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Ms. Sandra Thompson,
Senior Project Manager,
International Accounting Standards Board,
30 Cannon Street
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United Kingdom.

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Dear Ms Thompson,

AIB Group welcomes the opportunity to comment on the Exposure Draft of proposed amendments to LAS 39 on Fair Value Hedge Accounting for a Portfolio Hedge of Interest Rate Risk.

At the outset, we note the progress that has been made since the roundtable meetings in March. However, AIB believes that much work still needs to be done by the IASB if it is to develop a high quality accounting standard on financial instruments.

Accepting the principle that all derivatives must be measured at fair value has been a major concession by European Banks including AIB. While the IASB will have the view that accepting the principle of portfolio hedges is also a major step, without such a concept, the standard was flawed. What is required from the IASB is an accounting standard that reflects how banks manage their interest rate risk. The proposals as set out in the Exposure Draft need further revision for the following reasons:

(1) In the absence of inclusion of core deposits in fair value hedging strategies, the Exposure Draft adds nothing of real value from a banking industry perspective.

(2) The alternatives proposed in the Exposure Draft, based on a portion of assets or liabilities, do not recognise the manner in which banks manage interest rate risk. The complexity contained within the proposed portfolio hedging rules will require significant systems development.

(3) The rules in relation to ineffectiveness fail to recognise the nature of bank assets and liabilities. The interest rate exposures do not remain constant and, at any point in time a bank may find itself underhedged. It will close out this exposure by undertaking new hedges. However, based on the proposed definition of ineffectiveness within the Exposure Draft; it is likely that any open position as a result of lower than expected prepayments would constitute ineffectiveness. This will result in fair value being extended outside the trading book.

With respect to the questions raised within the Exposure Draft our responses are as follows:-

Question 1

For the reasons outlined above, we believe that construction of hedges should reflect how the interest rate is managed, i.e. on the net position, or on a designated percentage of the net position.

We do not agree that underhedging should result in hedge ineffectiveness.

In the absence of the Board introducing an accounting framework that reflects how interest rate risk is managed by banks, we would favour the use of Option C rather than Option D.

Question 2
A core deposit portfolio generates exposure to interest rate risk. It is important for the IASB to recognise that good risk management principles require this exposure to be hedged. It should be possible for the IASB to achieve fair value hedging for core deposits.

Accounting theory should not ignore risk management policies. We are not proposing that a gain be recognised on the origination of a core deposit. Accounting theory needs to be brought in line with risk management practice. Accordingly banks should have the facility to include within the fair value hedge accounting, the fair value effect of changes in interest rates on core deposits on the basis of expected, not contractual maturity.

Finalisation of IAS 32 and IAS 39
I note that it is intended to publish these standards (excluding the hedging components) this month. 1 am concerned that given the complexity of the rules and the extent of changes to the standards that are contemplated (based on the updates contained in monthly newsletter ‘Insight’), the Board is not proposing to publish the text for final review The standards remain deeply complex and the IASB should make a public commitment to make good any unforeseen consequences of the changes.

Yours sincerely,

Gary Kennedy
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