STAFF PAPER

27 February – 2 March 2012

IASB Meeting

Project	Macro Hedge Accounting		
Paper topic	Cover Paper		
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Overview

1. This purpose of this paper is to:

   (a) provide a project overview of the status of the macro hedge accounting project;

   (b) summarise the agenda papers to be discussed for the February 2012 IASB meeting;

   (c) provide an outlook regarding further topics to be discussed.

Project overview

2. The objective of this project is to develop an accounting solution for situations in which an entity manages continuously changing risk positions at an aggregated level (ie risk management of a net risk position for a particular type of risk in an open portfolio—"macro hedging").

3. The current *fair value hedge accounting for a portfolio hedge of interest rate risk* in accordance with IAS 39 represents an exception to the general hedge accounting requirements. Hence, it was not addressed when developing the general hedge accounting requirements for IFRS 9. However, even with the exception there are significant tensions between accounting and risk management (see paragraph 6) that are addressed with this project.

4. To date there are no tentative decisions for this project.

Outreach activities

5. To support the discussion of risk management for macro hedge accounting the staff and board members are discussing risk management aspects related to open portfolios with interested parties from various regions. As part of those discussions an education session with representatives from the banking industry was held in June 2011.

Status of the project

6. On the basis of research and the outreach activities described above, tensions between common interest rate risk management practice in the financial services industry and current accounting requirements were identified. Those relate to the following areas:

   (a) Risk management strategies are based on a net open portfolio as unit of account.

   (b) The focus is on net interest margin as the hedged risk.

   (c) Management of cash flow optionality (eg prepayments) is based on expected cash flows and layering approaches at a portfolio level.

   (d) Multi-dimensional targets are set for the risk management activities.

7. Consistent with the board's broad objective for hedge accounting of improving the decision usefulness of information about hedging activities, the target is to create within the general IFRS accounting framework a model that reflects how businesses deal with risk for open portfolios. For that a *valuation approach* is used, ie the hedged risk position is identified and measured through profit or loss for accounting purposes.

8. The advantages of this approach are:

   (a) The valuation of the risk position through profit or loss in combination with explanatory disclosures regarding the factors and inputs for this valuation increase transparency regarding the actual business and risk management activities.

(b) A business oriented model enables economic volatility to be more accurately portrayed rather than reflecting volatility that arises from applying a hedge accounting model that is inconsistent with risk management activities.

(c) It increases the possibility of using data already available for risk management purposes, rather than imposing system and data collection requirements solely for accounting purposes.

9. However, risk management practice for open portfolios involves management judgement. Therefore, the more closely accounting relates to risk management the more that judgment affects the financial statements. This creates a trade-off regarding the objective to develop a transparent macro hedging model, which has to be addressed.

10. For the discussion of the valuation approach full fair value measurement was used as a starting point. From there 11 steps were identified that reflect the main differences between full fair value measurement and common interest rate risk management practice. Those steps are currently being discussed by the Board as a basis for a future decision about which of those risk management features could be appropriately included in the accounting model.

11. The discussion of the 11 steps can be grouped into four areas:

(a) Accounting mechanics.

(b) Valuation of the risk position.

(c) Scope of the risk position (including hedging instruments).

(d) Risk management targets.

Outlook

12. In addition to the continued discussion of the 11 steps, the following areas are expected to be covered as the project progresses:

(a) Presentation and disclosures.

(b) Expansion of the model to risks other than interest rate risk and applying macro hedging approaches to industries other than financial institutions.

(c) Whether application should be mandatory.

(d) Transition to the new accounting model.

13. The appendix of this paper includes a more detailed project overview.

This meeting

14. For this meeting one paper has been prepared:

(a) **Agenda paper 11A** provides an overview of accounting alternatives reflecting the discussions to date. The focus is on the valuation of the risk position as well as the accounting mechanics.

Appendix: Project Overview

Legend

Green: *Discussed*

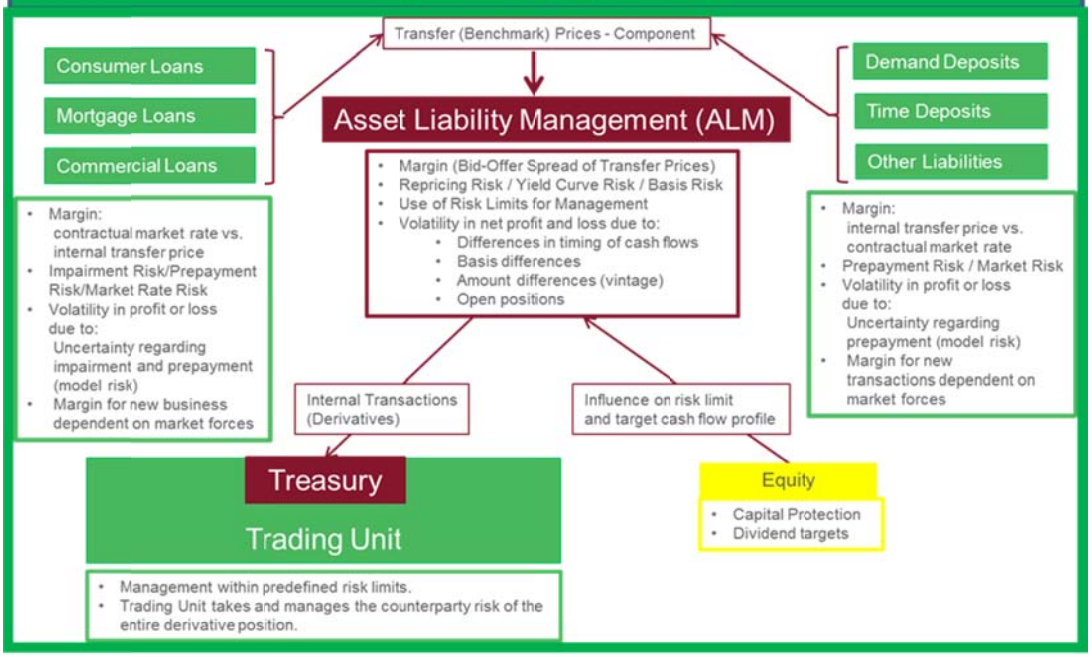
Yellow: *Initial discussion, follow up required*

Blank: *Not discussed yet*

Project Overview
Macro Hedge Accounting

Pre-Considerations
Papers 14 to 14B (Sep 2010) / 10 to 10D (Nov 2010) / 6 to 6B (Apr 2011)

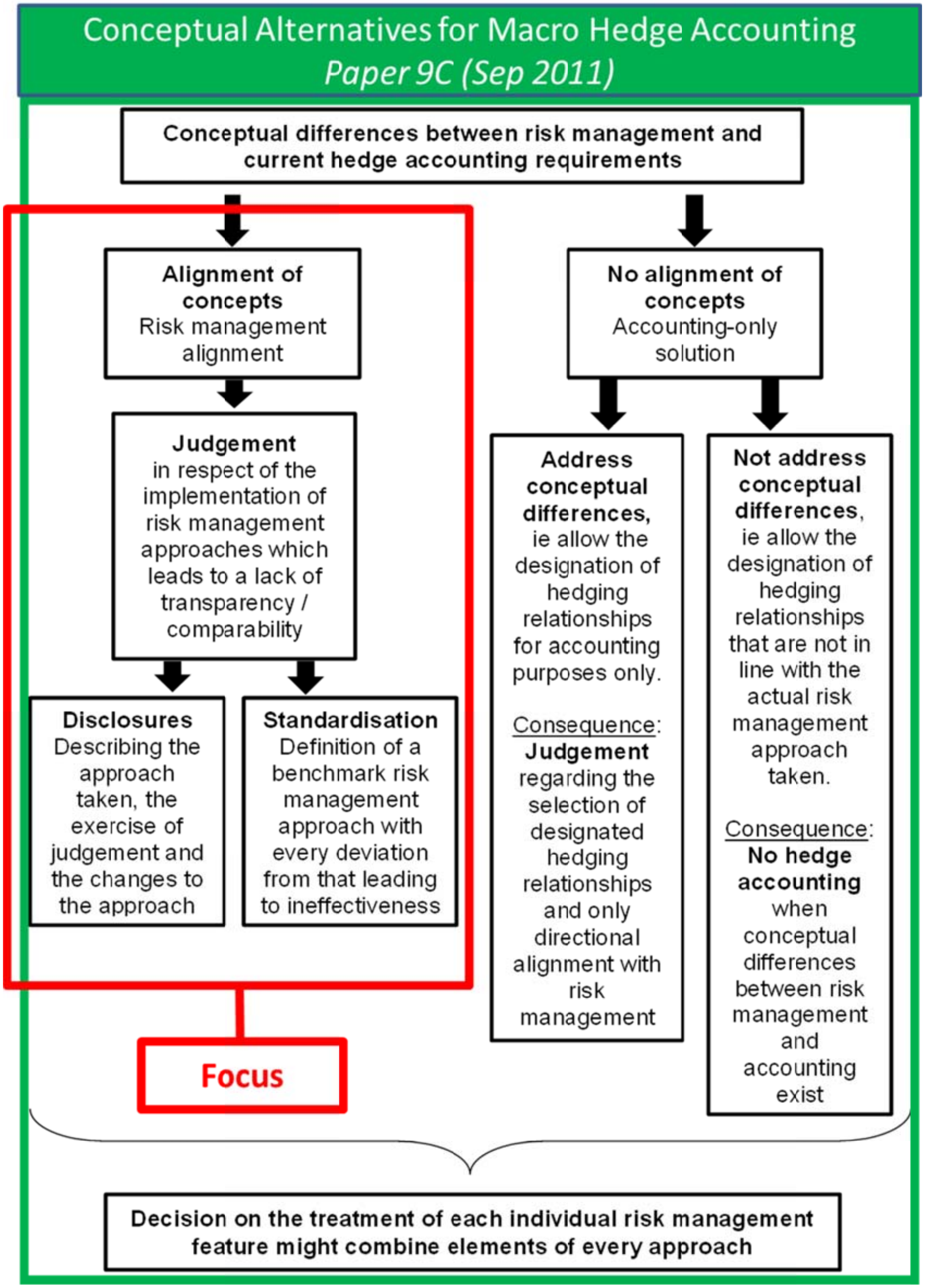
Outreach Activities
Interest Rate Risk Management of Financial Institutions
Education Session – Papers 5 to 5B (Jun 2011) / Paper 9A (Sep 2011)

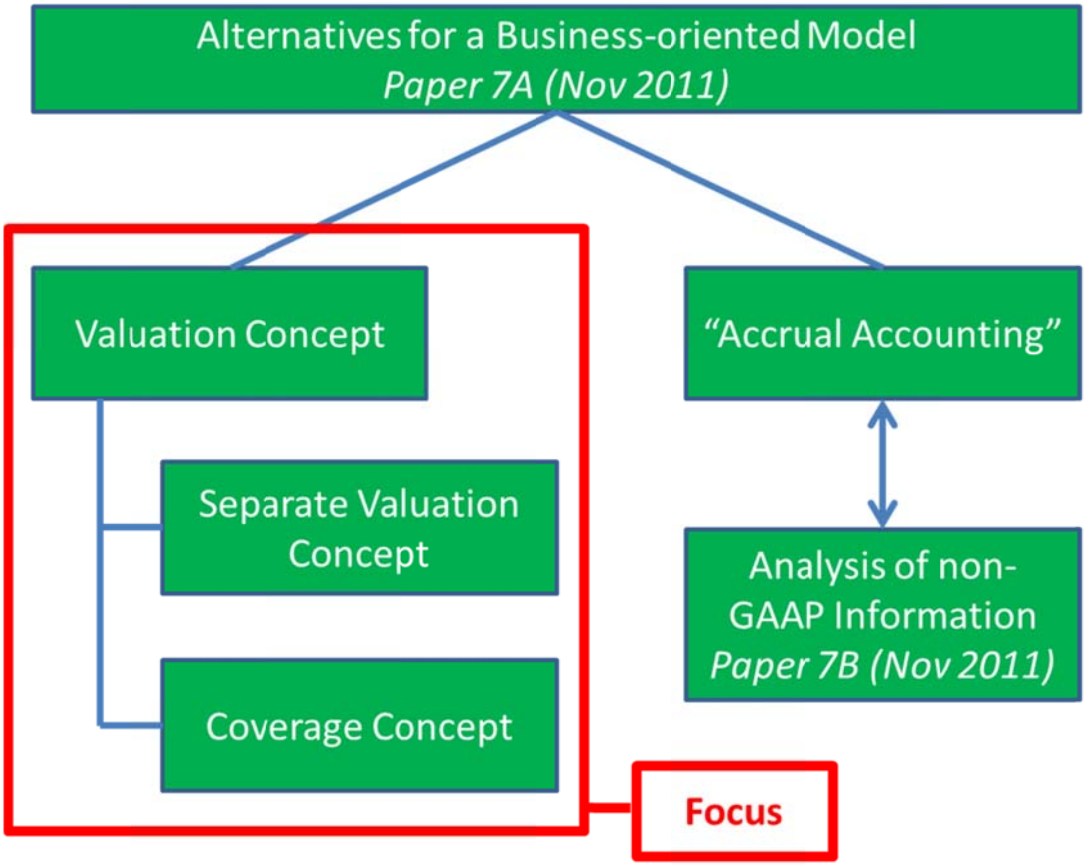


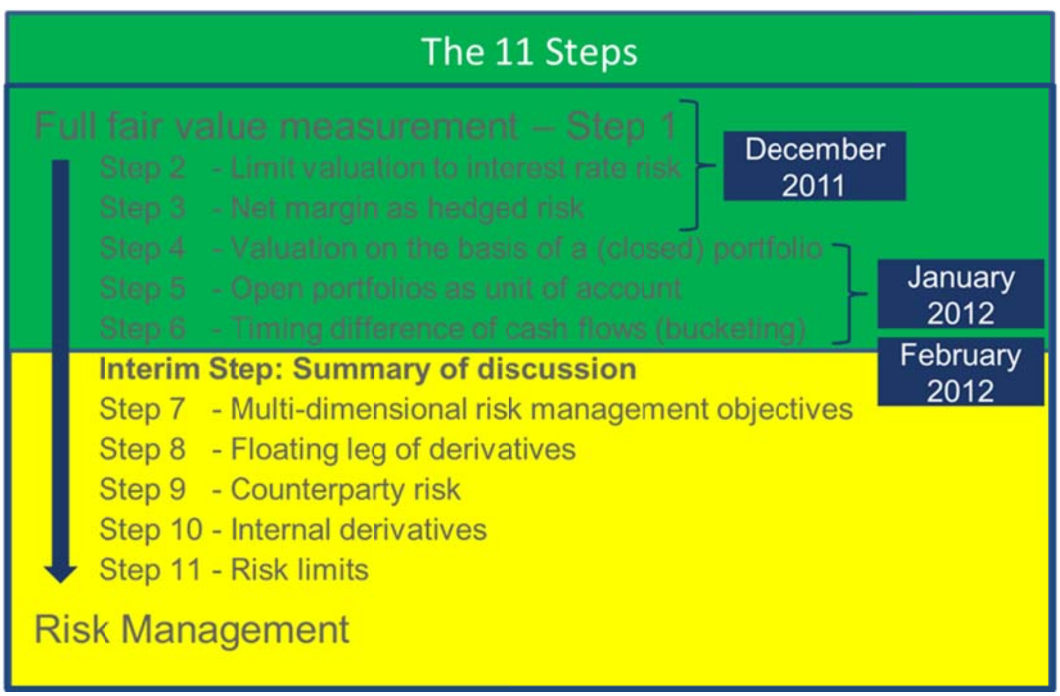
Tensions between Risk Management and Accounting
Paper 9B (Sep 2011)

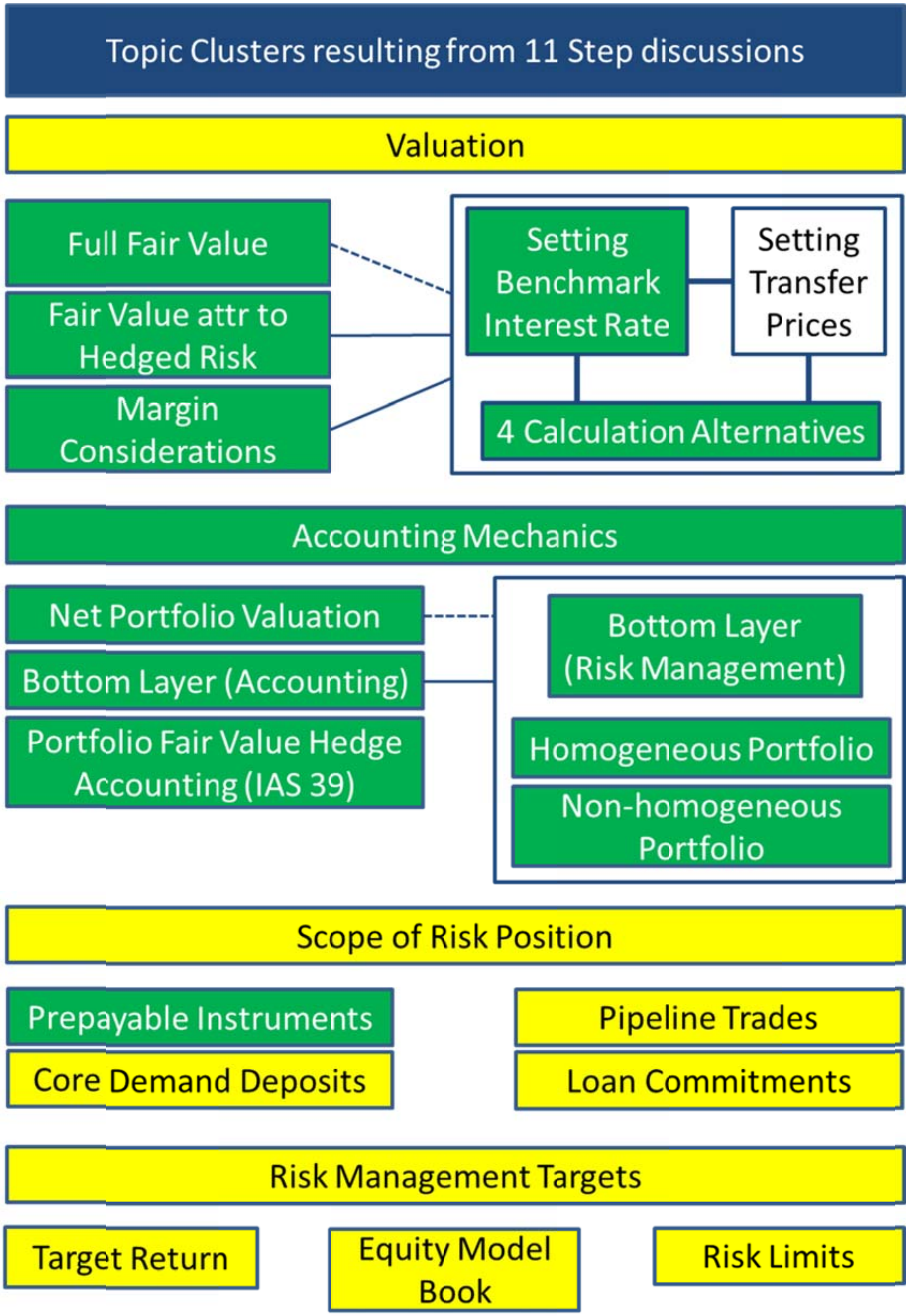
Net Open Portfolio as Unit of Account
Risk Management focus on Net Interest Margin
Management of Optionality based on expected Behaviour
Multi-dimensional Targets on Portfolio Level

Conceptual Alternatives for Macro Hedge Accounting
Paper 9C (Sep 2011)


Conceptual Alternatives for Macro Hedge Accounting
Paper 9C (Sep 2011)
Conceptual differences between risk management and current hedge accounting requirements
Alignment of concepts
Risk management alignment
No alignment of concepts
Accounting-only solution
Judgement in respect of the implementation of risk management approaches which leads to a lack of transparency / comparability
Address conceptual differences, ie allow the designation of hedging relationships for accounting purposes only.
Consequence: Judgement regarding the selection of designated hedging relationships and only directional alignment with risk management
Not address conceptual differences, ie allow the designation of hedging relationships that are not in line with the actual risk management approach taken.
Consequence: No hedge accounting when conceptual differences between risk management and accounting exist
Disclosures
Describing the approach taken, the exercise of judgement and the changes to the approach
Standardisation
Definition of a benchmark risk management approach with every deviation from that leading to ineffectiveness
Focus
Decision on the treatment of each individual risk management feature might combine elements of every approach


Alternatives for a Business-oriented Model
Paper 7A (Nov 2011)
Valuation Concept
Separate Valuation Concept
Coverage Concept
"Accrual Accounting"
Analysis of non-GAAP Information
Paper 7B (Nov 2011)
Focus


The 11 Steps
Full fair value measurement – Step 1
Step 2 - Limit valuation to interest rate risk
Step 3 - Net margin as hedged risk
December 2011
Step 4 - Valuation on the basis of a (closed) portfolio
Step 5 - Open portfolios as unit of account
Step 6 - Timing difference of cash flows (bucketing)
January 2012
Interim Step: Summary of discussion
February 2012
Step 7 - Multi-dimensional risk management objectives
Step 8 - Floating leg of derivatives
Step 9 - Counterparty risk
Step 10 - Internal derivatives
Step 11 - Risk limits
Risk Management


Topic Clusters resulting from 11 Step discussions
Valuation
Full Fair Value
Fair Value attr to Hedged Risk
Margin Considerations
Setting Benchmark Interest Rate
Setting Transfer Prices
4 Calculation Alternatives
Accounting Mechanics
Net Portfolio Valuation
Bottom Layer (Accounting)
Portfolio Fair Value Hedge Accounting (IAS 39)
Bottom Layer (Risk Management)
Homogeneous Portfolio
Non-homogeneous Portfolio
Scope of Risk Position
Prepayable Instruments
Core Demand Deposits
Pipeline Trades
Loan Commitments
Risk Management Targets
Target Return
Equity Model Book
Risk Limits

Further Topics

Hedging Instruments
Paper 7A (Nov 2011)

- Internal Derivatives
- Other Aspects

Presentation
Paper 7A (Nov 2011)

- Adjustment to Carrying Value
- Other Comprehensive Income
- Deferred Income
- by Contract/Transaction
- by Class of Transaction
- for entire Risk Position

Disclosures

Consideration of Other Risks

Macro Hedging Approaches applied in Other Industries

Application

- Mandatory
- Voluntary

Transition

- Effective Date
- Comparative Information
- Discontinuation of previous Hedges