Bank Austria Creditanstalt

Group Finance

Roland Nessmann/59621

14. November 2003

To: Sandra Thompson
Senior Project Manager
International Accounting Standards Board
30 Cannon Street, London EC4M 6XH, United Kingdom

<Comments to Exposure Draft of Proposed Amendments to IAS 39: Recognition and Measurement: Fair Value Hedge Accounting for a Portfolio of Interest Rate Risk>

Dear Mrs. Thompson.

Basically we fully join the point of view laid down in the statement of UNICE dated 10. November 2003, which you can see in the appendix.

Besides the problems mentioned there, however, we see other big difficulties that would hinder the proposed amendments to be a great step forward to bring IAS 39 in line with current risk management technics of banks.

Risk management of banks is in general done by managing open positions. Although the name of the proposed amendment would suggest that these amendments would allow banks to account risks the way as they are managing it. In our opinion this is not the case. Major problems in achieving the goal can be summarized as follows:

1. In Appendix A26 lit (c), which forms an integral part of the Standard, the designation of a net amount is not allowed.

2. Furthermore Appendix A30 states, that the hedged item cannot qualify for any time which is beyond the shortest time in which the holder may demand payment. This point of view is liquidity driven and has nothing to do with fair value hedging at all: Experience shows, that core deposits have a much longer average duration than the legal demand date, which is taken into account within risk management in a bank and is checked within the regular liquidity and risk management processes of the bank. The proposed Standard — by contrast would prohibite this.

3. Risk management in a multi-currency bank or group is not managed on single currency level but on the level of the main currency of the bank. Thus positions and forecasted transactions are converted into this currency by using spot and forward rates. We expect it to be crucial for the application of the proposed amendments to the standard that this risk management practice will be possible in hedge accounting under this proposed Standard too.

4. A knock-out criterion for the implementation of the proposed Standard is the rule laid down in Art 172: If this sentence means, that only transactions entered into by the bank after the date, the amendments are applied the first time within the bank/group, do qualify for this fair value hedge accounting for a portfolio hedge of interest rate risk - in other words, long term assets or liabilities the bank has already on the book do not qualify the proposed amendment would not have any effect for years, because banks enter into transactions involving such long term assets or liabilities much less frequently than transactions involving short term financial instruments.

5. A regulation we cannot understand either is laid down in Appendix A, A25 as compared with Appendix A, A 35: In Appendix A, A 26lit (h) it is stated, that any ineffectivenesses is to be recognised in the income statement as the difference between the change in fair value referred to in lit (f) (i.e. the change in fair value of the hedged item) and that referred to in lit (g) (i.e. change in fair value of the hedging instrument), whereas Appendix A A35 states, that only all material ineffectivenesses shall be identified and recognised in net profit or loss.

Please do not hesitate to contact us for further informations.

Best regards,

Bank Austria Creditanstalt

H. Gropper E. Heiss

Appendix

10 November 2003

Mr Johan van Helleman
Chairman
Technical Expert Group
EFRAG
41 Avenue des Arts
1040 Bruxelles

Dear Mr van Helleman,

RE: **IAS 39 *Financial Instruments;* Recognition *and Measurement - Fair Value Hedge Accounting for a Portfolio Hedge of Interest Rate Risk***

UNICE has read attentively the above-mentioned exposure draft and would like to offer the following comments.

We welcome the decision of the Board to address the issues of accounting for macro-hedging. The exposure draft is a step in the right direction of bringing hedge accounting requirements closer into line with entities' actual risk management. This should help to reduce the problem of excessively restrictive anti-abuse rules leading to financial statements which do not offer a true and fair view of an entity's results by excluding many real economic hedges.

However, there is still some way to go in this respect, as you will see in our response below. There are significant unresolved issues, particularly the inability to designate a net position as a hedged item and the arbitrary restriction of hedge accounting to certain types of items, e.g. the fact that the ED addresses only interest hedges whereas entities also use portfolio hedging for currency and other exposures.

Answer to Question 1 - Designation and resulting effect on measuring ineffectiveness

While we support the designation of portfolios of similar transactions for applying hedge accounting, we disagree with the requirements of paragraph 126A that say that an amount designated for hedge accounting is "an amount of assets or an amount of liabilities", and that the "designation of a net amount including assets and liabilities is not permitted"

We consider that, to be transparent and relevant for the users and to produce financial statements which give a true and fair view of an entity's results for a period, the revised IAS 39 should implement requirements that correspond to entities' actual risk management. We are not convinced by the arguments of the basis for conclusion (BC5 (b)) that leave paragraph 146 of IAS 39 unchanged. Since the objective of the current revision of IAS 39 is “to enable fair value hedge accounting to be used more readily for a portfolio of interest rate risk’ (background information page 4), we consider that this revision will not meet its objectives if IAS 39 paragraph 146 is not modified to allow the designation of net positions as hedged items. In particular, we are of the opinion that:

a) It should be possible for a hedged item to be a net position because enterprises designate net positions as hedged items in their risk management policies. Inasmuch as such positions are - and can be shown to be - homogenous in their critical terms such as risk, duration, types of instruments hedged, currencies and maturities, we do not see why they would be unacceptable for hedge accounting.

b) A net approach would still permit the identification and recognition of all material ineffectiveness where the net positions are homogeneous as under (a) above.

c) The ED’s proposals for elimination of the corresponding asset or liability would also still be appropriate.

Other Points

Portfolio hedges of currency and other risks

We consider the draft amendment fully inadequate since it arbitrarily restricts the acceptability of a portfolio hedge approach to interest rate risks. This effectively excludes from hedge accounting currency hedging that entities widely perform with treasury centres. Typically such treasury centres regroup the currency positions transmitted by their subsidiaries (sales and purchases in foreign currencies) and hedge net amounts by currencies and maturities with financial institutions

However, under the current requirements of IAS 39 §133, a derivative cannot hedge a net asset or liability position. It should be designated as a partial hedge of several gross asset or liability positions, which either makes the effectiveness tests almost impossible or requires administrative costs which are not justified by the benefits.

If the prohibition of designating net positions in paragraph 133 were removed, entities could apply hedging accounting to the net currency hedges of their treasury centres and not confuse the users by having to recognise risk management operations of their treasury centres as ‘trading” derivatives, which lead to a false picture of economic results in the income statement and have a highly misleading speculation connotation.

Use of internal contracts in hedging foreign currency transactions.

We fully concur with the arguments set out in discussions and letters that you have had with and received from representatives of ERT (European Round Table) and ACT (Association of Corporate Treasurers). We hence refer to them in this letter without repeating them.

The decision to limit the applicability of ICC 134 1- b) to separate financial accounts that the Board took in its September deliberations was taken without any reference to the abovelisted basic principles. The examples that the Board received from both ERT and ACT show that foreign currency transactions may be hedged through internal contracts with the Corporate Treasury Department, tracked right through to the external hedging instrument that offsets the risk externally, and allow all internal contracts to be eliminated upon consolidation. In allowing IGC 134 1- b) to apply to consolidated financial statements also, there is no breach of any fundamental principle involved in hedge accounting. We therefore ask the Board to revert to the existing IGC 134 1-b) when issuing the IAS 39 version applicable from 2005 onwards.

Furthermore the change made by the Board in September goes against the IASB due process, since it has never been exposed by the Board. It constitutes a significant change in the present practice of companies applying IFRS already and in the planned practice of those preparing to comply with IFRS in 2005. Most companies that we know have already designed the information systems to be set up in order to comply with existing requirements regarding the hedging of foreign currency transactions. Since no change was planned by the Board and that the IGC made sense in taking into account the economic and organisational underlying reality of corporates, those entities were right in planning their future accounting processes in accordance with the existing literature.

Hedging of a portfolio of commercial bids

Our comments here relate to entities that deal with long-term contracts. These entities generally carry at any point in time portfolios of commercial bids made in foreign currencies. Because not all bids are going to develop into firm orders being placed by customers, each portfolio is evaluated on the basis of weighted average probabilities of occurrence. It is on that basis that hedging relationships are documented and managed right through the process for production of the long-term contracts.

Historical practice of these entities show that they have reached a sound practice of estimating the probabilities of occurrence of the in- and out-flows of foreign currencies arising from their portfolios of commercial bids. Adequate documentation is essential to the process and is therefore complied with. Inefficiency can be determined and accounted for adequately. This practice is therefore compatible with the basic principles set up for hedge accounting.

We therefore request from the Board that a portfolio of commercial bids expressed in a foreign currency, and from which, as a whole, future in- and out-flows of currencies can be reliably estimated and adequately documented, is regarded as a highly probable future transaction.

Initial effectiveness

The present rules on hedge effectiveness are very strict and we do not believe that the requirement that a hedge is almost entirely effective at inception reflects the economic substance of the risk management transactions, e.g. in commodity hedging. For practical purposes we would recommend that the current rule of 80 to 125% for the retrospective effectiveness testing should also be applicable at the inception of the hedge. This would lead to a much fairer presentation of the entity's results and mitigate some of the crasser distortions from IAS 39's excessively rule-based approach.

It is appreciated that the incorporation of the above suggestions into IAS 39 would probably necessitate a re-exposure on hedge accounting. We nevertheless believe that the standard would remain excessively arbitrary and continue to give users a distorted picture of entities' results in many important situations if they are not incorporated.

Change made to IFRS 1 regarding the retrospective application of IAS 39 derecognition requirements

Last July, the Board decided to change IFRS 1 so that the exception made regarding retrospective application of IAS 39 derecognition requirements is set as of 1 January 2004.

Some entities however are listed in the US and have therefore planned their conversion to IFRS with a transition date being 1 January 2003. Those entities have planned their conversion effort well in advance, leaving some room for late adjustments arising from the last decisions to be made by the IASB. The conversion effort for these entities is an exceptional challenge since they compete with other entities in the US financial markets that offer consistency throughout periods in the presentation of their financial position and performance.

Those entities need to rely on a consistent IFRS I that should authorise a consistent set of standards to be applied from the transition date.

We therefore ask the Board to change its July decision on this account to set out that the exception to retrospective application of IAS 39 derecognition requirements is set as of I January 2004, unless retrospective application of IAS 39 derecognition requirements can be made as of the transition date if earlier and in full compliance with IAS 8 revised requirements.

We hope that the above concerns will be taken into account in your discussions and remain at your disposal to discuss them further.

Yours sincerely,

(original signed by)
Jerome P. Chauvin
Director, Company Affairs Department