

COMMITTEE ON CORPORATE REPORTING

April 25, 2011

Via email

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Sir David Tweedie, Chairman International Accounting Standards Board 30 Cannon Street London EC4M 6XH United Kingdom

Select Issues about Hedge Accounting (Including IASB Exposure Draft, *Hedge Accounting*) (File Reference No. 2011-175)

Dear Madam and Sir:

The Committee on Corporate Reporting ("CCR") of Financial Executives International ("FEI") appreciates the opportunity to provide its views to the FASB's invitation to comment on the IASB's recent exposure draft on hedge accounting (the "Exposure Draft") through the Discussion Paper, *Select Issues about Hedge Accounting (Including IASB Exposure Draft, Hedge Accounting)* (the "Discussion Paper").

FEI is a leading international organization of 15,000 members, including Chief Financial Officers, Controllers, Treasurers, Tax Executives and other senior financial executives. CCR is a technical committee of FEI, which reviews and responds to research studies, statements, pronouncements, pending legislation, proposals and other documents issued by domestic and international agencies and organizations. This document represents the views of CCR and not necessarily the views of FEI or its members individually. As a preliminary comment, CCR observes that while this Exposure Draft significantly impacts financial institutions, it also is important to other member companies that utilize hedge accounting in their respective risk management activities.

We support efforts to improve and simplify the hedge accounting model. The limitations of the current U.S. GAAP and IFRS models are recognized by many preparers, auditors and users alike as overly rules based, complex and not consistently allowing companies to faithfully reflect the effects of risk management activities in the financial statements. Consequently, preparers have struggled with the practical application of hedge accounting and users have difficulty understanding its financial statement impacts in the context of an entity's overall risk management activities. We are therefore encouraged by both Boards' commitment to improving the hedge accounting model.

We fully support a principles-based hedge accounting model based upon the underlying economics of an entity's risk management activities. We believe the IASB Exposure Draft is a superior starting point, relative to the FASB current proposal, to address the limitations of the existing U.S. GAAP and IFRS

models. CCR supports the efforts of the IASB and FASB to develop a converged set of high quality global accounting standards. We strongly support having a converged approach for hedge accounting under US GAAP and IFRS. If convergence is not achieved in this critical area of accounting, entities with significant multinational operations will be required to maintain multiple and complex systems and processes in order to comply with both U.S. and international reporting requirements.

Both Boards have agreed to align their respective hedge accounting models in connection with the Financial Instruments Project. However, thus far, they have pursued fundamentally different approaches to both hedge accounting and classification and measurement. The FASB's tentative decisions within the Financial Instruments Project to move toward a mixed attribute measurement model have increased the importance of addressing hedge accounting under U.S. GAAP. While the FASB made limited changes to its hedge accounting model in its original proposed Update¹, the IASB opted for a significant overhaul. The IASB's proposed simplification and increased flexibility of the hedge accounting model is a long-awaited and welcome change. Accordingly, we are encouraged by the IASB's decision to comprehensively address the shortcomings of the current models, including macro-hedge strategies. We are pleased such strategies are under deliberation by the IASB and thus, we qualify our response until a proposal for macro-hedging strategies is incorporated into the overall hedge accounting model. Fully understanding its interaction with the general hedge accounting model, is an important issue to our members. We encourage both Boards to work together to jointly redeliberate their respective proposals in an effort to produce a converged overall hedge accounting model.

We strongly support the following aspects of the IASB's proposed guidance:

- The replacement of arbitrary rules with a principles-based approach to hedge accounting;
- The linking of the hedge accounting framework to the entity's risk management strategies;
- A more flexible designation of hedged items, including risk components of financial and non-financial instruments, aggregate exposures and cash instruments;
- The ability to assess hedge effectiveness qualitatively; and
- The elimination of retrospective assessment of hedge effectiveness.

With the IASB Exposure Draft as a starting point, we offer the following recommendations for your consideration in developing a converged hedge accounting model:

- The proposed guidance must provide a more robust definition of risk management to more fully address situations where individual or micro-hedging strategies relate to risk management activities performed on a portfolio or macro-basis;
- Mitigation of credit and prepayment risk is integral to risk management; accordingly, we encourage the IASB to develop suitable solutions to facilitate hedge accounting for these risks;
- The unbiased and neutral requirement in the assessment of hedge effectiveness should be more clearly defined to avoid unnecessary rebalancing and quantitative effectiveness testing because as currently drafted, unbiased and neutral may be interpreted to require a "perfect" or "optimal" hedging relationship";
- We do not agree with the proposed guidance that prohibits hedge accounting for financial instruments measured at fair value through other comprehensive income ("OCI"). We believe such items should be eligible for hedge accounting as risk management activities can include OCI (i.e. not just earnings) risk exposures;
- While we support the concept of rebalancing hedging relationships instead of dedesignation and redesignation, we do not support mandatory rebalancing and believe further guidance is needed to illustrate its application, including clarifying that rebalancing is not required if not an objective of an entity's risk management strategy; and
- We believe illustrative examples are necessary to fully understand the Board's intent when implementing the concepts of designating a component as a hedged item and the assessment and measurement of hedge effectiveness. As a general comment we would be willing to work with the Boards in developing this examples and additional guidance.

¹ Proposed Accounting Standards Update – Accounting for Financial Instruments and Revision to the Accounting for Derivatives Instruments and Hedging Activities issued by the FASB in May 2010.

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In addition to our summary comments, we have also responded to your questions posed in the Discussion Paper in detail. Please find our responses to your questions in Appendix A.

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Thank you for the opportunity to share our thoughts with you on the Supplement. We would be pleased to discuss them at any time. If you have questions, please contact Lorraine Malonza at (973) 765-1047 or lmalonza@financialexecutives.org

Sincerely,

Loretta V. Cangialosi

Chair, Committee on Corporate Reporting

Financial Executives International

Appendix A

Question 1

When an entity uses financial instruments to manage risk exposures in economic hedges but those instruments are not designated in hedging relationships for accounting purposes, do you believe that the proposed guidance would provide useful information about all of the effects of an entity's risk management objectives?

• We believe it would be appropriate to provide users with qualitative disclosure information describing the nature of management's use of financial instruments to accomplish its risk management objectives for both accounting and economic hedges. This information would provide users with a complete picture of the entity's use of financial instruments in their risk management activities rather than including only those instruments used in designated hedging relationships. However, we believe without a more robust explanation of risk management activities (see our response to Question 2), providing meaningful disclosures about an entity's use of economic hedges and determining the scope of financial instruments to include in such a disclosure will be challenging. Should the Board determine not to include economic hedges used in risk management activities, we suggest the Board address those disclosures in its separate Disclosure Framework Project.

Question 2

Do you believe that the proposed guidance and illustrative examples included in the IASB's Exposure Draft are sufficient to understand what is meant by risk management, how to apply that notion to determine accounting at a transaction level, and how to determine the appropriate level of documentation required? Why or why not?

- CCR generally agrees with the proposed broad objective that hedge accounting should represent the effects of an entity's risk management accounting strategies in the financial statements. We support the IASB's principles-based approach that allows the entity inherent flexibility in the definition of its risk management objectives and respective risk management controls framework. We are concerned, however, that the Exposure Draft does not clearly define risk management, which may lead to situations in which an accounting interpretation of risk management differs from the established economic principles of risk management. In addition, in the absence of a clear definition the audit firms may develop their own interpretations of risk management which may conflict with the IASB's intent to acknowledge that a wide variety of valid risk management strategies are available and the objective to establish a clear link between the economic principles of risk management and the accounting framework. We recommend that the Boards provide additional implementation guidance, including illustrative examples, to demonstrate that a wide variety of valid risk management strategies can be utilized in managing the same risk area.
- CCR also acknowledges that while the Exposure Draft is not explicit with regard to the level at which an entity's risk management objective must be defined, it appears to require a definition of risk management at a transactional level. For example, the Exposure Draft requires discontinuing a hedge relationship only when the entity's risk management objective changes and prohibits voluntary discontinuation as long as the entity's risk management objective remains the same. We do not believe it is practicable to apply risk management objectives on a hedge by hedge basis. Generally, entities consider risk management at a macro or portfolio level. By requiring risk management to be defined on a transactional level, the accounting requirements may result in companies modifying their risk management strategies to meet the proposed accounting requirements as opposed to the principle represented in the Exposure Draft, that is, the accounting should reflect risk management strategies. We recommend that the Boards allow constituents more flexibility in defining risk management objectives at a level that is consistent with the entities' economic principles of risk management.

Do you foresee an entity changing how it determines, documents, and oversees its risk management objectives as a result of this proposed guidance? If yes, what changes do you foresee? Do you foresee any significant difficulties that an entity would likely encounter in establishing the controls related to complying with the proposed guidance?

- CCR does not anticipate a change to risk management objectives as a result of the proposed guidance. Rather, we believe the proposed guidance may allow entities more flexibility in determining how those objectives are achieved, i.e., design and execution of risk management strategies. Since the proposed guidance will now allow for a more appropriate reflection of risk management strategies in the financial statements, strategies once avoided because of accounting constraints may now become more attractive.
- Documentation and oversight processes may be modified to the extent we are able to achieve hedge accounting for risk management strategies which previously would not have achieved hedge accounting. However, assuming a more complete explanation of risk management is provided (see our response to Question 2), members of CCR do not anticipate issues with establishing controls around that process and believe the benefits of the proposed guidance would exceed any additional costs associated with the change.

Question 4

Do you foresee any significant auditing issues arising from the proposed articulation of risk management and its link to hedge accounting? For example, is the information required to be disclosed regarding an entity's risk management strategies measurable and objective? Could the inclusion of an entity's risk management objectives create an expectation gap that the auditor is implicitly opining on the adequacy of an entity's risk management objectives?

CCR encourages the FASB to solicit more detailed responses from audit practice professionals. However, from the perspective of the companies represented by CCR, we would not anticipate significant auditing issues, provided a more complete definition of risk management is developed that facilitates objective evaluation. Collectively, we believe that the auditors' responsibility should lie in ensuring that the preparers of financial statements are complying with accounting principles. Specifically, auditors would focus on expressing an opinion on whether the entity's designated hedges are executed in compliance with the entity's documented risk management objectives and whether the entity's hedge transactions are recorded in accordance with accounting standards. The responsibility of determining the adequacy of the risk management objectives should reside with the entity's risk management groups and should not be subject of the auditor's opinion. However, we are unable to speak to whether CCR's expectations would mirror those of audit practice professionals.

Question 5

Should cash instruments be eligible to be designated as hedging instruments? Why or why not? If yes, is there sufficient rigor to prevent an entity from circumventing the classification and measurement guidance in other relevant accounting guidance (for example, IFRS 9, Financial Instruments, and IAS 21, The Effects of Changes in Foreign Exchange Rates)? Are there any operational concerns about designating cash instruments (such as items within a portfolio of receivables) as hedging instruments?

CCR supports the designation of non-derivative instruments measured at fair value through earnings. In practice, many institutions economically hedge their risks with non-derivative financial assets and liabilities, or hedge exposures that are combinations of a derivative and another exposure. We believe the eligibility criteria for hedging instrument designation should not discriminate solely based upon the form of the instrument (i.e. cash vs. derivative). Rather, eligibility should focus on an evaluation of the instruments' economic characteristics and how it's used to mitigate risk exposures in an entity's risk management activities. Accordingly, since this change would be consistent with

companies' risk management activities, we do not foresee significant operational concerns with designating cash instruments as hedging instruments.

CCR believes limiting the eligibility to designate cash instruments as hedging instruments to only those measured at fair value through earnings, prevents circumvention of classification and measurement guidance in other relevant accounting guidance, such as IFRS 9. Limiting the designation to cash instruments measured at fair value through earnings is consistent with permitting derivative instruments to be designated as hedging instruments, which are also measured at fair value through earnings. CCR believes cash instruments which are not measured at fair value through earnings under other relevant classification and measurement guidance should not be eligible for hedging instrument designation, therefore preventing entities from changing the measurement attribute of such items simply by declaring its designation as a hedging instrument.

Question 6

Do you believe that the proposed guidance is sufficient to understand what constraints apply when determining whether an item in its entirety or a component thereof is eligible to be designated as a hedged item (for example, equity instruments measured at fair value through profit or loss, standalone derivatives, hybrid instruments, and components of instruments measured at fair value through profit or loss that are not permitted to be bifurcated)? If not, what additional guidance should be provided?

- We strongly support the IASB's proposal that would allow a broader range of risk components to be considered hedged items. It is a common risk management strategy when hedging exposures of both financial and non-financial items for entities to hedge one or more risk components, such as interest rate, credit or commodity price risk, rather than the entire item. In CCR's opinion, the Exposure Draft's removal of the arbitrary distinction between risk components of financial and non-financial instruments is a significant step towards establishing a principles-based standard that better aligns hedge accounting with risk management activities.
- However, we believe additional guidance is required for the purposes of the appropriate implementation of the proposal. Please see our responses to questions 7 and 8 for specific details.

Question 7

Do you believe that the proposed criteria are appropriate when designating a component of an item as a hedged item? If not, what criteria do you suggest? Do you believe that the proposed guidance and illustrative examples are sufficient to understand how to determine when the criteria of separately identifiable and reliably measurable have been met? If not, please describe what additional guidance should be provided.

- We agree with the Exposure Draft that hedge accounting should be permitted for risk components of both non-financial and financial items if the risk component is "separately identifiable" and "reliably measurable." We believe this is consistent with the objective of hedge accounting outlined in the Exposure Draft. However, we recommend that the Boards provide more illustrative examples to better enable entities to determine when the criteria of "separately identifiable" and "reliably measurable" have been met and how hedge effectiveness should be assessed. CCR would be willing to work with the Boards to develop these examples.
- We are concerned that through its illustrative examples, the Exposure Draft appears to indicate that prepayment, credit, and inflation risk components are unable to meet the "separately identifiable" and/or "reliably measurable" criteria and, thus, cannot be designated as hedged items. We disagree with the arbitrary exclusion of certain risk components as eligible hedged items. Mitigation of these risks is integral to risk management. Accordingly, we encourage the IASB to develop suitable solutions to facilitate hedge accounting for these risks. In light of the objective to produce a more principles-based hedge accounting model, we do not believe it is necessary to specifically exclude, by rule, these risks as eligible risk components. The principles of "separately identifiable" and "reliably

measureable" should be sufficient, as rules have difficulty adjusting to market and product evolutions over time.

Question 8

Do you believe that "separately identifiable" should be limited to risk components that are contractually specified? Why or why not?

- We agree with the Exposure Draft that both contractually and non-contractually specified risk components should be eligible hedged items if they are separately identifiable and reliably measurable. This is because while a risk component(s) may not be contractually specified, it may be a standard part of the pricing structure by market convention, or an entity is able to infer an implicit pricing formula based on the relationship between the observable market price of the total item and risk component(s) within it. However, we recognize that a wide variety of analyses may be developed to identify and measure a non-contractually specified risk component(s) and, therefore, we recommend that the Boards provide additional guidance in the form of broad principles and illustrative examples to identify and measure a non-contractually specified risk component(s).
- Appendix B15 of the Exposure Draft indicates that non-contractually specified risk components can be designated as hedged items if there is a relationship between the component's prices and the prices of an overall forecasted transaction. We believe it would be informative if the Boards provide guidance as to whether this relationship is meant to be a direct relationship (i.e., is a direct component in the process of creating the hedged item) or whether the relationship can be one that is correlated to the forecasted transaction. We urge the Boards to allow hedging of the latter as in practice as the exact composition of a manufactured/produced item is often only known by the manufacturer/seller and not by the buyer. This can make it difficult for a buyer of a manufactured/produced item to identify specific components. In addition, we propose that the Boards include illustrative examples demonstrating how an entity would assess hedge effectiveness for a non-contractually specified risk component(s).

Question 10

Do you believe that the proposed guidance is sufficient to understand what constraints apply to determining a layer component from a defined, but open, population? (For example, do you believe that the sale of the last 10,000 widgets sold during a specified period could be designated a layer component in a cash flow hedge?) If not, what additional guidance should be provided?

- CCR believes the Exposure Draft could be clarified regarding the application of designating layer components from a defined, but open population. The Application Guidance section provides certain examples which could be further supplemented with examples that clearly articulate the constraints. CCR believes based upon the Basis for Conclusions paragraphs BC65 through BC69 that the IASB intended to carry forward the principle in both the current IFRS and U.S. GAAP hedging models permitting designation as hedged items forecasted transactions that represent a layer component of a nominal amount and apply that principle to existing transactions. This principle requires forecasted transactions to be designated with sufficient specificity such that when the forecasted transaction occurs, it is clear whether it is the hedged item. Given its reference in the Basis for Conclusions paragraph BC65, CCR believes this "sufficient specificity" requirement would continue, and accordingly the sale of the last 10,000 widgets sold during a specified period could not be designated as a layer component because it would not meet the sufficient specificity requirement.
- CCR generally supports the Exposure Draft's expansion of the ability to designate layer components of individual or groups of items (including designating a 'bottom layer'), which allows for further alignment of hedge accounting with risk management activities. However, consistent with our response to Question 7, we do not support the rule prohibiting designation as a hedged item a layer component that contains a prepayment option. This effectively does not allow hedge accounting for portfolios of pre-payable assets. We believe the risk component principle of "separately identifiable" and "reliably measurable" should be sufficient guidance to determine risk component eligibility.

Therefore, we recommend removing the specific restriction related to hedging layer components with prepayment risk. Alternatively, the Boards could consider an approach that allows designation of such components conditioned upon including prepayment risk as a component of interest rate risk for purposes of hedge effectiveness assessment and measurement.

Question 11

Do you foresee any operational concerns applying other guidance in IFRS (for example, guidance on impairment, income recognition, or derecognition) to those aggregated positions being hedged? For example, do you foresee any operational concerns arising when an impairment of individual items within a group being hedged occurs? If yes, what concerns do you foresee and how would you alleviate them?

 CCR does not believe this is a significant issue for our members and would defer to respondents more significantly impacted on application of the proposal relative to other IFRS.

Question 12

Do you believe that the proposed guidance on aggregated exposures will provide more transparent and consistent information about an entity's use of derivatives? Why or why not? The proposed guidance would permit net offsetting positions involving only cash instruments to be accounted for as a hedge if certain requirements are met.

• We support the IASB's proposal that an aggregated exposure of a derivative and another exposure be eligible as a hedged item. As noted in the example in paragraph BC50 of the Exposure Draft an entity may not always desire to hedge multiple risks similarly (i.e., hedging one risk for a different duration than the other). Therefore, we believe this will allow entities to better reflect in the financial statements how they manage the risks of multiple exposures (e.g. foreign exchange and interest rate in the IASB's example) differently.

Question 13

Do you believe that an entity should be permitted to apply hedge accounting to a group of cash instruments or portions thereof that offset and qualify as a group under the proposed guidance and satisfy the proposed hedge effectiveness criteria? Why or why not?

- We are supportive of the IASB's proposal that groups of cash instruments that offset and qualify as a group are eligible hedged items as long as they meet the hedge accounting requirements. We believe that hedging a net position of cash instruments may be more closely aligned with how an entity manages those positions and therefore is an improvement in the existing hedge accounting model. However, we believe that the requirement restricting cash flow hedges to those in which the cash flows must occur in the same reporting period should be removed because it may not be reflective of how an entity actually manages the portfolio of cash flows.
- Also, we disagree with the Board's proposal that requires any offsetting cash flows in the group of hedged items that are exposed to the hedged risk must affect profit or loss in the same reporting period. This prevents an entity from grossing up net hedging instrument gains or losses for recognition in different periods and deferring value changes from one hedged item to match the later recognition of another hedge item. This accounting is inconsistent with common risk management strategies, which hedge net positions based on the timing of cash flows rather than the timing of impact on profit and loss. In general, entities group exposures, including offsetting items, in order to reduce the number of external derivative transactions entered into. Using a group methodology practice today helps companies in reducing complexity and costs. A methodology based on the timing of when a transaction affects profit or loss will result in entities entering into significantly more hedges in order to execute their risk management strategy. The hedge gain or loss is determined when the hedged transaction occurs, not when it is reported in profit or loss. In the case of inventory purchases, the cash flow impact typically occurs with the intra-group sale, which ultimately impacts

the price of inventory on the external sale of the inventory. The delay in the intra-group sale and the external sale does not economically mean an offset was not achieved for the hedged period. However, the proposal requires the accounting to reflect this delay, which does not aligning with an entity's risk management strategies.

Question 14

Do you foresee any significant operational concerns, including auditing issues, in determining how to assess whether a hedge achieves other-than-accidental offset? If yes, what concerns do you foresee and how would you alleviate them?

- We support the proposed flexibility to determine the appropriate effectiveness method and the ability to perform the effectiveness assessment on a qualitative and prospective-only basis. Specifically, removing the quantitative assessment requirement and the 80-125 percent "bright-line" effectiveness testing threshold is a welcome change.
- We do have concerns, however, regarding the hedge effectiveness requirements to achieve otherthan-accidental offset. We are not clear on the Board's intent of "other- than- accidental offsetting." We do not believe that the examples provided in the Exposure Draft fully explain this principle and how it should be applied in practice. We believe the Board should consider clarifying the connection, or perceived connection, between the hedging effectiveness requirement of other than accidental offsetting and the hedging objective of minimizing the expected hedge ineffectiveness. Given that minimizing the expected hedge ineffectiveness is a component of the first criteria in determining whether a hedging relationship meets the hedge effectiveness requirements, does that imply that a relationship could be highly effective and not meet the second criteria of achieving other than accidental offsetting? Even though the Board's proposal explicitly states that there must be an economic relationship between the hedged item and the hedging instrument, it is not clear what evidence would be required to validate that such a relationship exists. We acknowledge that the economic relationship is clearly identifiable and easily supportable in most instances. However, we are not sure that given the complexities in the global market that two parties will always agree whether an economic relationship exists. We believe in those instances entities may use quantitative assessments in an effort to validate the relationship. This may have the unintended consequence of using an effectiveness assessment to prove or disprove that an economic relationship exists, which may ultimately lead to a quantitative threshold being established in practice for certain arrangements.
- One possible alternative may be to remove the concept of other- than- accidental offsetting from the hedging effectiveness requirements. We believe that the economic relationship should already be included in the documentation of an entity's risk management objectives and the documentation of the hedging relationship at inception. Furthermore, when no economic relationship exists it would most likely not minimize ineffectiveness; thus, it would fail the hedge effectiveness requirements anyway. Another possible alternative CCR supports is to replace the proposed hedge effectiveness requirements with the FASB's "reasonably effective" criteria, which may need further refinement and interpretation to promote consistent application in practice.
- The new hedge effectiveness requirements may be interpreted differently and therefore applied inconsistently by entities and auditors. Providing additional examples in the guidance to illustrate the Board's intent would limit the varying degrees in interpretation of the effectiveness requirements.

Question 15

Do you believe that the proposed guidance and illustrative examples are sufficient to understand how to analyze hedge effectiveness (for example, how to measure the change in the value of the hedged item attributable to the related hedged risk for nonfinancial items)? If not, what additional guidance is needed?

- We do not believe that the proposed guidance and examples are sufficient to clearly understand how to measure hedge ineffectiveness. It would be helpful to include examples of hedge ineffectiveness measurements for financial items as well as for nonfinancial items.
- We support the IASB's overall position to simplify hedge accounting. However, the Exposure Draft only addresses quantitative methods of measuring hedge ineffectiveness. The proposed guidance is silent on any possible qualitative methods of measuring hedge ineffectiveness. It would be beneficial, if additional guidance is provided around qualitative methods of measuring ineffectiveness. For plain-vanilla hedging strategies, the measurement and recognition of hedge ineffectiveness should be simplified. Accordingly, we recommend the Boards' consider an approach whereby simple, plain-vanilla hedging strategies can be accounted for in a simple fashion (e.g., assuming no ineffectiveness if key terms are matched).
- To be consistent with a hedge effectiveness assessment where both the qualitative and the quantitative assessment methods are allowed under the Exposure Draft, both the qualitative and the quantitative measurement methods of hedge ineffectiveness should be allowed as well. Otherwise, the qualitative assessment method permitted under the proposal will not simplify the matter as intended, since the quantitative method of measurement, which could also serve the purpose of effectiveness assessment, will likely be required in most circumstances.

Do you foresee any significant operational concerns or constraints in determining whether (a) a change to a hedging relationship represents a rebalancing versus a discontinuation of the hedging relationship or (b) an entity's risk management objective has changed? If yes, what concerns or constraints do you foresee and how would you alleviate them?

Question 17

Do you foresee any significant operational concerns or constraints relating to the potential need to rebalance the hedging relationship to continue to qualify for hedge accounting? If yes, what concerns or constraints do you foresee and how would you alleviate them?

- In response to questions 16 and 17, CCR has concerns regarding the application of the proposed guidance related to the rebalancing requirements and the criteria for discontinuation of a hedging relationship, including determining when an entity's risk management objective has changed.
- The ability to determine whether rebalancing or de-designation is appropriate under the proposed guidance will be dependent upon the level (i.e. transaction, portfolio or macro) at which the hedging strategy is documented and how that strategy interacts with other risk management activities. In order to make this determination it is important to understand the level at which changes in risk management strategies are to be assessed. Under the proposed guidance, this is not clear. Consistent with our response to Question 2, the proposed guidance should more fully consider and provide clarification regarding how hedging strategies designed to mitigate exposures arising at one or more levels of an organization should be assessed with regard to applying the rebalancing and dedesignation requirements. For example, if a hedging strategy designated at the instrument-level is changed, but the revised designation strategy remains consistent with portfolio or macro risk management strategies, is that considered a *change* in the risk management strategy for purposes of applying the proposed rebalancing and termination provisions?
- In order to address our concerns, we suggest the following to allow a more appropriate reflection of an entity's risk management activities:
 - consistent with our response to Question 2, provide a more complete definition and explanation of risk management including illustrative examples;
 - allow for voluntary de-designation of hedge relationships;
 - permit, but do not require rebalancing unless risk management practices require it; and

- provide additional guidance, including illustrative examples, to better illustrate the concepts of rebalancing versus de-designation of a hedging relationships.
- When considered in conjunction with the proposed guidance in paragraph B29 that the hedge relationship produce an "unbiased result" and "minimize hedge ineffectiveness", we are concerned the rebalancing requirements may have significant unintended consequences, including:
 - requiring frequent quantitative reassessments to support the designation of the perfect or optimal hedge ratio both at inception of the hedging relationship and on an ongoing basis, which increases administrative burden and runs counter to simplification efforts;
 - potentially requiring the entity to incur unnecessary additional costs by entering into new derivatives or terminating existing derivatives upon rebalancing; and
 - potentially have the effect of dictating risk management actions to be taken, such as requiring a perfect hedge ratio even though risk management practices may tolerate or desire less than complete offset, or requiring the use of instruments that represent a more precise offset of the hedged risk than other instruments that risk management strategies may prefer due to superior pricing or liquidity characteristics.
- We believe rebalancing should be permitted, but not required. The necessity for rebalancing should be driven by the risk management strategy. Entities should have the ability to rebalance the hedging relationship if risk management practices require it, but the accounting model should not dictate that rebalancing occur if not required by risk management practices. Accordingly, we do not agree with the proposed guidance requiring continuous rebalancing to the optimal hedge ratio. Such a requirement could separate hedge accounting from the risk management objectives of a company and would appear to seek to dictate risk management activities rather than reflect the accounting for them.
- The concept of rebalancing should be further described to emphasize the prospective, point-in-time nature of the timing of effectiveness assessments (i.e., the act of rebalancing does not call into question prior hedge effectiveness assessments) and the Boards should provide examples of the rebalancing concept and contrast those examples with examples of de-designation to further illustrate their conceptual and practical application. Rebalancing may be a preferable alternative to de-designation in instances where market conditions have changed causing ineffectiveness, yet it is expected that the hedging relationship, once modified, will meet the effectiveness requirements going forward. Optional rebalancing may be less operationally intensive than de-designation and redesignation and should allow entities to more easily align hedge accounting with risk management objectives.
- We believe the proposed guidance should remove the restrictions related to de-designation of hedging relationships. Companies should be free to adjust their hedging relationships, including ceasing their hedging relationships, in reaction to changes in market conditions. Further, we neither believe that accounting should dictate transactions to be executed, nor should accounting limit the circumstances that may give rise to risk management transactions. However, similar to the previous point, additional clarification is necessary regarding the appropriate level to assess changes in the qualifying criteria so as not to unduly limit the ability to voluntarily de-designate hedging relationships.
- We are also concerned that the IASB wording may lead some to only assess effectiveness at the quarter end, as opposed to when the hedging relationship actually breaks down. For U.S. public companies with Form 8-K material event intra-period reporting requirements, this wording may lead to confusion as to when the accounting should occur. We suggest the wording be adjusted to reflect assessing effectiveness when it is apparent the hedging relationship will no longer be an effective hedge.

Do you believe that capitalizing the time value of an option as a basis adjustment of nonfinancial items (in other words, marking the asset or liability away from market) will improve the information that is provided in an entity's statement of financial position? Why or why not?

We support the Board's conclusion that the time value of an option is better reflected as a form of insurance cost. We also generally support the notion of adjusting the basis of nonfinancial items. This treatment is consistent with certain other ancillary costs related to some nonfinancial items. However, we are not certain that the cost/benefit of differentiating between transaction related hedged items and time period related hedged items is justified. We also encourage the Board to provide more examples or guidance on how to identify when the time value of an option is related to a time period related hedged item or a transaction related hedged item.

Question 19

Do you believe that the proposed presentation of the gains and losses in other comprehensive income will provide users of financial statements with more useful information? Why or why not?

• We disagree with the proposed change in presentation for fair value hedges. While the presentation for derivatives in hedging relationships would be consistent for all three hedging relationship types under the proposed model, we believe that the presentation for derivatives should follow the basic model (i.e., fair value through earnings) unless a change in presentation is required, such as under cash flow hedges of forecasted transactions in order to ensure an offset in earnings at the time the transaction occurs. We believe it will neither improve the usefulness of information for users nor simplify the existing requirements. In fact, it creates additional complexity under U.S. GAAP with the required recycling of the fair value adjustments from other comprehensive income into earnings which would necessitate significant system changes.

Question 20

Do you believe that the proposed presentation of a separate line item in the statement of financial position would increase the transparency and the usefulness of the information about an entity's hedging activities? Why or why not?

Question 21

Do you believe that there is sufficient guidance to specifically link the hedging adjustments to the hedged assets and liabilities that compose a hedged net position with respect to presenting a separate line item in the statement of financial position?

• In response to questions 20 and 21, we believe the proposed presentation would confuse users of financial statements rather than provide additional transparency and result in an overly complex statement of financial position. While information about the fair value adjustment of the hedged item may be useful to users of financial statements since it provides the hedging effect, we believe that disclosing the hedge accounting adjustment in the notes to the financial statements is sufficient. This alternative presentation also avoids burdening the face of the financial statements with potentially immaterial amounts.

Question 22

Do you foresee any significant auditing issues arising from the inclusion of risk management disclosures in the notes to the financial statements? If yes, what issues do you foresee and how would you alleviate them? Do you believe that it is appropriate to include risk management disclosures in the notes to the financial statements rather than in other information in documents containing financial statements? Why or why not?

- Since this is the Board's only question on disclosures, we wanted to take the opportunity to provide an overall comment on the Exposure Draft's disclosure requirements. We recognize that in a principles-based environment, more disclosures will be necessary and, overall, we support the Exposure Draft's proposal to request more transparency around the entity's risk management objectives through expanded disclosure requirements. We are concerned, however, that the Exposure Draft's disclosure requirements are too granular. Specifically, we do not support the Exposure Draft's requirements in paragraph 46 to disclose for each subsequent period a breakdown of the monetary amount or other quantity to which the entity is exposed, the quantity of the risk exposure hedged and how the hedging changes the exposure. Disclosing the degree to which forecasted transactions are hedged is no doubt of some value, but we question whether it will be practical, particularly over a long time period. Rather, we believe that disclosures should be qualitative and in enough detail to give the user an overall understanding of the nature of the entity's risk exposures and the entity's risk management strategy for each risk.
- We encourage the IASB to revise the proposed disclosure requirements to align with those currently required by the FASB and the SEC. We believe that the existing FASB and SEC disclosure requirements regarding the entity's risks, the entity's risk management strategies and the effect that hedge accounting has on the entity's financial statements are sufficient and that the additional requirements proposed in the Exposure Draft do not add significant incremental value to the users of the financial statements. However, to avoid redundancy we would support the consolidation of all risk management related disclosures in the notes to financial statements, or the ability to reference previously provided disclosures in documents containing the financial statements.
- Although we encourage the FASB to solicit more detailed responses from audit professionals, we do
 not anticipate significant auditing issues with respect to the Exposure Draft's disclosure requirements
 as they largely represent a convergence with the current FASB and SEC disclosure requirements.

Do you believe that the changes proposed by the IASB provide a superior starting point for any changes to U.S. GAAP as it relates to derivatives and hedging activities? Why or why not? Should the FASB be making targeted changes to U.S. GAAP or moving toward converging its overall standards on derivatives and hedging activities with the IASB's standards?

- CCR believes that a hedge accounting model that emphasizes the alignment of hedge accounting with risk management activities is superior to the existing rules-based approach that does not always reflect how companies manage their risks. We believe it is imperative that the Boards reach a converged standard for financial instruments, including hedge accounting and considering the FASB's tentative decisions on classification and measurement. The IASB's proposed Exposure Draft should serve as the basis for future deliberations.
- We strongly believe the IASB and FASB should issue uniform hedge accounting standards with uniform effective dates. We also reiterate CCR's encouragement to include any changes to the proposed model related to the macro hedging project in the final standard. This will ensure consistency and comparability of financial information in today's increasingly competitive global marketplace.

Other Matters

Eligibility of Items Measured at Fair Value through OCI

• We do not agree with the proposed guidance that prohibits hedge accounting for financial instruments measured at fair value through OCI. We believe such items should be eligible for hedge accounting. An entity's risk management objectives are not limited to earnings exposures, but may also include exposure to volatility in OCI. Due to the current status of the competing positions of the IASB and FASB on classification and measurement, the preclusion of hedge accounting for financial instruments measured at fair value through OCI will likely impact a broader population of instruments for U.S. entities². The IASB reasoned that these instruments should not qualify for hedge accounting because such qualification is counter to its principal that gains and losses recorded in OCI should not be recycled to earnings. This rationale seems to contradict the proposed use of OCI for hedge accounting gains and losses and the recycling of hedge ineffectiveness to earnings. We fully support this use of OCI and strongly encourage convergence in this area due to the correlating impact on hedge accounting for financial instruments measured at fair value through OCI. If the IASB and FASB are unable to converge, expanded guidance may be necessary for U.S. entities that wish to use hedge accounting for these instruments.

Intragroup Transactions

- We note that the IASB has carried over from IAS 39 the accounting requirements and associated guidance in relation to hedge accounting of highly probable forecasted intragroup transactions. In practice, this has led to a number of interpretative issues, particularly as the standard states that royalty payments, interest payments or management charges between members of the same group do not qualify unless there is a related external transaction. Questions arise as to how the internal transaction is related to the external transaction. For the sale of inventory between entities prior to an onward sale of inventory to an external party the guidance is more intuitive, but for the sale of non-physical goods, such as licenses and resulting royalties, it is less clear. It would be beneficial if the standard made clear that an internal transaction is eligible as a hedged item if the internal transaction only arises because an external transaction occurs, i.e., there must be a clear link between the two transactions. In cases where external transactions give rise to internal royalty payments it would appear that the internal transaction is related to an external transaction even though currently the standard implies that generally internal royalties cannot be hedged.
- Furthermore, intragroup transactions denominated in a currency other than the entity's functional currency give rise to transaction gains or losses if exchange rates change. These gains and losses can impact the financial results at the segment or subsidiary reporting level. Therefore, we recommend retaining the existing guidance within U.S. GAAP which allows for forecasted transactions between members of a consolidated group to qualify as a hedged item if the risk being hedged is a foreign currency exposure.

² It is expected that many securities held for investment purposes (i.e., not for trading purposes) will be measured at amortized cost under the classification and measurement guidance in IFRS 9. Investment securities held for investment will be measured at either amortized cost or at fair value with changes in OCI under the classification and measurement proposal offered by the FASB.