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Date	15 January 2003	Ref.	CCA/Reporting
Telephone	(02) 510 53 40		
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Subject	Exposure Draft of Proposed Amendments to "IAS 32: Financial Instruments: Disclosure and Presentation" and "IAS 39: Financial Instruments: Recognition and Measurement"		

Dear Sir,

We are referring to the Press release of December 18, 2002 and appreciate the opportunity to provide comments on the Exposure Draft of Proposed Amendments to "IAS 32: Financial Instruments: Disclosure and Presentation" and especially to "LAS 39: Financial Instruments: Recognition and Measurement".

Our purpose is not to repeat the comments raised in the numerous letters published on the IASB 's website. However, we fully agree with the comments raised by the Banking & Insurance industry and by the European Banking Federation which has summarised the major remarks of Fortis Bank and other European banks. We believe that the application of hedge accounting should be based on principles and not on rules, and should reflect the economic substance of risk reducing hedging strategies. When applying the detailed rules of IAS 39, it appears clear that a significant number of currently economically valid hedging strategies will not get hedge accounting and will be qualified as trading under the standard. On the other hand, it appears perfectly feasible that well designed speculative derivative strategies could obtain hedge accounting treatment under IAS 39, when for example the terms and conditions of a hedging interest rate derivative match those of an existing item on the balance sheet.

In our concern to contribute to find constructive solutions to the problems arising from the application of IAS 39 and specifically from the hedge accounting rules, we would nevertheless like to explain briefly our point of view on the following topics:

a) The accounting treatment of the derivative should follow that of the hedged item: maintaining accrual accounting for interest rate derivatives

We consider that the accounting treatment of the hedging derivative should follow the treatment applied to the hedged item and not the opposite as proposed by IAS

39. As a result, we are in favour of maintaining accrual accounting on derivatives used for hedging interest bearing items otherwise accounted for in accordance with the amortised cost method. Although we understand the objectives behind recording derivatives at fair value on balance sheet, we believe that in view of the mixed measurement model (e.g: derivatives and AFS securities at fair value, and loans, borrowings at amortised cost) proposed by [AS 39, this requirement would often lead to a misleading representation of the true substance of the business of banks. Accordingly, the requirement to disclose the fair values of derivatives in the notes to the accounts seems more appropriate to us.

b) Transfers into and out of the trading book

If the conditions for hedge accounting formulated in the amendment to IAS 39 are maintained in the final version of the standard, the bank would be favourable to the possibility offered in the amendment to designate any financial asset or liability as a trading item. However this possibility does not allow reclassification of financial items into or out of the Trading book (e.g: transfer from the trading book to the available-for-sale or held-to-maturity books). Banks often use a Trading desk as a sole interface ("window-to-the-market") with the financial markets; securities are for example purchased by the Trading desk at the request of other departments, and transferred after a short period of time at market price from the Trading to the AFS or HTM books.

c) Prohibiting the use of internal transactions as hedges

As already mentioned by other banks, internal hedges between two entities of the same group or between desks of a dealing room are currently transacted under well controlled procedures defined by local banking supervisory authorities. The use of internal hedges within banking groups serve the following important business and risk management objectives:

- Development of expertise in derivatives in one centre of excellence;

- Centralisation of market risk in one unique entity or desk (acting as one "window to the market") under stringent risk mandates (requiring in most instances the centralisation unit to offset the internal exposure with third party counterparts); and as a consequence;

- Reduction of credit risk towards external third parties;

- Reduction in fees, costs and operational risks through decrease of the number of external deals.

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Disallowance of hedge accounting for internal hedges could result in many of these internal hedges being unwound and replaced by third party transactions only for the sake of obtaining hedge accounting under IAS.

Typically, entities/desks within a banking group/bank will hedge their risks with another risk centralisation entity/desk. Currently, the “hedging” leg of the internal deal gets hedge accounting under local GAAP, whereas the other leg of the deal with the risk centralisation unit is marked-to-market through P&L. In this context, we would like to propose the following new wording for the paragraph 134 of IAS 39, which can be written as follows:

134.Intercompany hedging transactions that have been entered into with another member of a consolidated group or intra-company hedging transactions that have been entered into with another desk of the same company, both acting as inter faces with the external market, can be considered as hedging instruments in a hedge in the consolidated and non consolidated financial statements if such internal contracts fulfil the requirements for hedge accounting at the individual entity or desk level and are aggregated or netted against each other and the exposure is offset externally with unrelated third parties.

d) Prohibiting the use of macrohedging

Banks’ Assets & Liabilities management ("ALM") departments are responsible for managing the aggregated net interest rate risk exposure arising from portfolios of various types of interest bearing items both on the asset and liabilities sides of the balance sheet. By nature, ALM hedges do not reduce risk on specifically identified items on the balance sheet. We believe that allocation of hedges of net exposures to portions of specifically identified gross positions on the assets or on the liabilities side of the balance sheet for the sake of getting hedge accounting under IAS 39 as suggested by paragraph 133 of the amendment, and the resulting accounting treatment (in the case of the fair value hedge model, fair value adjustments are booked exclusively on those items which have been designated as representing the net exposure hedged and not on other non-designated interest bearing items), does not reflect the substance of the hedges undertaken by ALM departments.

Many banking supervisory entities across Europe such as the Banking and Finance Commission in Belgium allow the use of macro hedging strategies to qualify for hedge accounting under a specific control framework, and when the banks are able to demonstrate the risk reduction effect of those strategies.

e) Prohibiting hedging non homogeneous portfolios

Economically valid hedging strategies may involve hedging portfolios of items, which would not be qualified as homogeneous under paragraph 132 (“the change in

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fair value attributable to the hedged risk for each individual item in the group will be expected to be approximately proportional to the overall change in fair value attributable to the hedged risk of the group"). This would for example be the case when hedging baskets of equities replicating stock indices through the sale of stock index futures.

In this context, we would like to propose the following new wording for the paragraph 132 of IAS 39, which can be written as follows:

132. Companies are allowed to hedge non homogeneous portfolios of items provided they share exposure to the risk hedged (interest rate risk for example). In this case, gains and losses on hedging derivatives are recognised in income statement at the same time as losses and gains relating to the hedged risk are recorded on the hedged portfolio.

We sincerely hope that we will have the opportunity to develop those points of view during the roundtable forum discussions in March and/or during an informal meeting with you. We generally believe that most IAS standards increase transparency and comparability in the financial statements. However, as you will have understood by going through this letter, the accounting framework and the hedge accounting rules proposed by IAS 39 need further thinking and alignment with the realities of the business of banks, in order to represent a stable true and fair image of their activities to the financial community, and ultimately to corporate clients and retail depositors.

Yours sincerely,

G. MITLLER

Chief Financial Officer Fortis.