LIBA

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Dear Sandra,

Exposure Draft of Proposed Amendments to IAS 39
Cash Flow Hedge Accounting of Forecast Intragroup Transactions

I am writing on behalf of the London Investment Banking Association (LIBA) to comment on the IASB Exposure Draft of Proposed Amendments to IAS 39 - Cash Flow Hedge Accounting of Forecast Intragroup Transactions, which was published on 8 July. LIBA is, as you know, the principal UK trade association for investment banks and securities houses; a full list of our members is attached.

Financial instruments form a key component of the European business activities of the majority of LIBA members. We have therefore closely followed, and have in large measure supported, the IASB work on accounting for financial instruments, and we are very pleased to have the opportunity to comment on this further Exposure Draft.

Our responses to the questions in the Invitation to Comment section of the ED are set out below.

Question 1

Do you agree with the proposals in this Exposure Draft? If not, why not? What changes do you propose and why?

We support the proposals in this ED, which we believe provide a pragmatic and practical solution to an issue faced by many LIBA members and by their clients.

Certain groups which have overseas subsidiaries will manage foreign exchange exposure against the presentational currency of the consolidated financial statements. This is done on behalf of shareholders who generally hold their investment in the entity's presentational currency and expect to be able to assess the entity's performance in that currency. There is an expectation from shareholders, as for other forms of financial risk, that a consolidated entity will appropriately manage foreign exchange exposure arising from transactions in currencies different to the currency of its financial results and dividend payments. This approach aligns with the views expressed by the Board in paragraph BC14 of the ED.

Where a consolidated group is managed in this way, the ED will allow the group to minimise the volatility in consolidated earnings. This volatility can arise because a group is currently precluded from applying hedge accounting at a group level where a forecast transaction in a subsidiary is in the same functional currency as that entity, but in a different currency to the presentational currency of the group as a whole.

Take an example of consolidated group with a GBP presentational currency, which has a EUR subsidiary. It is the consolidated group's policy to hedge non-GBP forecast transactions (such as salaries paid outside the UK). Currently under IAS 39 a derivative hedging EUR forecast salary payments from its EUR subsidiary will create earnings volatility as it cannot be designated as a hedged item in a cashflow hedge of a forecast transaction. The ED will allow the consolidated group to designate and thus minimise the volatility otherwise caused by its policy of actively managing forecast EUR salary payments.

The management of foreign exchange risk on a consolidated basis as described above is, however, not universal. Some consolidated groups prefer to manage foreign exchange exposure at an entity level, hedging against the functional currency of each entity. For these groups, the currency of the consolidated group is for presentation purposes only and the investor effectively takes on the inherent foreign exchange exposure. We note that these proposals will result in such groups potentially showing foreign exchange exposure, and the related volatility, where hedge accounting at the subsidiary level will not survive on consolidation because the forecast transaction is in the group's presentational currency.

On balance, we believe the proposal put forward by the Board is conceptually stronger than other potential solutions. We also believe that certain groups could amend their foreign exchange hedging policy if the proposals had such a negative impact on their consolidated results.

Question 2

Do the proposals contained in Exposure Draft appropriately address the concerns set out in paragraph 3 of the Background on this Exposure Draft? If not, why not, and how would you address these concerns?

We believe the proposals in the ED do address the concerns raised in paragraph 3(a) and 3(b). We also recognise that the proposals are likely to have a wider application than these concerns, but as indicated above, we believe the proposals have conceptual merit and therefore support this broader application.

The proposals in the ED create a difference with US GAAP, but we understand the Board's conceptual concerns regarding designation of inter-company transaction as hedged items where those items do not impact the consolidated results.

Question 3

Do you have any other comments on the proposals?

We urge the Board to do all it can to incorporate these proposals into IAS 39 in time for those entities that wish to adopt the proposals early to do so from 1 January, 2005. This will minimise some of the practical difficulties that would otherwise arise through a staggered transition.

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I hope that the comments in this letter are helpful. We would of course be very pleased to expand on any particular points if there are aspects which you find unclear, or where you would like further details of our views.

Yours sincerely

Ian Harrison
Director

LONDON INVESTMENT BANKING ASSOCIATION

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