ING GROUP

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EXECUTIVE BOARD

Cees Maas
Chief Financial Officer

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

Date

13 November 2003

Dear Sir David,

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

We appreciate the opportunity to provide comments on the 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 ("the Exposure Draft").

We recognise the Board's efforts to address the concerns of the financial services industry and amend the standard in order to accommodate the practice of managing risks on a portfolio basis. However, we do not believe that the current exposure draft adequately addresses the concerns of the financial industry. Furthermore, it addresses neither of the intended aims of the Board to develop an approach that is workable in practice and which does not require entities to make major systems changes.

Our most significant concern with the approach outlined in the exposure draft is that it does not recognise the need to align accounting models to actual risk management practices. In our opinion, accounting should reflect actual risk management practice.
We believe that in developing a fair value macro hedge solution, the Board should focus on providing principles based guidance that is not based on specifying the designation of the hedging relationship and the impact on effectiveness under one specific method. Instead, the actual risk management policy of financial institutions should be reflected in their accounting. The Board could, as an alternative approach, permit different approaches (as set out under approach A,B,C and D in paragraph BC19 of the exposure draft), provided that they are consistent with an entities documented risk management strategy and that the entity can demonstrate that the strategy has effectively reduced risk. Accounting standards should not ignore existing sound risk management policies and practices, applied on a world-wide basis and accepted by regulators and supervisors.

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Other significant concerns on the approach outlined in the exposure draft are the following:

- If an entity has significant amounts of demand deposits, as is the ease for many savings banks, it will be unable to apply the proposed fair value macro hedge approach solely because the proposed approach prohibits the designation of demand deposits as a hedged item beyond their contractual term. We agree with the Board's decision that a stand-alone demand deposit should not be measured below the amount redeemable on demand (resulting in initial profit on recognition). However, we see no reason why demand deposits should not qualify as hedged items beyond their contractual term as this is common practice in the sound risk management of financial institutions. We believe that including demand deposits in the fair value hedge accounting model is not in conflict with the stand-alone measurement principle.
- The proposed approach requires ineffectiveness to be recognised when a portfolio is under-hedged, even when such an under-hedge is an explicit part of an entity's evidenced risk management strategy (e.g. because prepayment risk is explicitly part of the strategy). In our opinion, ineffectiveness recognised should be aligned to the risk management strategy. As such, no ineffectiveness is recognised on under-hedging if that under-hedging is part of the entity's documented risk management strategy.

These items are also included in our response to the questions in the "Invitation to Comment" paragraphs in the exposure draft, which are included in the appendix. We also concur with the arguments that have been communicated in the discussions and letters between the IASB and the European Banking Federation (FBE); hence we have not repeated these in detail in this letter.
In our opinion, there is little added value from the Exposure Draft for the financial industry if these issues are not resolved.

Furthermore, we note that there are several other concerns of the financial industry with regard to hedge accounting under IAS 39 that have been raised earlier to the Board, but have still not been addressed in the Exposure Draft or in any other way. We still believe that resolution of these issues is required before IAS 39 can be implemented. For example the following items have not been resolved:

Prohibiting the use of internal transactions as hedge. Internal hedges are currently used under well-established procedures between portfolios under operationally segregated responsibilities. These internal transactions between separately managed trading and banking books are in substance similar to external transactions. We agree that no intercompany profits should be recognised in consolidated financial statements. The process of hedging through internal transactions in the financial industry is however not inconsistent with that principle. IAS 39 forces entities to engage in expensive external transactions where they could also utilise positions within the group with the same effect. In our opinion internal hedges should be allowed, under the same criteria as external hedges.

- The ED only addresses portfolio hedging of interest rate risk; it does not address other types of risk (e.g. currency risk, equity risk, etc.). Similar issues exist for these types of risk.

We trust that the above concerns will be taken into account and we are available to discuss any of these in more detail.

Yours faithfully,

Cees Maas

APPENDIX

Question 1

Draft paragraph 128A proposes that in a fair value hedge of the interest rate risk associated with a portion of a portfolio of financial assets (or financial liabilities), the hedged item may be designated in terms of an amount of assets (or liabilities) in a maturity time period, rather than as individual assets or liabilities or the overall net position. It also proposes that the entity may hedge a portion of the interest rate risk associated with this designated amount. For example, it may hedge the change in the fair value of the designated amount attributable to changes in interest rates on the basis of expected, rather than contractual, repricing dates.

** However, the Board concluded that ineffectiveness arises if these expected repricing dates are revised (e.g. in the light of recent prepayment experience), or actual repricing dates differ from those expected. Draft paragraph A36 describes how the amount of such ineffectiveness is calculated. Paragraphs BC16-BC27 of the Basis for Conclusions set out alternative methods of designation that the Board considered, their effect on measuring ineffectiveness and the basis for the Board's decisions including why it rejected these alternative methods.*

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?

We do agree with the proposed designation of an amount of hedged items rather than individual assets and liabilities.

(b) would your approach meet the principle underlying IAS 39 that all material ineffectiveness (arising from both over- and tinder-hedging) should be identified and recognised in profit or loss?

No, we do not believe that ineffectiveness should be identified and recognised in the profit and loss account if it arises as a result of under-hedging when such under-hedging is part of an institutions documented risk management practices.

(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?

Value adjustments presented in the balance sheet line item should be amortised over the period to maturity of the hedged item. We believe that the requirements in the exposure draft should be amended to provide practical principle based guidance without prescribing the exact method entities should apply and without requiring entities to undertake major system changes.

Question 2
Draft paragraph A30(b) proposes that all of the assets (or liabilities) from which the hedged amount is drawn must be items that could have qualified for fair value hedge accounting if they had been designated individually. It follows that a financial liability that the counterparty can redeem on demand (i.e. demand deposits and some time deposits) cannot qualify for fair value hedge accounting for any time period beyond the shortest period in which the counterparty can demand payment. Paragraphs BC13-BC15 of the Basis for Conclusions set out the reasons for this proposal

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?

We disagree.

If not,

(a) do you agree with the Board's decision (which con firms 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?

Whilst we agree that demand deposits should not be measured in the balance sheet at an amount less than the amount payable on demand, we do not believe that such liabilities should be excluded from qualifying as hedged items in a fair value hedge.

(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?

We believe that inclusion of demand deposits as hedged items does not give rise to a conflict with the principle of not recognising gains on the initial recognition of such deposits since entities would not be permitted to adjust the carrying amount of deposits not designated as part of such hedges. in addition the separate balance sheet presentation of the value adjustments arising from the application of hedge accounting highlights to the user of the financial statements that such adjustments arise as a result of the application of hedge accounting and not because the liability is stated at less than the amount received from the depositor.

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 would characterise the change in value of the hedged item as being an adjustment that arises from the application of hedge accounting in accordance with the entities risk management objectives.