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Via electronic mail

November 14, 2003

Sandra Thompson
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International Accounting Standards Board
30 Cannon Street, London EC4M 6XH
United Kingdom
commentletters@iasb.org.uk

Re: Exposure Draft of Proposed Amendments to IAS 39, *Financial Instruments: Recognition and Measurement*, Fair Value Hedge Accounting for a Portfolio Hedge of Interest Rate Risk

Dear Ms. Thompson:

Credit Suisse Group (CSG) appreciates the opportunity to comment on the International Accounting Standards Board's (IASB's) Exposure Draft of Proposed *Amendments to IAS 39, Financial Instruments: Recognition an Measurement, Fair Value Hedge Accounting for a Portfolio Hedge of Interest Rate Risk* (the Exposure Draft or ED).

Overall, we recognize the progress the Exposure Draft makes in further incorporating relevant aspects of hedging strategies commonly applied by banks in their asset and liability management practices. However, we have some concerns with the proposals, which are further addressed below in response to the specific questions posed in the ED.

Question 1: Do you agree with the proposed designation and the resulting effect on measuring ineffectiveness? If not,

- **(a) in your view how should the hedged item be designated and why?**
- **(b) would your approach meet the principle underlying IAS 39 that all material ineffectiveness (arising from both over- and under-hedging) should be identified and recognised in profit or loss?**
- **(c) under your approach, how and when would amounts that are presented in the balance sheet line items referred to in paragraph 154 be removed from the balance sheet?**

We agree with the proposal that a fair value hedge may be designated on a portfolio of financial assets and liabilities in terms of an amount of assets (or liabilities) in a maturity time period consistent with current risk management practice. However, we disagree that the measurement of ineffectiveness should be based upon an amount of assets (or liabilities). By looking to the effect on an amount of assets (or liabilities) rather than the impact on a net position, the model fails to recognize the impact of the movement of the liabilities (or assets) in a net portfolio position. Thus the model purports to be a portfolio approach, but fails to follow commonly applied risk management practices, which consider the net position.

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Despite our concerns as described in the preceding paragraph, we believe that Approach C is the most logical Approach presented. Under-hedging the net position is common practice in risk management strategies to consider prepayment risk while maintaining exposure to the unhedged position. To measure the ineffectiveness also considering the unhedged portion would be inconsistent with the IAS 39 hedging model, which states that the ineffectiveness should arise solely from the item designated as being hedged. However, also based upon this rationale, we agree that an overhedged position should result in ineffectiveness. Therefore, we disagree with Approach D as proposed.

We believe that the approach presented to treat the resultant fair value adjustment as a separate balance sheet line item to be pragmatic. We believe that by applying a layered approach, whereby the adjustments are tracked by their maturity bucket, the concern regarding the removal of these balances from the balance sheet may, in part, be resolved as they will be removed as the respective layer matures. We believe the manner in which they are amortized during their life should be an estimation process which considers the change in the hedged versus unhedged portion of the maturity layer and time to maturity.

Question 2: Do you agree that a financial liability that the counterparty can redeem on demand cannot qualify for fair value hedge accounting for any time period beyond the shortest period in which the counterparty can demand payment? If not,

- **(a) do you agree with the Board's decision (which confirms an existing requirement in IAS 32) that the fair value of such a financial liability is not less than the amount payable on demand? If not, why not?**
- **(b) would your view result in such a liability being recognised initially at less than the amount received from the depositor, thus potentially giving rise to a gain on initial recognition? If not, why not? If you do not agree that the situation outlined in (b) is the result, how would you characterise the change in value of the hedged item?**

We disagree with the Board's conclusion that fair value hedge accounting cannot be applied to demand deposits at any time period beyond the shortest period in which the counterparty can demand repayment. While we agree that the recorded fair value of demand deposits cannot be less than their callable value (i.e., cannot incorporate NPV discount due to an expectation of longer-term maturity) we believe that the concept of balance sheet value and hedge accounting needs to be separated.

From an economic perspective, prepayable fixed-rate assets and non-maturing assets and liabilities (such as demand deposits, including savings and private accounts) are similar in that they have interest rate risk beyond their contractual maturity. Replicating models are applied to address the difference between behavioural maturity and contractual maturity for purposes of asset and liability risk management.[1]. Just as the behaviour of prepayable assets can be modelled and hedged to reduce prepayment risk, the maturity behaviour of the stable component of demand deposits (i.e., core deposits) can be, and is in practice, modelled and hedged for the same reasons. This is a fundamental element of risk management practices at banks; the proposed model recognizes this to a point but stops short of accepting the inherent similarities of hedging such assets and liabilities.

[1] It should also be noted that the Swiss banking regulator explicitly require the modelling of non-maturing accounts for interest rate risk management (Circular 99/1 Art 32 and 33).

In addition, we believe the Board's proposal that a separate balance sheet line item be created to track the resultant hedge accounting adjustments presents the distinction between the balance sheet valuation and the accounting for the hedging of the economic risks in a more understandable format.

Additional issues

While the proposal gives suggested approaches for the manner in which ineffectiveness will be measured, it fails to address the matter of how effectiveness should be assessed. Application of the requirements in paragraphs 142 and 146 of IAS 39 needs to be clarified further.

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We thank the Board for their attention to our comments. We are available to further discuss these points. Please contact Alanna Weifenbach at +411 332 2785 or Todd Runyan at +411 334 8063.

Sincerely,

Rudolf Bless
Managing Director, Chief Accounting Officer

Alanna Weifenbach
Vice President, Group Accounting Policies