Purpose of the paper

1. At the 3 August 2010 IASB meeting the staff presented a paper on effectiveness assessment to the Board. At that meeting, the staff was asked to consider the notion of ‘neutrality’ of the hedging relationship in the context of effectiveness testing.

2. This paper consists of a diagram. We believe that using such a diagram will help the Board understand the issue of ‘neutrality’ of the hedging relationship and how it relates to other aspects of the new effectiveness test.

3. The diagram summarises the narrative description in paper 4A (refer to paragraphs 9 to 33 of that paper). Paper 4A also includes an outline of the overall effectiveness test (ie all its key features) for the new hedge accounting model.
**Current IAS 39.AG107A**

- Determines/influences the weight of the hedged item and hedging instrument
  - Headroom
  - Recognition of ineffectiveness
    - Prohibition of including headroom to avoid understatement of ineffectiveness
      - Applicable to CFH due to the ‘lower of test’
  - Correlation
  - Effectiveness assessment
    - Optional adjustment of the hedge ratio to other than 1 to 1 to maximise expected effectiveness
      - Applicable to FVH and CFH for effectiveness assessment

**Proposed Model**

- Determines/influences the weight of the hedged item and hedging instrument
  - Headroom
  - Correlation
    - Recognition of Ineffectiveness
      - Effectiveness assessment
        - Objective: unbiased hedging relationship that minimises ineffectiveness (‘neutral’)
          - Statistical neutrality
            - Not mandatory
  - Mandatory optimal hedge ratio defined by RM (Screen-out #1)
  - No merely accidental offset (Screen-out #2)
  - Hedge Accounting

- Described approach in paper 4A