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International Accounting Standards Board
30 Cannon Street
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Re: ***IASB ED Hedge Accounting***

Dear Sir/Madam,

we are pleased to have the opportunity to comment on your Exposure Draft Hedge Accounting ("the ED").

The OIC welcomes the IASB's efforts to review the general hedge accounting requirements in IAS 39 in order to provide more useful hedge accounting information.

In general, we agree with the hedge accounting objective proposed in the ED that allows entities to align hedge accounting rules with the risk management practice followed by the entities and, at the same time, to avoid manipulation of financial statements. However, we have a fundamental concern about the scope of the project and the decision not to consider the issues related to the application of hedge accounting to open portfolios (so-called macro-hedging). We would ask the IASB to ensure that the final IFRS 9 addresses the macro hedging issues, allowing the elimination of the current carve out on IAS 39.

Bearing in mind this general concern, our detailed responses to the ED questions are as follows:

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 hedge accounting objective proposed in the ED. In fact, it enables more consistency between the risk management policies and the accounting presentation.
Moreover, we do not support the prohibition to designate equity instruments as hedging instruments. We understand that this requirement arises from the requirements included in IFRS 9 that do not allow reclassification of realised gains/losses on equity instruments to the

P/L. In the past we have already widely criticized this requirement included in IFRS 9. We believe that it does not make sense to require restrictions on other rules just because the IASB does not want to eliminate a widely criticized requirement.

Question 2
Do you agree that a non-derivative financial asset and a non-derivative financial liability measured at fair value through profit or loss should be eligible hedging instruments? Why or why not? If not, what changes do you recommend and why?

We agree with the IASB proposal 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.
We note the issue related to the impossibility of designating an embedded derivative as a hedging item. We believe that this is not conceptually correct. In this case, because of a rule included in the IFRS 9, it is not allowed to correctly represent the accounting effects of risk management. As this is one of the major concerns of our constituents, we recommend that the IASB find a solution.

Question 3
Do you agree that an aggregated exposure that is a combination of another exposure and a derivative may be designated as a hedged item? Why or why not? If not, what changes do you recommend and why?

We agree with the IASB proposal.

Question 4
Do you agree that an entity should be allowed to designate as a hedged item in a hedging relationship changes in the cash flows or fair value of an item attributable to a specific risk or risks (ie a risk component), provided that the risk component is separately identifiable and reliably measurable? Why or why not? If not, what changes do you recommend and why?

We agree with the IASB proposal. In particular, during our internal consultation process, we have been informed that usually inflation is not separately identifiable and reliably measurable and, therefore, the IASB decision not to allow its designation as a risk component eligible as a hedged item unless it is contractually identified is acceptable.

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 agree with the IASB proposal that allows the designation of a layer of the nominal amount of an item as the hedged item. However, we do not support the requirement that excludes the designation of a layer component of a contract that includes a prepayment option as a hedged item in a fair value hedge if the option's fair value is affected by changes in the hedged risk. We note that interest bearing instruments containing prepayment options might be effectively hedged, according to common risk management practices, and referring to a specific layer either:

- through combination of IRS and/or swaptions or

- through IRS having a maturity equal to the expected maturity of the hedged layer.

Alternatively, only part of the items composing the group of hedged items might have prepayment options (while all of the instruments are exposed to interest rate risk). In this case, it would be possible to designate as hedged exposure only that part of the portfolio not including the prepayment option.

We note that if this requirement is effective also for macro hedging, it will not be absolutely applicable for banks.

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?

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?

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?

We welcome the removal of the 80 to 125 percent bright line test for assessing and measuring hedge effectiveness and the introduction of an objective-based assessment. The proposal enables a considerable simplification in the hedge accounting application, removing too many rigorous aspects in the IAS 39 that implied the ineffectiveness of hedging. However, we believe that the wording is not always clear and some definitions may need to be explained (e. g. accidental offsetting).

With regard to rebalancing, we believe that it has many advantages because it should imply a reduction in cases of discontinuing of hedging and of related economic effects. However, the assessment of variances of the hedge ratio arising from regular or symptomatic floating of a change in the long period trend could be very complex and subjective.

Moreover, the boundary between the rebalancing requirements and the discounting requirements of hedging may not be very clear. In particular, it should be clarified when an entity can establish that a hedging does not meet the criteria for the hedge accounting also if the risk management objective remains the same and a no-accidental offsetting is ensured.

We note that in risk management activity, the rebalancing of hedging is a daily activity that allows a correct mitigation of risks over the time. This aspect should be strictly traced back to the risk management objectives pursued and these objectives should be reflected in the financial statement.

We note that the prohibition of voluntary discontinuing could create significant problems because there are a number of hedging strategies that provide for voluntary discontinuing. The hedge accounting objective of alignment between risk management strategies and accounting should always be valid.

In any case, we believe that the IASB should carry out field testing to analyse the application of rebalancing and discontinuing requirements in order to avoid possible excessive operational concerns in contrast with the objective of flexibility in the ED.

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?*

We believe that the introduction of the two-step approach would not imply additional information value. We believe that the requirement for a fair value hedge that 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 would only create operational complexity for preparers without adding value to the information for users.

We support the IASB proposal 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 because it would result in a more transparent presentation of the hedged item on the face of the statement of financial position.

We agree with the IASB not to allow linked presentation for fair value hedges. We believe that the linked presentation could create confusion and reduce comparability between entities.

We agree with the IASB proposal for cash flow hedge (i.e. basis adjustment). However, the IASB should evaluate the impacts of the basis adjustment on the disclosure needs for the preparation of the cash flow statement and on disclosure requirements included in the IFRS 7.

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 agree with the proposals about the ineffectiveness due to the time value component in options and believes that it is useful to avoid the time value volatility to P/L. However, we note that the IASB has introduced a quite complicated mechanism to solve this issue. We propose that the IASB should add an example to clarify the issue. In any case, we suggest that the IASB select a single approach for the reclassification from other comprehensive income to profit or loss of the time value component accumulated in other comprehensive income. In particular, we believe that the most appropriate method would be an allocation over the relevant period on a rational basis.

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?
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?

The IASB concluded that permitting designation of cash flows that occur in different periods would be inconsistent with the general hedge accounting requirements; therefore, cash flow hedge accounting of net positions is only permitted if the corresponding cash flows offset in the same reporting period. We believe that this issue has not been explored sufficiently and the reasoning behind this decision requires a better explanation.

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?*

We note that the ED requires the entity to separate by risk category the information disclosed and to determine each category of risk on the basis of the risk exposures that an entity decides to hedge and for which hedge accounting is applied. We note that, especially for non-financial entities, preparing this information might be burdensome because it has to be provided for each risk category and for each year of hedging (for instance, the operational complexity required to produce the information related to a significant hedging of pluriennial duration).
Moreover, we believe that the following aspects should be further developed:
- the consistency between the disclosure requirements in the ED and the disclosure requirements included in IFRS 7;
- if, in relation to cash flow hedge, the detail of OCI reserve should be provided only for transactions not in basis adjustment;
- if and how the information about the changes in OCI related to the basis adjustment should be provided.

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?

In general, we agree with the IASB proposal. We note that from a methodological point of view it is not clear because the ED proposes some amendments that are not strictly linked to the object addressed in the ED (i.e. own use scope exception).

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?*

We have a slight preference for alternative 3.
We note that the application of some proposed alternatives implies that also changes in the fair value from risks not hedged through the CDS (such as the fair value option) could affect the P/L, introducing an element of volatility. Therefore, it would be necessary to carry out a field test.

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 1 January 2015 for all phases of IFRS 9 and the prospective application of the proposals.

Moreover, we have other minor concerns as follows:

- We note that paragraphs B43-B45 of the ED mention the concept of 'hypothetical derivative' to calculate the change in the value of the hedged item for the purpose of measuring hedge ineffectiveness. We would like to understand better how these paragraphs could apply to fair value hedges because it could give rise to ineffectiveness.
- We note that para B43 of the ED requires entities, when measuring hedge ineffectiveness, to consider the time value of money and, therefore, determine the value of the hedged item on a present value basis and the change in the value of the hedged item should also includes the effect of the time value of money. We note that in some circumstances the undiscounted spot rate method is used for measurement of hedge ineffectiveness for currency hedging. Therefore, this paragraph may be inapplicable.
- We note that in the implementation guidance of IAS 39 there are useful applications of hedge accounting (e.g. hedge accounting considerations when interest rate risk is managed on a net basis). Such guidance should be replicated in the forthcoming standard.
- In our opinion, it seems that paragraphs 37 and B79 refer only to CFH. We kindly recommend an explicit pronouncement.

If you have any queries concerning our comments, please do not hesitate to contact us.

Yours faithfully,
Angelo Casò
(Chairman)