Project	Financial Instruments: Hedge Accounting
Topic	Outreach Summary

Purpose of this paper

1. During the 3-month consultation period for the exposure draft *Financial Instruments: Hedge Accounting* (the ED), Board members and staff conducted extensive outreach across all major geographical regions of the world. The IASB held outreach meetings in Africa, Asia Pacific, Europe, North America, Central America and South America. More than 2,500 individuals have participated in the IASB's outreach activities. We received feedback on the ED from preparers, auditors, regulators, users, standard setters, treasurers, risk management experts and academics.

2. The purpose of this paper is to provide a summary of the feedback from these extensive outreach activities.

Outreach approach

3. Outreach meetings were held in a large variety of locations, especially those for which hedge accounting is of particular importance and impact (ie in locations where entities enter into a significant volume of economic hedges). The following table shows the different geographic regions and the number of meetings held in each region:

Geographic Region	Number of meetings
Africa	10

This paper has been prepared by the technical staff of the IFRS Foundation for discussion at a public meeting of the IASB.

The views expressed in this paper are those of the staff preparing the paper. They do not purport to represent the views of any individual members of the IASB.

Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRS Interpretations Committee or the IASB can make such a determination.

The tentative decisions made by the IASB at its public meetings are reported in IASB *Update*. Official pronouncements of the IASB, including Discussion Papers, Exposure Drafts, IFRSs and Interpretations are published only after it has completed its full due process, including appropriate public consultation and formal voting procedures.

Region	
Asia-Pacific	44
Europe	47
North America	10
Central America	14
South America	20
TOTAL	**145**

4. The format of the outreach meetings varied. The majority of the outreach meetings were face-to-face interactive sessions. Time spent in most meetings was balanced between providing explanation or clarification of the proposals by Board member/s and/or staff and receiving feedback from participants (ie interactive sessions). Some sessions were general sessions for a wide range of audience while other sessions were held for a more targeted audience, eg financial institutions or extractive industry, corporate treasurers, auditors, users etc.

5. The largest outreach meeting was attended by more than 200 participants while the average group meetings range between 20-50 participants. Individual sessions were also held with a particular preparer, auditor, regulator or user at a time. Most individual meetings with preparers also include risk management experts within their organisation. A number of outreach meetings were also conducted by telephone conference.

6. All participants appreciate the extensive outreach effort from the IASB and are pleased with the open and continued dialogue with the IASB on this topic. All participants have found the outreach approach very helpful and constructive. They found that the physical outreach meetings have provided a platform to facilitate communication on this complex area.

7. Participants are also impressed with the extensive geographical coverage of the IASB's outreach activities and are pleased that the meetings were held in locations where hedge accounting is of significant interest and impact.

Overview

8. Almost all participants are supportive of the ED. Most participants welcome the Board's approach to address hedge accounting comprehensively. They also agree with the principles-based approach of the ED.

9. Almost all participants support the Board's approach to better align hedge accounting with risk management because that better reflects the business risk management activities and the economic substance. Participants also noted that the Board's proposals resolve many of today's practice problems under IAS 39 *Financial Instruments: Recognition and Measurement*.

10. Many participants are of the view that today's hedge accounting requirements had a detrimental effect on the risk management decisions of many entities (ie IAS 39 has influenced the decisions of many entities on whether and how to hedge economically). Participants are pleased that the ED would allow entities to reflect the effects of risk management activities in the financial statements rather than influencing the way entities manage risk.

11. Many participants, although supportive of the ED, think that the ED still does not enable entities to fully reflect their risk management strategy for some economic hedges (eg hedges of financial instruments that are classified as fair value through other comprehensive income (FVTOCI)). They therefore feel that limitations within the document mean that the document in a sense fails to enable a full reflection of risk management activity. Some participants are also disappointed that the ED did not address macro hedging or the interaction between the hedge accounting model and other standards, particularly IAS 21 *The Effects of Changes in Foreign Exchange Rates,* IAS 2 *Inventories* and IFRS 4 *Insurance Contracts*.

12. Some participants would like more detailed guidance and illustrative examples while others hold the opposite view, ie they do not want more detailed guidance or examples.

13. The rest of the paper summarises the feedback from the outreach activities by the following topics:

    (a) objective;

    (b) hedged items;

    (c) hedging instruments;

    (d) hedge effectiveness;

    (e) discontinuation and rebalancing;

    (f) groups and net positions;

    (g) presentation and disclosure;

    (h) alternatives to hedge accounting;

    (i) other issues; and

    (j) macro hedging.

Objective

14. Almost all participants agree with the ED's proposed objective of hedge accounting, which is to reflect the risk management activities that use financial instruments to manage exposures.

15. Many participants believe that the objective should also extend to risks that could affect other comprehensive income (see paragraph 64 to 66). This view was particularly strong in parts of Asia and Europe and some parts of Latin America.

16. A few participants in Asia Pacific would like the Board to clarify what 'risk management' means. Some participants in Latin America and some parts of Europe strongly believed that the Board should clarify the notion of consistency with risk management as it can be viewed as another test to achieve hedge accounting and deter people from applying hedge accounting.

Hedged items

Risk components

17. All most all participants are strongly supportive of the proposal to permit the designation of risk components as hedged items irrespective of whether the item is a financial or non-financial item. Many agreed with using the criteria already used in IAS 39 for financial hedged items (ie that risk components should be separately identifiable and reliably measurable) while some were confused by how the two criteria relate to each other and potential overlap and some supported using a less restrictive criterion.

18. All most all participants agree that the proposal will enable entities to better reflect their risk management activities and would remove today's accounting bias that requires non financial hedged items to be treated as if they were always hedged for all risks (unless an entity qualifies for the FX risk exception) . Most corporate treasury functions manage exposures by risk type and the proposals provide a better reflection of the risk management strategies pursued by corporate treasurers.

19. For non-contractually specified risk components, many participants have asked for more guidance in identifying whether a particular factor that influences the value or cash flows of a non-financial exposure is a risk component (ie an eligible hedged item). Some participants would like an explanation of how risk components and "ingredients" relate to each other.

Aggregated exposures

20. Most participants are supportive of the proposal for aggregated exposures as it allows entities to better reflect the different risk management strategies for different risks. The proposal also eliminates a significant practice issue under IAS 39 today of de-designation and re-designation when a second derivative is entered into to manage the aggregated exposure.

21. Many participants asked for clarification on how the hedging relationship would be designated and think illustrative examples would be helpful.

22. Some participants in Western Europe were disappointed that the Board did not propose allowing the use of synthetic accounting for combinations of loans and interest rate and inflation swaps when the two are interlinked and the combined outcome shares the same risks as the assets. These participants believe that synthetic accounting will provide more useful information than by designating the two hedging instruments in separate hedging relationships.

23. Some participants in Central and South America felt that the proposal could be more flexible and allow companies to consider within the scope of hedge accounting scenarios where entities choose (because of unavailability of hedging instruments in their functional currency) to create an aggregated exposure in a currency that is not their functional currency.

Nominal components

24. Most participants are supportive of the proposals for a layering approach for fair value hedges for nominal components. The flexibility in designating nominal components in layers allows entities to better reflect the different risk management approaches.

25. However, most participants also —especially financial institutions—would like this proposal to be extended to prepayable items for which the prepayment option's fair value is affected by changes in the hedged risk particularly in considering group of items.

Sub-libor issue

26. Some participants in Europe raised particular concerns about situations in which the sub-libor issue affects the hedging of interest margin. These participants believe that there should be no restriction as the overall result in their view would be correct.

27. Many participants have raised particular concerns where the sub-libor issue is extended to non-financial items. Negative spreads (ie discounts) are common in many contracts for non-financial items due to quality differences between the non-financial item and the benchmark. In many of these instances the

premium/discount ie the quality difference cannot be determined at the inception of the hedge (ie at the date of designation). These participants believe that designating the benchmark component should be permitted unless the benchmark moves below the absolute spread—a highly unlikely scenario for most contracts of non-financial items.

Inflation

28. Many participants felt that the Board should not restrict an entity from being able to designate an inflation component in a financial item. They argue that this is a rule rather than a principle. They believe that the principle that a risk component should be separately identifiable and reliably measureable is appropriate for inflation components as well.

Hedging instruments

Eligibility

29. In particular areas of Asia the use of derivatives is restricted. Participants in these areas favour the ED's proposal for non-derivative financial instruments measured at fair value through profit or loss as eligible hedged items.

Time value of options

30. Almost all participants are supportive of the ED's proposal for the treatment of the time value of option as it better reflects the economics of the transaction.

31. Some participants in Asia and Western Europe commented that the ED's proposals are complex and some would prefer a single treatment of all options. Some participants seek further clarification on how to determine whether a particular hedged item is transaction or time period related.

32. Participants who use zero cost collars strongly supported that the treatment should also be extended to those instruments. This would avoid arbitrary outcomes and artificial structuring incentives.

33. Some participants asked why combinations of options that include a written option but together (ie in combination) are a a zero cost collar or a *net* purchased option are not eligible hedging instruments.

34. Some financial institutions (in Africa, Asia Pacific and Europe) also believe that the proposed accounting treatment for time value of options should also be extended to forward points, when the forward points of foreign currency forwards are left undesignated. Many financial institutions in Asia have a very strong deposit base and invest funds in foreign currencies as they have more deposit funds than they can invest domestically. These banks enter into foreign currency swaps (commonly referred to as 'funding swaps') to hedge the FX risk of those funds invested in a foreign currency. Under IAS 39 today, the forward points create volatility in profit or loss and do not reflect the economic substance of the transaction. In particular, even if hedge accounting is achieved under IAS 39, the transaction is reflected as an FX hedge whereas the forward points are economically part of the interest margin (ie the economic character of forward points as the interest differential between currencies and hence the net interest margin is distorted using the hedge accounting model of IAS 39).

35. Some participants in Central and South America asked for additional guidance on how to distinguish between options and '*in substance'* forwards as it is common in this region to structure forward contracts as a combination of options.

Hedge effectiveness

Objective

36. Almost all participants support the removal of 80-125 per cent range for hedge effectiveness testing. Almost all participants also support the removal of the retrospective hedge effectiveness testing requirement.

37. A majority of participants support the objective based, prospective hedge effectiveness requirements. Some participants in Asia and Central America would like more stringent guidance. Some participants suggest that a

quantitative test should still be required while others support the two different effectiveness testing models (the current model of IAS 39 and the proposed model) depending on the sophistication of the risk management activities.

38. Almost all participants would like clarification on the meaning of 'unbiased' and 'minimising hedge ineffectiveness'. In particular, participants wanted clarification whether this requirement:

    (a) is one criterion or two criteria; and

    (b) whether it requires an entity to enter into a particular derivative that would involve less ineffectiveness but be more expensive than an other derivative that might involve more ineffectiveness but be less expensive (ie whether the requirements restrict the entity's choice of the actual derivative used in order to achieve hedge accounting).

39. Many also would like clarification on 'accidental offset' while others considered further elaboration unnecessary.

40. Some participants also seek to clarify whether perfect offset is required to qualify for hedge accounting. Some participants also would like further guidance on when a quantitative test is required.

41. Some participants in Western Europe would like to have the option to use the hypothetical derivative as described in US GAAP particularly in relation to consideration of credit risk and the use of deemed terms (ie using terms that differ from the actual exposure).

Rebalancing and discontinuation

Rebalancing

42. A majority of participants agree with the Board's proposal to require rebalancing and believe that it aligns better with risk management compared to IAS 39 today. Some participants think that the proposal eliminates current practice issues under IAS 39 today in relation to re- and de-designation of hedging relationships.

43. Many participants also seek clarification on instances where there is a change in trend and for which—if considered a purely mathematical optimisation—rebalancing would be required but for risk management purposes the entity does not rebalance. This could be related in particular to aspects such as lot size of derivatives, the cost of adjusting a hedge position or immaterial effects that are below the materiality threshold that risk management considers for revisiting decisions. Some participants also believe that mandatory rebalancing would be onerous on systems.

44. Some participants in Africa, Europe and Asia Pacific would like more guidance on how to differentiate fluctuations versus change in trend of economic relationship between the hedged item and hedging instrument. However, other participants think that this is inevitably a judgemental area and should be left to management exercising its own judgement.

Discontinuation

45. Many participants seek clarification on the requirement on mandatory discontinuation. The ED proposes that an entity should only discontinue hedge accounting when it no longer reflects the risk management strategy. Many participants seek clarification on which level of risk management strategy the ED refers to, ie whether at the hedging relationship level or some higher level.

46. Many participants in Africa, Northern and Western Europe and some in Asia Pacific and North America believe that an entity should have the ability to voluntarily discontinue hedge accounting. They believe that it is an option to apply hedge accounting and that it should also be an option to discontinue. However, others agreed that against the background of the proposed objective of hedge accounting revoking the designation of a hedging relationship at will would be inappropriate. Those participants recommended clarifying that a change in the risk management objective is the entity's decision but that hedge accounting should then follow that decision (ie not involve discretion at the accounting level).

Groups and net position

47. Most participants welcome the Board's proposals to permit groups and net positions to be eligible hedged items.

48. Most participants believe that the proposals will enable entities to portray management's hedging strategy better in many more situations than today. In particular, many participants emphasised that in many situations entities manage their risk exposure on a group or a net basis rather than on a transaction by transaction basis. Participants from non-financial entities emphasised that this applies also to them and not only to financial entities (see also the section on macro hedging below).

49. However, many participants would like the Board to extend the eligibility to hedge net positions to cash flow hedges for items in the group that would affect profit or loss across multiple financial reporting periods. While many participants understand the Board's rationale for not permitting cash flow hedging for net positions for which the hedged items affect different periods many of them are of the view that if the entity does economically hedge on a net cash flow basis across multiple financial reporting periods, then cash flow hedges of net position should be permitted since the objective of the ED is to better reflect the entity's risk management activities.

50. Almost all participants that are financial institutions and also a some non-financial institutions would like the Board to further explore extending the proposals to allow for hedges of dynamic net positions (see paragraph 79) .

Presentation and disclosures

Fair value hedge mechanics

51. While most participants understand the Board's rationale for presenting the fair value hedge adjustment as a separate line item on the balance sheet and leaving the carrying amount of the hedge item unaffected, preparers (particularly financial institutions) are concerned with the additional number of line items that

will result on the balance sheet. Some preparers suggest presenting one single line item on the balance sheet for all fair value hedge adjustments and then disclosing in the notes a breakdown of the adjustments.

52. In relation to the statement of comprehensive income, some preparers prefer the current fair value hedge mechanics (ie only presenting hedge ineffectiveness in profit or loss without any effect on other comprehensive income (OCI)) and suggest that the offsetting changes in fair value of the hedge item and the hedging instrument could be disclosed in the notes. Some preparers also believe that presenting the changes in the value of the hedging instrument and the hedged item in OCI would create additional operational complexity.

53. Many participants do not see a clear rationale for the increased use of OCI. This typically is a more general comment, though. Hence, many participants are also concerned with the inconsistent use of OCI and think the Board should fundamentally address the purpose of OCI.

54. Users who participated in the Africa, Europe and Asia outreach prefer transparency and gross presentation and hence are supportive of the Board's proposal to present the fair value hedge adjustment as a separate line item and the proposed gross presentation of the changes in fair value of the hedged item and hedging instrument in OCI.

Linked presentation

55. Participants in Korea are of the view that linked presentation should be allowed for fair value hedges. They are of the view that without linked presentation financial reporting could induce adverse decision making by some entities to not hedge FX exposures. These participants believe that hedged assets and liabilities produce a net cash flow because their cash flows are offset at the same time hence are interconnected and hence linked presentation should be allowed. These participants believe that without linked presentation, the balance sheet of entities that hedge economically would be volatile compare to entities that do not hedge—even if fair value hedge accounting is achieved. They believe that without linked presentation leverage ratios are overstated and would hence

distort comparability, unduly affect debt covenants and mislead management's decision making. In their view, without linked presentation accounting also creates an adverse impact on the ability of these companies to win customer contracts.

Disclosures

56. Most participants agree with the Board's objective for the proposed disclosures. They believe that it would provide more clarity on how an entity applies hedge accounting and increase transparency.

57. However, some preparers are concerned that the proposed disclosure requirements would result in an excessive amount of information disclosed. Some preparers are concerned with the commercial sensitivity of the information being required to be disclosed in relation to the timing and uncertainty of cash flows. However, other preparers do not share these concerns as they are already disclosing such information to investors as part of their non-GAAP information. Also, some preparers believe that robust and informative disclosures as proposed in the ED are an appropriate context of a more business and risk management focused hedge accounting model. Other preparers are of the view that the extent and sensitivity of the disclosure requirements could influence their decision to not apply hedge accounting.

58. Users are broadly supportive of the disclosures and are of the view that information in relation to the timing and uncertainty of cash flows would be very useful especially as inputs for their own modelling purposes. However, users have also raised concerns that some of the disclosure requirements might be too commercially sensitive.

Alternatives to hedge accounting

Accounting for a contract for a non-financial item that can be settled net in cash as if it were a derivative

59. Some participants in Africa, Europe, Canada and Australia want clarification on the scope of the proposed change and whether this would affect contracts that cannot be settled net in cash. Some participants in Asia and Canada would like this to be extended to a fair value based management strategy where the net position is not managed to be close to zero.

60. A participant in Asia does not like to apply the proposal due to the effect on the presentation of the income statement even though they do manage on a fair value basis. This participant would prefer their risk management strategy be accommodated within hedge accounting because they do not want their margin to be presented as a fair value change.

61. Some participants in Europe thought it should be clarified that except for a fair value based business strategy the own use scope exception is not changed.

Accounting for credit risk using credit derivatives

62. Almost all financial institutions are disappointed that the Board did not propose a solution in the ED for hedges of credit risk. Financial institutions think that the current accounting grossly distorts the financial effects and mischaracterise the financial performance and position of entities that hedge credit risk using credit derivatives. Analysts in the banking industry are of the same view and similarly frustrated.

63. Some participants would like that a solution be found within the hedge accounting framework. They suggest that credit risk might be measurable for bonds and some would consider extending that to loans. They believe that designating a risk component is appropriate in this circumstance and that the Board should not introduce complicated alternatives. Some in Europe consider it inconsistent that the Board has required separate identification of credit risk for the purposes of liabilities measured under the fair value option (FVO) in

IFRS 9 *Financial Instruments* but states that this measure is not sufficiently reliable to support hedge accounting.

64. Other participants are of the view that due to differences between the credit derivative and the hedged item (loans, loan commitments or bonds), measuring the fair value change that is directly attributable to changes in credit risk of the hedged item is by no means straightforward. The different elements/characteristics of the hedged item increase the complexity of measuring credit risk. These participants believe that using risk components would not provide a reliable solution (if the risk components criteria are applied properly) but instead consider that alternative 3 discussed in the basis for conclusions would be the most operable alternative and that it could accommodate almost all of the financial products for which credit risk is hedged.

65. Participants have also commented that the difference in the accounting treatment of the measurement change adjustment (MCA) for loans and loan commitments discussed in the basis for conclusions would add operational complexity and hence suggest that the treatment of the MCA should be consistent for both loans and loan commitments.

Other issues

Fair value through other comprehensive income

66. Many participants are of the view that hedge accounting should also be available for financial instruments that are classified as fair value through other comprehensive income.

67. These participants think that the economic hedges for either foreign currency risk or price risk for the equity instruments classified in the FVTOCI category should be accommodated in the final requirements. By not allowing hedge accounting, it the ED does not reflect the entity's risk management strategy.

68. Many participants understand the technical difficulty that the Board faces in relation to permitting hedge accounting for the FVTOCI category of financial

instruments. Some participants propose that for this category of financial instruments hedge ineffectiveness could be presented in OCI since there is one overall performance statement. Other participants propose that if the fair value change in the hedging instrument is more (less) than the hedged item, hedge ineffectiveness could be presented in profit or loss (OCI). Others think that for equity instruments measured at FVTOCI recycling should be allowed to eliminate the tension with recognising hedge ineffectiveness.

Transition

69. Many participants in Australia and New Zealand would prefer a transition approach that allows for retrospective application for some aspects of the new hedge accounting model—particularly the proposed treatment for the time value of options. Some participants also would like to retrospectively re-designate hedging relationships based on the new final requirements.

Net investment hedging

70. Some participants in Africa and Asia Pacific and Europe are disappointed that the ED did not address hedges of net investments in a foreign operation and dividends from foreign subsidiaries.

71. Some participants in Western and Northern Europe are disappointed that the Board did not address the issue of hedging specific line items of forecasted 'profit or loss accounts' or hedging a portion of aggregated balanced sheets when both are in a foreign currency different to the functional currency of the reporting entity.

Highly probable forecast transactions

72. There are instances where highly probable forecast transactions fail hedge accounting when there is a delay in the timing of the transaction, eg due to production delays. Under IAS 39 today, hedge accounting is discontinued for these transactions while for risk management purposes many entities may roll over the hedges for risk management purposes. Participants in Australia,

Northern and Western Europe believe that in these situations hedge accounting should be accommodated. The feedback also revealed that the exact scope of hedged items to which the restrictions regarding changes in the timing of future cash flows apply are ambiguous (and that the rationale for those restrictions is unclear).

Basis swaps

73. Under IAS 39, basis swaps do not meet the definition of a cash flow hedge or a fair value hedge and hence hedge accounting cannot be applied (unless basis swaps are used in combination with other derivatives such that in combination they qualify as a hedging instrument). Participants in Asia Pacific have commented that final hedge accounting requirements should also accommodate basis swaps as qualifying hedging instruments.

Embedded Derivatives

74. Some financial institutions in Western and Northern Europe would like to have the possibility of separating embedded derivatives when these are subject to economic hedging using a freestanding derivative. This issue has been raised by some financial institution granting loans with embedded caps, floors or collars who argue that the IFRS 9 model creates an accounting mismatch because the embedded derivative is not subject to separation (and the host financial asset is measured at amortised cost) while the hedging derivative is measured at fair value through profit or loss.

Internal Derivatives

75. Many participants (in particular financial institutions and large conglomerates) would like to have the possibility of designating internal derivatives as hedging instruments.

Cooperation with the FASB / convergence

76. A number of participants noted that the IASB proposals were very different from the proposals of the US Financial Accounting Standards Board (FASB). There was a concern that the IASB proposals might be delayed or 'diluted' if the hedge accounting project would be conducted jointly with the FASB.

77. In addition, a major criticism was that the IAS 39 hedge accounting model was in effect a copy of a US centric hedge accounting model and that that model implicitly discriminates against economies that have significant differences regarding aspects such as the most important risk exposures, market structures, and hedging strategies. Also, many participants in Asia and some in Latin America were concerned that the US centric hedge accounting model implicitly discriminates against 'less developed' financial markets. That also gives rise to a concern that a joint project with the FASB would again create a bias towards a US centric hedge accounting model and result in 'marginalising' areas outside of the US (and Europe).

78. Overall, most participants commenting on this issue were against a convergence approach for hedge accounting with the FASB with the sole exception of entities that expect to apply US GAAP in the future but would like to have the hedge accounting model proposed by the IASB available to them.

Macro hedging

79. All financial institutions participants are looking forward to the Board's macro hedging work stream and have raised the following as the main issues that the Board should address:

    (a) prepayment options;

    (b) core deposits; and

    (c) dynamic hedging strategies.

80. Some corporate participants also have a dynamic risk management strategy for both financial and non-financial items and hence are also looking forward to the

upcoming ED on macro hedging. Many non-financial entities are concerned that the macro hedge accounting debate could end up inappropriately biased towards financial institutions.