DRSC e. V. • Zimmerstr. 30 • 10969 Berlin

Telefon +49 (0)30 206412-12
Telefax +49 (0)30 206412-15
E-Mail info@drsc.de

EFRAG
Stig Enevoldsen / Svetlana Boysen
13-14 Avenue des Arts
B-1210 Brussels
Belgique

Berlin, 7 January 2008

Dear Svetlana, dear Stig,

EFRAG Draft Comment Letter on the IASB's Exposure Draft of Proposed Amendments to IAS 39 Financial Instruments: Recognition and Measurement: Identification of Exposures Qualifying for Hedge Accounting

On behalf of the German Accounting Standards Board (GASB) I am writing to comment on EFRAG's draft comment letter (referred to as "DCL" in the following) on the IASB Exposure Draft of Proposed Amendments to IAS 39 Financial Instruments: Recognition and Measurement: Identification of Exposures Qualifying for Hedge Accounting (herein referred to as 'the ED'). We appreciate the opportunity to comment on EFRAG's draft comment letter.

We generally agree with the views set out in the draft comment letter. However, there are some parts of the comment letter that could be made more explicit and further aspects of the Exposure Draft that you might want to consider addressing in your comment letter to the IASB.

In the answer to question 4, the DCL argues that, EFRAG generally supports retrospective application of revised standards, unless this causes practical problems. The DCL then identifies a situation in which retrospective application may cause problems. Whilst we concur with this view and the analysis, we think that the CL should consequently take a step further and indicate which accounting treatment EFRAG thinks should be applied. We think it would be more helpful for the IASB if the comment letter *explicitly stated* which other treatment EFRAG suggest (e.g. prospective application).

With regard to question 1, we have identified two more aspects which could be addressed in the comment letter:

a) Since the proposed par. 80Y does not contain a definition of credit risk, it is unclear to us whether the definition contained in IFRS 7 is to be applied. The definition in IFRS 7 is a broad definition that comprises both unsystematic and systematic credit risk. We are not sure whether the systematic credit risk (i.e. the risk of changes in the credit spread for a given credit risk in the market place) is eligible for being designated as the hedged risk under the proposed amendment and note that, currently, this is an acceptable hedgeable risk (see IAS 39.IG F.4.7).

b) We understand, and concur with, the notion behind the example in par. 80Y(e). Splitting a fixed interest rate into an inflation component and a residual does not, economically speaking, have substance. This would even be true if inflation was a contractually specified cash flow, since, as the example sets out, "the remaining component would be a residual." However, we are not sure whether this wording is appropriate. After splitting out a specified cash flow or particular risk, any remaining part is a "residual" by definition, and it is in the nature of a residual that it does not necessarily have any particular characteristics. We are concerned that this example might be interpreted as requiring that any exposure of the changes of the cash flows or fair value of a financial instrument can be split up into different risks completely, i.e. any residual must be one of the risks in par. 80Y or a combination thereof.

Also in relation to question 1, we do not see, conceptually speaking, any reason why equity price risk and commodity price risk, should no longer qualify for hedge accounting, provided the portion can be separated and reliably measured. With regard to equity price risk, one may argue that, as long as equity price risk is substantially the only material risk, the entity may still choose to designate all of the changes in the financial instrument's cash flows or fair value as the hedged risk. However, this would not be possible if the financial instrument (e.g. a share) was traded in a currency other than the functional currency of the reporting entity. In this situation, the reporting entity has two exposures (a currency exposure and an equity price risk exposure, see IG F.2.19,) but would be prevented from hedging solely the latter. Overall, we would rather *request the IASB to reconsider* the list of qualifying risks instead of *requesting the IASB setting out its reasons* why those risks have been omitted (as does the DCL).

With regard to question 2, we note two more aspects which could be addressed in EFRAG's comment letter:

a) The wording in par. 80Z refers to cash flows only. This could be interpreted as if the proposed amendments are limited to cash flow hedge accounting. We think that this was not the IASB's intention and, therefore, suggest amending par. 80Z accordingly, since some portions in par. 80Z can clearly be defined in terms of fair values as well, e.g.

   - Par. 80Z(b): a percentage of the cash flows *or fair values* of a financial instrument.
   - Par. 80Z(c): the cash flows *or fair values* [..] falling below a specified level

b) We note that the example given for a partial term hedge in par. 80Z(d) is not very helpful, as the situation could be subsumed under par. 80Z(a) already. We suggest that a different example be used.

Finally, we would encourage the IASB to consider amending par. 82 of IAS 39 as well, in order to allow, in limited circumstances, portions of non-financial items to be eligible for hedge accounting. Preparers frequently asked the IASB to do so and the IASB's Financial Instrument Working Group made a similar suggestion.

For example, certain commodities are traded in active markets (e.g. oil, gas in the UK, electric power in Europe). Those commodities could be treated the same as financial instruments. Possible situations where we would think that portions should be eligible for being designated as hedged items include

a) the cash flows of a commodity contract for **part of the time** period to maturity, e.g. only the first year of a five year gas delivery contract if the first year is traded in an active market.

b) a **percentage of the cash flows** of a commodity, e.g. for a 100 MWh electricity contract only 70 MWh could be hedged;

c) the cash flows of a commodity contract **associated with a one-sided risk** of that instrument, e.g. the cash flows resulting from an oil price falling below a specified level;

d) any **contractually specified cash flows** that are **independent** from other cash flows of that instrument, i.e. pricing structures where the price of a commodity is *indexed* to the price of another commodity that is traded in an active market and where the changes in the cash flows can thus be attributed to the changes in a market price observable in an active market.

e) the portion of the cash flows of a commodity contract that is **equivalent to a commodity contract with a quoted fixed or variable price**: this could apply to a long-term own-use power delivery contract at a fixed price; if this contract was hedged with regard to its fair value exposure ineffectiveness might arise if the power market price had changed: the power delivery contract has a fair value (marked-to-model) which is subject to interest exposure and credit exposure whereas the hedging instrument with a fair value of zero at inception of the hedge is not subject to these exposures so that ineffectiveness will arise if the whole contract is designated as the hedged item.

We note that we consider example c) to be a hedging relationship eligible for hedge accounting under the current standard – as set out in par. 10 of the DCL (the example is only included in the list above for reasons of completeness).

Yours sincerely,

Liesel Knorr

President