRS 9 (among the reasons for issuing the new standard) that although since 2005 the IASB had the long term objective of improving and simplifying reporting for financial instruments, it had never undertaken a fundamental reconsideration of reporting for financial instruments and had decided an accelerated timetable to replace IAS39 in three phases. Phase 3 was to improve and simplify hedge accounting requirements in response to views that the IASB had received in connection with the difficulty to apply, interpret and understand IAS39.

The economic importance that the market practice has naturally attached to hedge accounting (by allowing the accounting treatment to affect sound risk management), forms the basis of my suggestion that the IASB should consider having as a stated guiding principle that sound economic risk management should always have some form of hedge accounting treatment provided this treatment serves to improve the qualitative characteristics of the financial reporting of an entity.

The general comments I can provide on the hedge accounting exposure draft are:

1. it includes some proposed changes which represent a valuable step forward for hedge accounting as illustrated by many of the comment letters that have been published so far.
2. it continues to not allow hedge accounting treatment for certain very simple sound and important economic risk management transactions (perhaps the simplest example, though not the most important, being the derivative that transforms a fixed rate bond into a synthetic inflation-linked liability) and therefore precludes the application of hedge accounting that would result in improved qualitative characteristics of an entity's financial reporting
3. it does not appear to be the result of a fundamental reconsideration of the existing framework but rather builds on it thus inheriting some of its fundamental drawbacks. Building on the existing framework is a sensible approach given that the existing framework has a very sound fundamental base and the difficulty to develop consensus on an entirely new framework while simultaneously achieving global accounting convergence within the time frame objectives in accordance with G20 recommendations.
4. The resulting hedge accounting model exclusively allows hedge accounting treatment for situations that can be described as a "hedge of a risk exposure that affects P&L". While this forms a very solid foundation for a hedge accounting approach and perhaps an approach that would naturally evolve from the context within which the

existing model was originally developed, it also brings about some considerable disadvantages:

- a. Because the existing framework does not recognize the true underlying economic and business objective of many so called derivative hedge transactions which are used to transform an asset or liability and are thus being used as a “building block” to achieve a combined result (the combination of one or more derivatives and another asset or liability) the application of the model to these common risk management situations becomes more complex.
- b. More importantly, the model precludes the application of hedge accounting to certain important sound economic risk management situations that would result in financial reporting that would better reflects the underlying economics of the reporting entity as well as exhibiting improved qualitative characteristics that financial reporting is meant to have.

Given all the above I would strongly urge that the IASB consider a fundamental change to the hedge accounting framework that would represent a significant step forward in bringing hedge accounting closer to the true economics of many important derivative transactions by explicitly recognizing that hedge accounting can also be applied (and perhaps in a substantially simplified form consistent with the amortised cost accounting applied to financial instruments) not only to financial instruments used to manage risk exposures that affect P&L but also to financial instruments that are used to transform other financial instruments with a simple and sensible risk management approach.

The specific comment I can provide on the exposure draft is in relation question 1, the proposed objective of hedge accounting which bearing in mind my previous comments and not counting with the benefit of an accounting background I would suggest along the following lines:

“Reporting entities often enter into a financial instrument transaction not with the purpose of achieving the economic outcome that that financial instrument will generate on its own, but rather, with the objective of achieving a specific economic outcome IN CONJUNCTION with one or more financial instruments, or in conjunction with a non-financial instrument. Accounting for these instruments independent of each other can erode the qualitative characteristics that financial statements are meant to exhibit by providing little insight as to the underlying economics that the combination of these instruments brings to the reporting entity.

These financial instrument transactions often come in the form of financial derivatives that are entered into with the aim of transforming a financial asset or liability into the objective financial instrument (such as a fixed coupon bond transformed to a floating liability) or to hedge a particular risk exposure.

The objective of hedge accounting is to account for those financial instruments that are entered into with the purpose of producing a given economic outcome in conjunction with other financial (or non-financial) instruments, in a manner that is consistent with and reflects the resulting underlying economics that the combination of the instruments brings to the reporting entity in accordance with the conceptual framework for financial reporting.”

I trust this letter will contribute to generate some discussion as to further improvements that can be implemented as soon as practicably possible and to bring hedge accounting closer to the economics of many derivative transactions that are used as building blocks while simultaneously contributing to a material simplification when such approach is merited.

I would like to take the opportunity to wish the IASB the best success in the process of improving and simplifying hedge accounting. I am confident that the final outcome, in whichever form that may eventually be implemented, will represent an important step forward that will serve to improve hedge accounting and financial information to the different stakeholders as well as facilitate effective risk management thereby contributing to increased efficiency of the global economy.

Yours truly,

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