

# Hedge accounting

Tentative decisions up to September 2011  
(Completion of redeliberations)

The views expressed in this presentation are those of the presenter,  
not necessarily those of the IASB or IFRS Foundation

- Where are we now?
  - Redeliberations were completed at the September 2011 Board meeting
- Next steps
  - The Board decided that re-exposure would not be necessary
  - A staff draft will be posted on the IASB website for around 90 days
  - During this time the Board will undertake extended fatal flaw review and outreach processes

# Tentative decisions

Redeliberations taking into consideration the feedback received from the comment letters and the outreach activities

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# Changed in redeliberations

Topic	Decision
Equity investments measured at fair value through OCI	<ul style="list-style-type: none"><li>• Agreed to allow hedge accounting.</li></ul>
Fair value hedge accounting mechanics	<ul style="list-style-type: none"><li>• Retain mechanics of IAS 39.</li><li>• Require single note about cash flow and fair value hedges.</li><li>• Disclosure of fair value hedge adjustment.</li></ul>
Hedging of layers with prepayment options	<ul style="list-style-type: none"><li>• Can hedge:<ul style="list-style-type: none"><li>• a layer component within the hedged item for the amounts that are <i>not</i> pre-payable.</li><li>• pre-payable layer <i>if</i> prepayment effect included in measurement of hedged item.</li></ul></li></ul>

Topic	Decision
<b>Net position cash flow hedges</b>	<ul style="list-style-type: none"><li>• Cash flow hedges of net positions are only be available for hedges of foreign currency risk.</li><li>• Remove the restriction that the offsetting cash flows in a net position must all affect the income statement in the same reporting period.</li><li>• Instead, the eligibility criteria are extended to require that the items within the net position must be specified in such a way that the pattern of how they will affect the income statement is set out as part of the initial hedge designation.</li></ul>

# Changed in redeliberations

Topic	Decision
'Own-use' scope exception	<ul style="list-style-type: none"><li>Extend to contracts that meet the 'own use' scope exception the FVO in IFRS 9 if it eliminates or significantly reduces an accounting mismatch.</li></ul>

Topic	Decision
Accounting for forward points	<ul style="list-style-type: none"><li>• Permit forward points that exist at inception of the hedging relationship to be recognised in profit or loss over time on a rational basis.</li><li>• Recognise the difference between cumulative amortisation and subsequent fair value change in accumulated other comprehensive income.</li></ul> <p>This is to provide a better representation of the economic substance of eg a ‘funding swap’ transaction and the performance of the net interest margin.</p>

# Changed in redeliberations

Topic	Decision
<b>Disclosures</b>	<ul style="list-style-type: none"><li>• Changed the disclosure requirements related to the amount, timing and uncertainty of future cash flows in the exposure draft. The Board tentatively decided to rather focus on the terms and conditions of the hedging instrument.</li><li>• Entities that use a dynamic hedging strategy that involves frequent resetting of hedging relationships are exempt from disclosing terms and conditions of the hedging instruments. Instead, they will:<ul style="list-style-type: none"><li>• expand the risk management strategy description and explain how hedge accounting is used to reflect the dynamic hedging strategy; and</li><li>• if applicable, disclose that the volumes at year end do not reflect normal volumes.</li></ul></li></ul>



# Changed in redeliberations

Topic	Decision
<b>Hedges of credit risk using credit derivatives</b>	<ul style="list-style-type: none"><li>• Allow elective fair value through profit or loss (FVTPL) accounting for a credit exposure (eg loans, bonds and loan commitments) when hedged with a credit derivative:<ul style="list-style-type: none"><li>• FVTPL can be elected at initial recognition of the credit exposure or subsequently (incl. for a component of nominal amounts).</li><li>• Difference between carrying amount and fair value is immediately recognised in profit or loss.</li><li>• When FVTPL is discontinued amortisation similar to fair value hedge (incl. for loan commitments).</li></ul></li></ul>

Topic	Decision
<b>Hedges of credit risk using credit derivatives (cont.)</b>	<ul style="list-style-type: none"><li>• Disclosure requirements added:<ul style="list-style-type: none"><li>• A reconciliation of the nominal amount and the fair value of the credit derivatives that have been used to manage the credit exposure.</li><li>• Gain or loss recognised in profit or loss as a result of electing fair value through profit or loss.</li><li>• For discontinuations of elective fair value through profit or loss accounting for credit derivatives, the fair value that becomes the new deemed cost or amortisable amount.</li></ul></li></ul>

Topic	Decision
<b>Cash instruments measured at FVTPL as eligible hedging instruments</b>	<ul style="list-style-type: none"><li>• Did not extend to other cash instruments (ie those not at FVTPL).</li><li>• Clarified that liabilities measured at fair value under the FVO with the own credit effect in OCI are <u>NOT</u> eligible hedging instruments.</li></ul>
<b>Hedging sub-LIBOR cash flows</b>	<ul style="list-style-type: none"><li>• Cannot hedge a ('full') LIBOR component of a sub-LIBOR cash flow.</li><li>• Will clarify that total cash flows can be hedged for changes in LIBOR.</li><li>• Also applies to non-financial items.</li></ul>

Topic	Decision
<p>Effectiveness testing: clarification of the term ‘<b>other than accidental offsetting</b>’</p>	<ul style="list-style-type: none"><li>• Clarify intention and rather refer to:<ul style="list-style-type: none"><li>• The notion of an economic relationship between the hedged item and the hedging instrument, which gives rise to offset.</li><li>• The effect of credit risk on the level of offsetting gains or losses on the hedging instrument and the hedged item that may reduce or modify the extent of offsetting.</li></ul></li></ul>

Topic	Decision
<p>Effectiveness testing: clarification of ‘unbiased’ and ‘minimise expected hedge ineffectiveness’</p>	<ul style="list-style-type: none"><li>• Clarify intention that the hedge ratio of the hedging relationship shall be based on the entity’s ‘economic hedge’ ie:<ul style="list-style-type: none"><li>• The quantity of hedged item that it actually hedges.</li><li>• The quantity of the hedging instrument that it actually uses to hedge that quantity of hedged item.</li></ul></li><li>• But designation must not reflect an imbalance that would create hedge ineffectiveness in order to achieve an accounting outcome that is inconsistent with the purpose of hedge accounting.</li></ul>

Topic	Decision
Accounting for <b>time value of options</b>	<ul style="list-style-type: none"><li>• Confirm the accounting outcomes for the accounting for time value of options as proposed in the ED (ie based on the nature of the hedged item).</li><li>• Expand the application guidance in the ED to assist distinguishing accounting for ‘transaction related’ and ‘time period related’ hedged items.</li><li>• Not introduce an accounting choice to account for time value of options either as: (i) proposed in the ED or (ii) in accordance with IAS 39.</li></ul>

Topic	Decision
<p>Designation of <b>combinations of options</b> as hedging instruments</p>	<ul style="list-style-type: none"><li>• To amend the requirements such that a combination of a written and a purchased option (regardless of whether the hedging instrument arises from one or several different contracts) can be jointly designated as the hedging instrument provided that the combination is not a net written option.</li></ul>

Topic	Decision
Rebalancing	<ul style="list-style-type: none"><li>• Align the notion of rebalancing with the Board’s tentative decision on the hedge effectiveness assessment, hence:<ul style="list-style-type: none"><li>• The hedging relationship is rebalanced for hedge accounting purposes when the ‘hedge ratio’ is adjusted for risk management purposes.</li><li>• But designation must not reflect an imbalance that would create hedge ineffectiveness in order to achieve an accounting outcome that is inconsistent with the purpose of hedge accounting.</li></ul></li></ul>



Topic	Decision
Rebalancing (cont.)	<ul style="list-style-type: none"><li>• The notion of proactive rebalancing is eliminated.</li><li>• Clarify that rebalancing covers only adjustments to the quantities of the hedged item or the hedging instrument for the purpose of maintaining a hedge ratio that complies with the requirements of the hedge effectiveness assessment.</li></ul>

Topic	Decision
<b>(No) Voluntary Discontinuation</b>	<ul style="list-style-type: none"><li>• Add guidance about how the risk management objective and the risk management strategy relate to each other using examples contrasting these two notions.</li><li>• Confirm the proposals in the ED and hence prohibit voluntary discontinuation of hedge accounting when the risk management objective remains the same and all the other qualifying criteria are still met.</li></ul>

Topic	Decision
Aggregated exposures	<ul style="list-style-type: none"><li>• Confirm proposal in the ED, that is, allow designation of an aggregated exposure as the hedged item in a hedging relationship.</li><li>• Add illustrative examples to accompany the final standard.</li><li>• Explicitly clarify in the final standard that the proposal does not allow 'synthetic accounting'.</li></ul>

Topic	Decision
<b>Aggregated exposures</b>	<ul style="list-style-type: none"><li>• Do not impose achieving hedge accounting for the relationship between the exposure and the derivative that constitute the aggregated exposure as a precondition for the aggregated exposure being eligible as the hedged item.</li><li>• Provide additional clarification by:<ul style="list-style-type: none"><li>• explaining how aggregated exposures relate to forecast transactions; and</li><li>• adding application guidance on how to apply the general requirement in the context of aggregated exposures.</li></ul></li></ul>

<b>Topic</b>	<b>Decision</b>
<b>Net presentation in a separate line item in the income statement</b>	<ul style="list-style-type: none"><li>• Confirm the proposals in the ED regarding presentation in the income statement and that the separate line item for hedging gains and losses also includes the gains or losses on forecast transactions deferred to later periods.</li></ul>

# Confirmed in redeliberations

<b>Topic</b>	<b>Decision</b>
<b>Linked Presentation</b>	<ul style="list-style-type: none"><li>• Confirm the proposal in the ED that linked presentation not be allowed for fair value hedges.</li></ul>

Topic	Decision
<b>Hedging of risk components</b>	<ul style="list-style-type: none"><li>• Retain the notion of risk components as eligible hedged items.</li><li>• Determine eligible risk components on the basis of the criteria proposed in the ED, ie that a risk component must be separately identifiable and reliably measureable.</li><li>• Use a single set of criteria for all items, ie that the criteria should apply for all types of items—risk components of financial and non-financial items.</li><li>• Provide guidance on how to apply the criteria.</li><li>• Eliminate the general prohibition regarding designating inflation risk components (but add a ‘caution’ and rebuttable presumption).</li></ul>

Topic	Decision
Disclosures	<ul style="list-style-type: none"><li>• Confirm the scope of the disclosures in the ED.</li><li>• Confirm the disclosure requirements related to an entity's risk management strategy in the ED.</li><li>• Confirm the disclosure requirements related to the effects of hedge accounting on the primary financial statements in the exposure draft.</li></ul>



Topic	Decision
Transition requirements	<ul style="list-style-type: none"><li>• Prospective with limited exceptions.</li><li>• Exceptions (for hedging relationships that exist at the beginning of the comparative period [or later]):<ul style="list-style-type: none"><li>• Required retrospective application for accounting for time value of options.</li><li>• Permitted retrospective application for accounting for forward elements (if elected, applies to all such hedging relationships).</li></ul></li></ul>

Topic	Decision
Transition requirements	<ul style="list-style-type: none"><li data-bbox="903 391 1452 439">• Practical expedients<ul style="list-style-type: none"><li data-bbox="996 518 1873 815">• Entities allowed to consider the moment IAS 39 ceases to apply and the moment from which the new model applies as one point in time.</li><li data-bbox="996 896 1908 1200">• For the purpose of rebalancing, the starting point will be the hedge ratio used under IAS 39 (any gains or losses will be recognised in profit or loss).</li></ul></li></ul>