



Project	Fair Value Measurement
Topic	Examples for measuring the fair value of a financial instrument when there are offsetting risk positions

1. This supplement clarifies paragraphs 3, 46-52 of Agenda Paper 2D (IASB)/3D (FASB) and provides examples of ‘offsetting risk positions’.
2. There are situations in which the value of a group of instruments (a portfolio) is different from the sum of the individual instruments. This happens when the instruments in the group are exposed to the same risk, but the entity has both long and short positions in that risk. For example:
 - (a) an entity has purchased a call option (a long position) and written a put option (a short position) on the £/\$ exchange rate (*see Example 1*).
 - (b) an entity has entered into 2 interest rate swaps with the same counterparty; one of the swaps is in an asset position (long) and one is in a liability position (short) (*see Example 2*).
3. The amounts in the examples are for illustrative purposes only to facilitate discussion at the board meeting.

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Example 1: Bid-ask spread example

Assume an entity holds two derivatives exposed to the same market risks. The entity has:

- a long position in one of the derivatives (an asset) with a quoted mid-price of 58 (bid = 56; ask = 60) and
- a short position in the other derivative (a liability) with a quoted mid-price of 33 (bid = 30; ask = 36).

Approach 1: Accounting without portfolio adjustment (IASB ED)

Fair value of long position	56
<u>Fair value of short position</u>	<u>36</u>
Fair value of net (long) position	20

Approach 2: Accounting with portfolio adjustment (as IAS 39.AG72 is widely interpreted in practice)

Step 1: Mark to mid

Value of long position	58
<u>Value of short position</u>	<u>33</u>
Value of net (long) position	25

Step 2: Mark to bid-ask

Value of net (long) position	25
<u>Bid-ask adjustment</u>	<u>(3)</u>
Fair value of net (long) position	22

Example 2: Credit risk example

Assume an entity holds two derivatives held under a master netting agreement. The entity has:

- a long position in one of the derivatives (an asset) with a fair value of 58 (including a credit risk adjustment for counterparty credit risk of 5 based on a BB rating) and
- a short position in the other derivative (a liability) with fair value of 33 (including a credit risk adjustment for own credit risk of 3 based on a AA rating).

Approach 1: Accounting without portfolio adjustment (IASB ED)

Fair value of long position	58
<u>Fair value of short position</u>	<u>33</u>
Fair value of net (long) position	25

Approach 2: Accounting with portfolio adjustment (as IAS 39.AG72 is widely interpreted in practice)

Value of long position	63
<u>Value of short position</u>	<u>36</u>
Value of net (long) position	27
<u>Credit adjustment</u>	<u>(2.3)</u>
Fair value of net (long) position	25.7