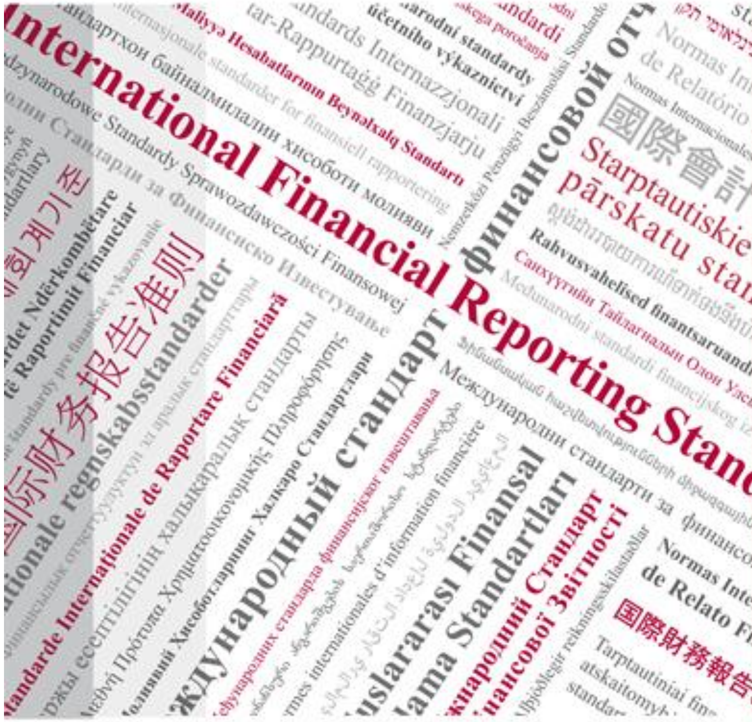
International Financial Reporting Standards



GPF meeting, March 2014
Agenda paper 2

Financial instruments: Accounting for macro hedging (Global Preparers Forum meeting)

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

IFRS

Purpose of the meeting

- Overview of the project
- Seek input from participants on whether the considerations in the accounting for macro hedging project about dynamic risk management for interest rate risk is applicable to other types of risks (eg commodity price risk)

What are the problems today?

- IFRS 9/IAS 39 **static** hedge accounting (HA) is not developed to represent **dynamic** risk management (RM) of **open** portfolios.
- Limitations of HA requirements for dynamic RM include:
  - One-to-one static designation
  - Designation only on a **gross** basis (RM looks at the **net** risk position)
  - Inability to include exposures on a **behaviourised** basis (eg core demand deposits)
- The lack of an appropriate accounting model has caused problems in transparency (eg HA solution with the aim of stabilising P/L) and in operational feasibility (eg repeated discontinuations and designations).

IFRS

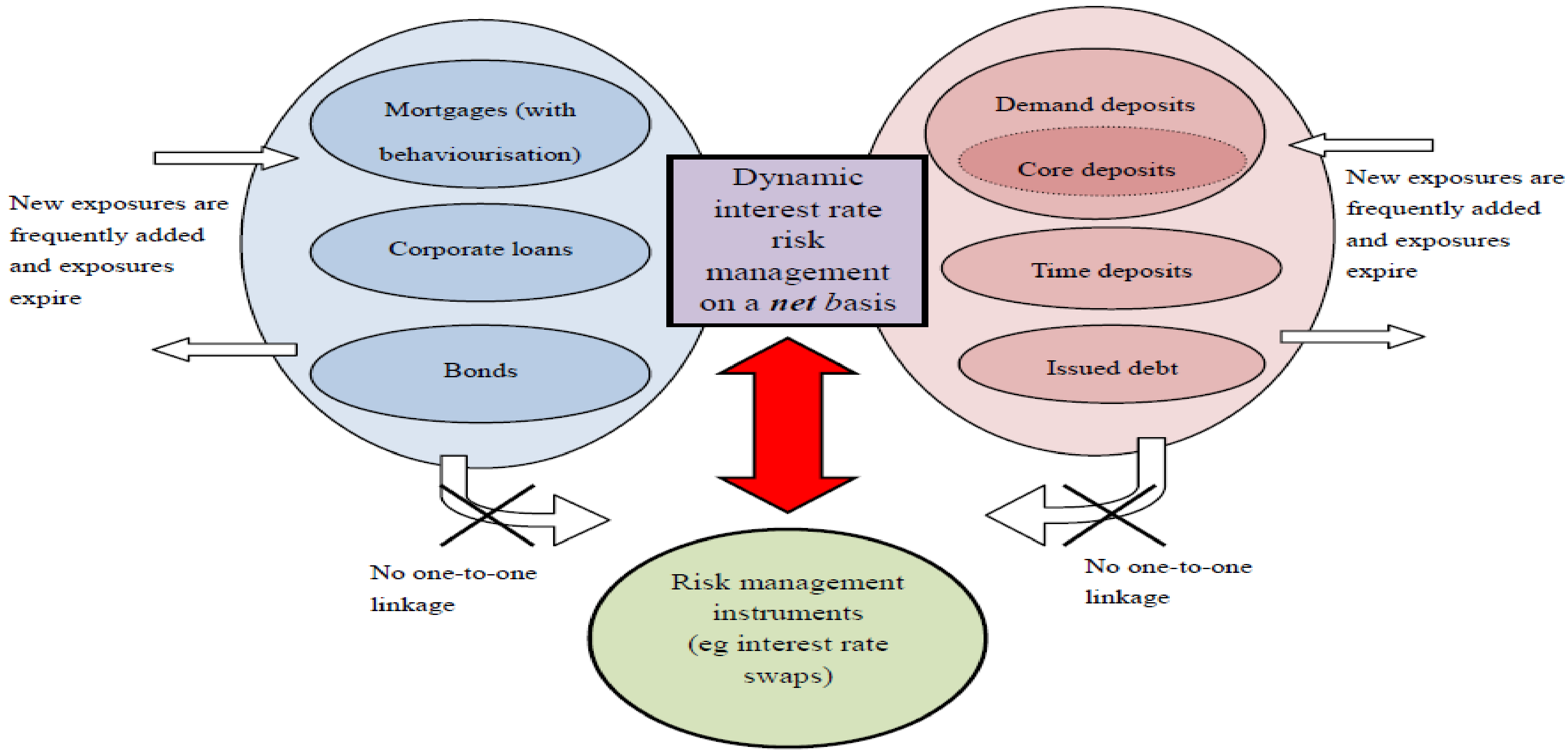
The purpose of the project

- Develop an accounting solution that:
  - provides useful information on how entities manage risk dynamically; and
  - is operationally feasible
- So far, focused on interest rate RM in banks, because it is a well-known example.
- However, consideration includes an accounting solution for a variety of dynamic RM activities such as commodity price and FX risk in corporates.
- The Discussion Paper (DP) is expected in Q1 2014.

Dynamic RM

- Major characteristics of dynamic RM include:
  - ✓ RM is undertaken for open portfolio(s), to which new exposures are frequently added and existing exposures expire.
  - ✓ As the risk profile of the open portfolio(s) changes, RM is updated frequently in reaction to the changed net risk position.

Dynamic interest rate RM in banks



The purpose of dynamic RM is usually to manage
Net Interest Income

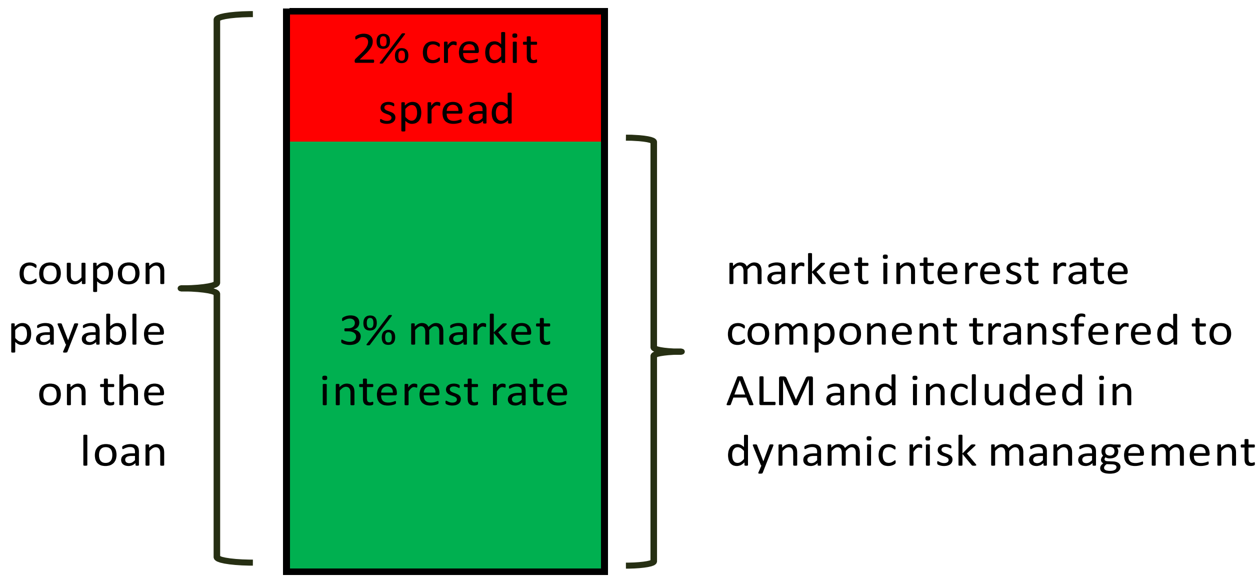
Portfolio revaluation approach (PRA)

- Main features of the approach include:
  - Exposures are revalued with respect to the managed risk, while RM instruments (derivatives) remain at fair value through profit or loss.
  - To the extent that economic offsetting risk positions exist, reflected in profit or loss.
  - No one-to-one designations.

- **NOT** a full fair value model
  - Only remeasured for managed risk (eg interest rate risk)

Portfolio revaluation adjustment

- Exposures are **revalued** by calculating net present value (NPV) of cash flows based on the **managed risk**



- Customer margin (eg credit spread) is not included in the portfolio revaluation approach. This approach is **NOT** a full fair value model.

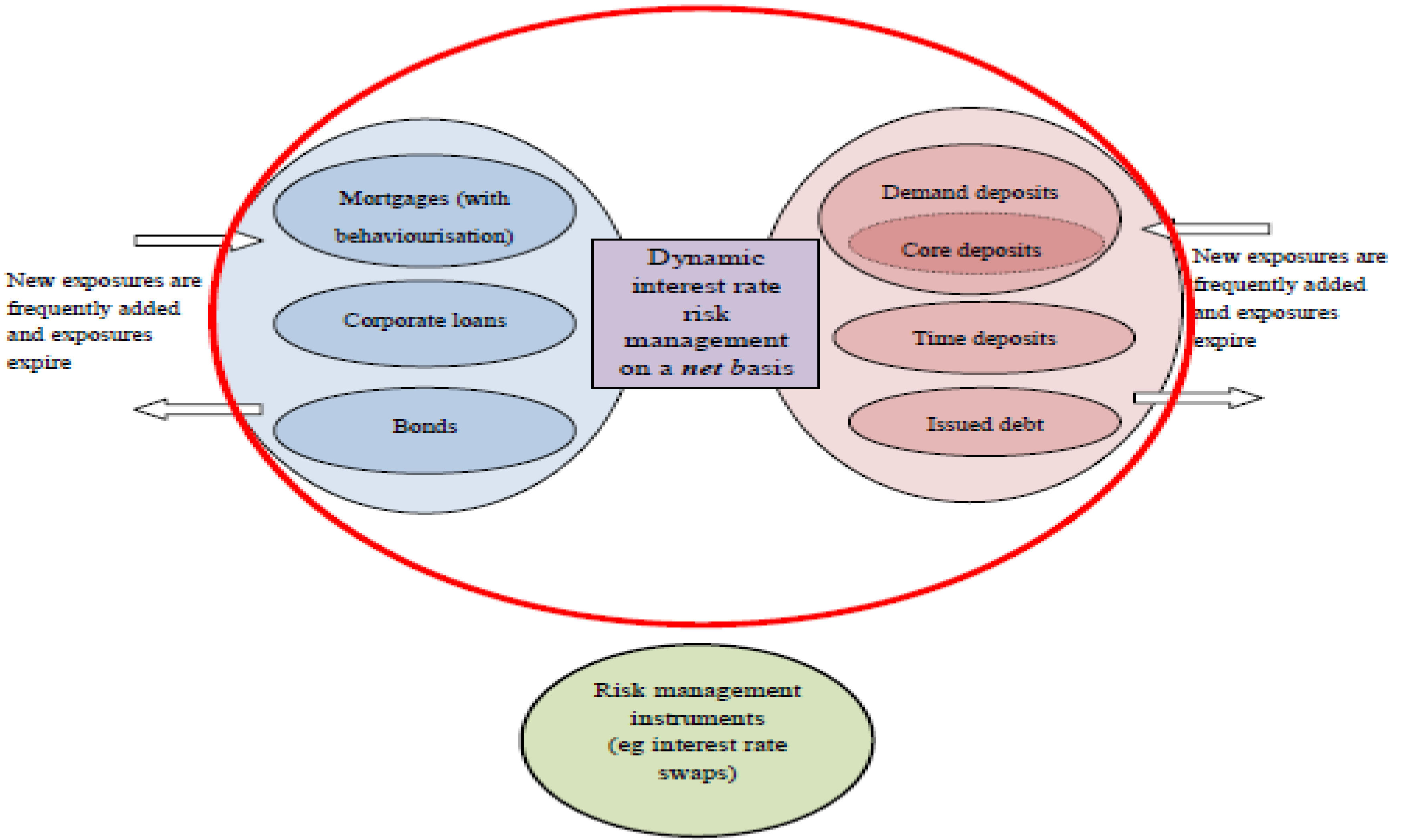
‘Core’ demand deposits

- At a portfolio level, the ‘sticky’ nature of demand deposits leads to the identification of a stable portion in the amount outstanding.
- These **core demand deposits** are deemed as **fixed rate deposits** with longer maturities for risk management purposes (behaviourisation).

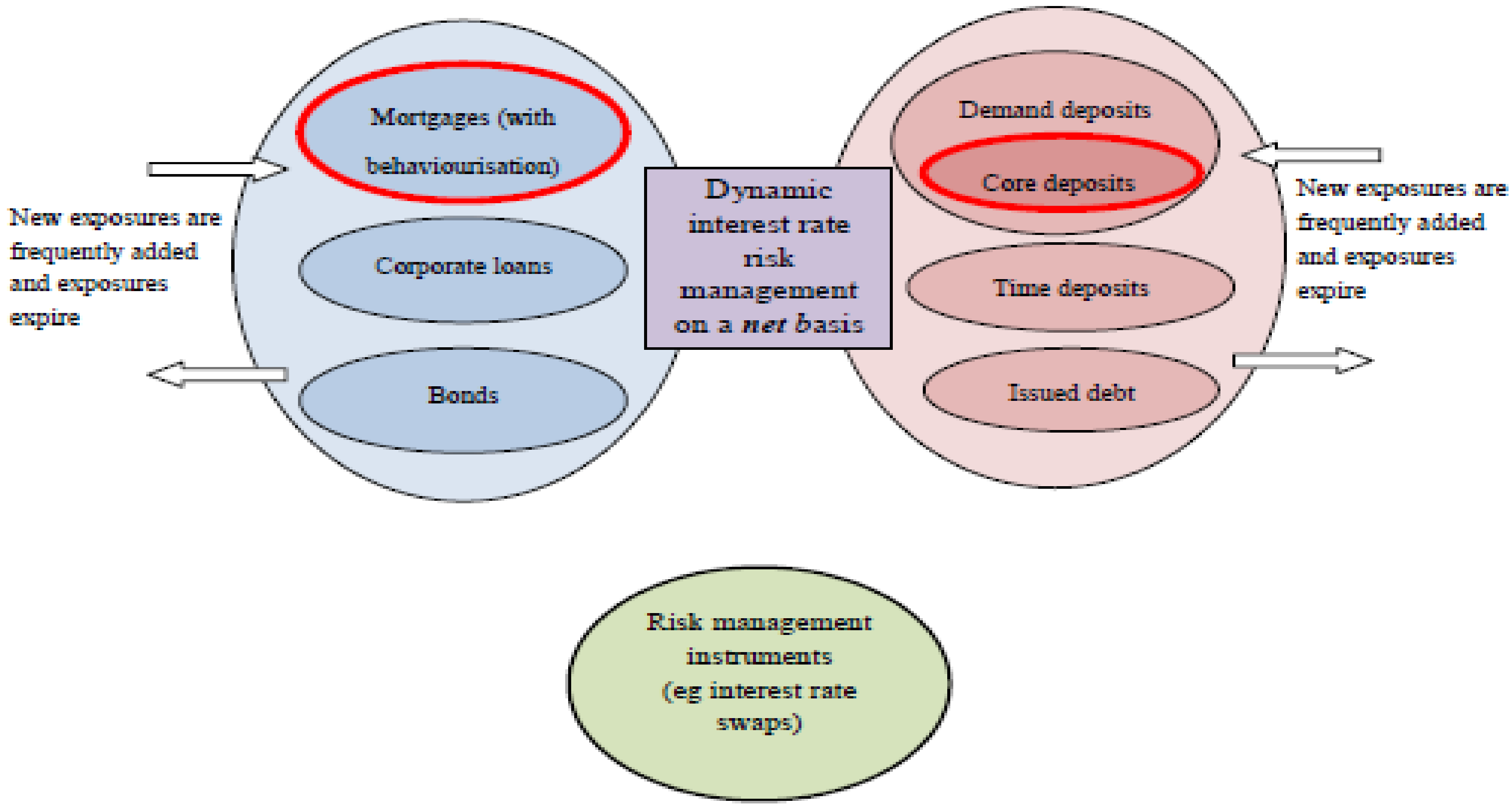
Scope of the PRA

- The scope has significant implications for the information provided to users of financial statements and on how operationally feasible for preparers the application of the PRA will be.
- Alternatives:
  – Focus on dynamic risk management
  – Focus on risk mitigation (sub-portfolio approach, proportional approach)

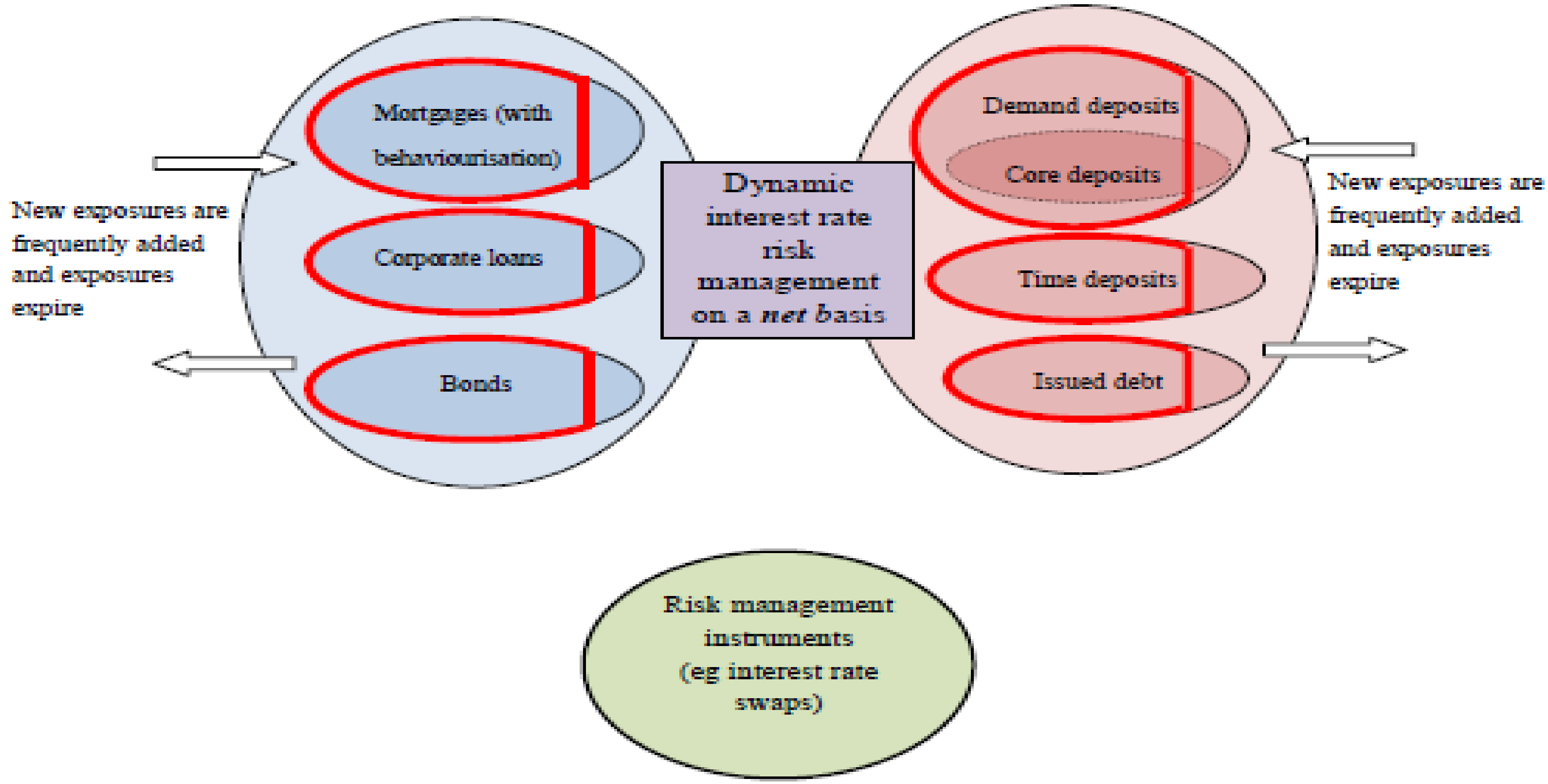
Scope – focus on dynamic RM



Scope –focus on risk mitigation (sub-portfolio)



Scope – focus on risk mitigation (proportion)

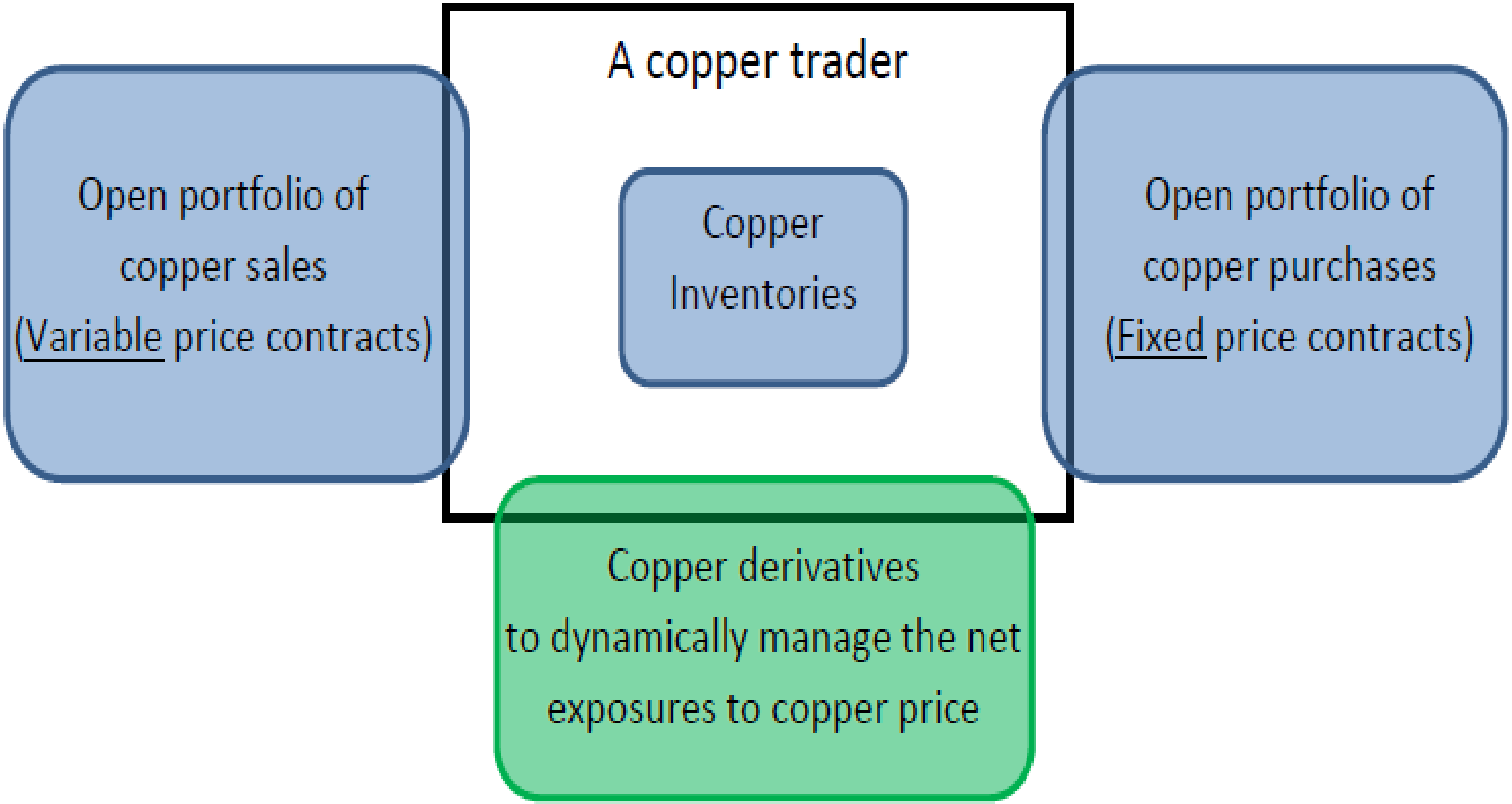


Questions
(risks other than interest rate risk)

- Any good examples for dynamic RM for other risks?

- Is there a need for the PRA to be available for dynamic RM of all entities (ie other than the dynamic interest rate RM of banks) ?

Commodity price RM



Commodity price RM (continued)

- For example, commodity price risk may arise from purchases and sales (and inventory).
- The pricing of both purchases and sales contracts are based on the market price of the commodity.
- In this case, RM activity might focus on pricing mismatches in purchases and sales (and inventory).