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Australian Government
Australian Accounting Standards Board

Financial Instruments

Macro Hedge Accounting December 2011

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Macro hedge accounting

- Macro hedging = hedging an open portfolio
- eg. Management of a net interest margin by banks
- On 31 March 2004 the IASB issued an amendment to IAS 39
- The general objective of the amendment was to simplify the implementation of IAS 39 by enabling fair value hedge accounting for a portfolio hedge of interest rate risk.
- EU Carve out of IAS 39 permitted hedging core deposits – not permitted by full IAS 39



Current status

- IASB discussions continued at November meeting
- IASB Staff provided educational sessions
- One tentative decision made at the November 2011 meeting, that derivatives should be measured at fair value and the change in accounting should be made to the risk position
- No decision has been made whether adjustment is to balance sheet or OCI



Example – macro hedging

Example portfolio - for interest rate risk

- Fixed and floating financial assets (including prepayable)
- Fixed and floating liabilities (including prepayable)
- External derivatives and non-derivatives
- Internal derivatives and non-derivatives
- Core deposits (on demand but with expected “stickiness”)
- Pipeline trades (constructive obligations to offer products)

Objective: stabilise/optimize net interest margin



Risk management activities

- Gap analysis – comparing interest bearing items by allocating to time buckets by maturity/next repricing date
- Value at risk – maximum adverse deviation in value for a certain confidence level over a time horizon
- Earnings at risk – maximum adverse deviation in net interest income for a particular confidence level and time horizon.
- Duration – price sensitivity of fixed rate financial instruments on the basis of predefined changes in interest rates
- Risk limits – set for a predefined corridor (may use more than one limit)



Macro hedge accounting

Fair value hedge approach: IAS 39 AG114 - AG132

- Items allocated into expected rather than contractual re-pricing time buckets
- Financial assets OR financial liabilities designated
- Change in fair value not required to be allocated to individual items
- If prepayment is other than expected - ineffectiveness
- Demand deposits not eligible for designation



Macro hedge accounting

Cash flow hedge approach: IAS 39 IG F6.2 & F6.2

- Generally easier to apply cash flow hedge accounting
- Can allocate cash flows into time buckets and hedge “first cash flows” in a given time bucket
- Prepayment risk may not lead to ineffectiveness
- Depends on whether sufficient floating rate financial instruments available
- Banks with significant fixed rate mortgage assets may not be able to designate all hedging derivatives as cash flow hedges.

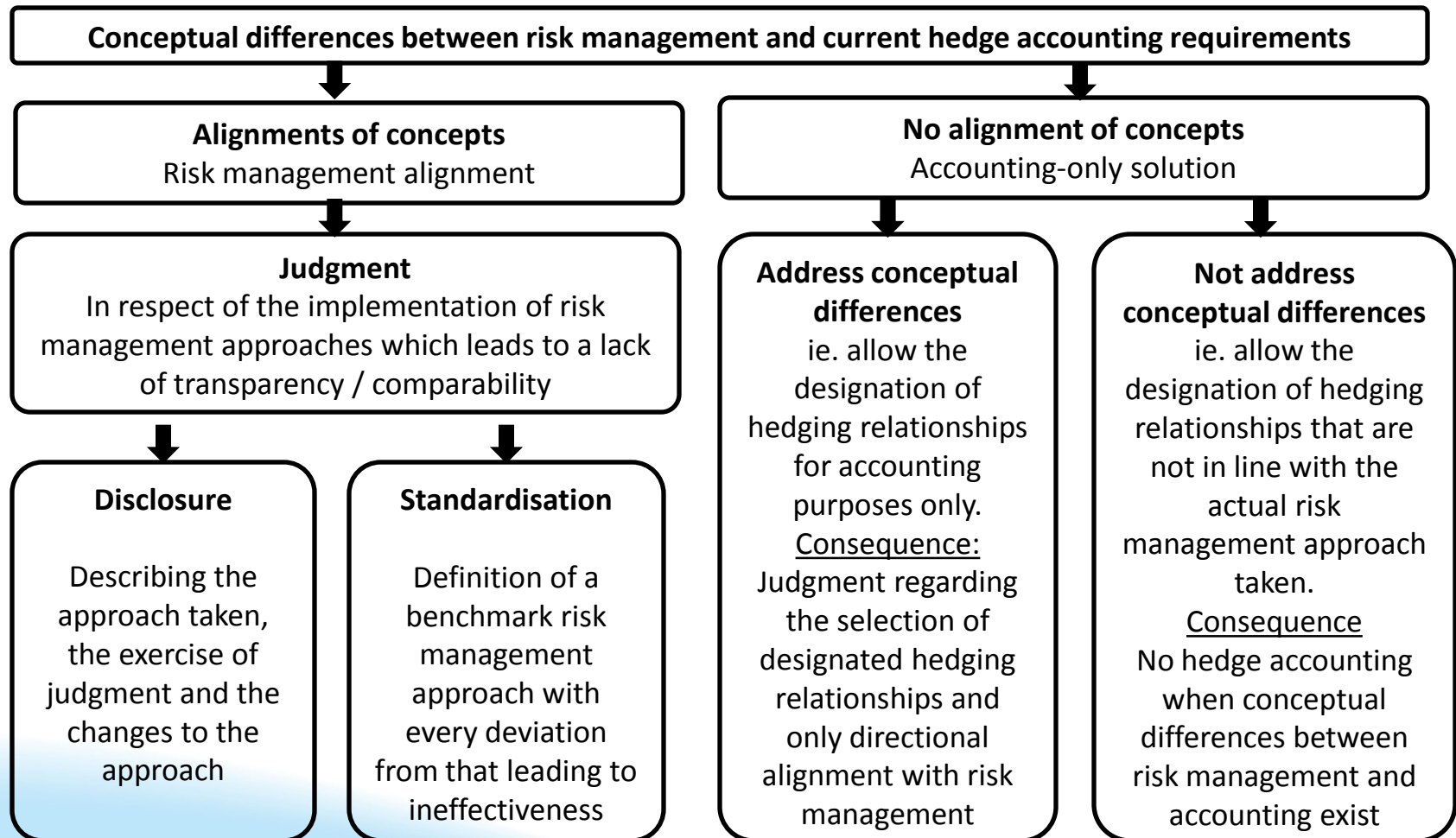


IAS 39 limitations

- Requires designation of a specifically identified gross position
- Cash flow OR fair value hedge accounting
- Core demand deposits cannot be designated as hedged items
- Replacing hedged items requires discontinuation accounting (for a fair value hedge amortising the adjustment to the hedged item, for cash flow hedge amortise OCI)
- Frequent designations to capture new items in the portfolio (eg. weekly)
- Internal derivatives – need externalising




IFRS 9 considerations





Steps for valuation of risk position

1. Full fair value measurement
2. Fair value attributable to interest rate risk
3. Net interest margin as risk management objective
4. Portfolio as unit of account
5. Open portfolios to be included
6. Applying re-pricing risk for periods rather than days
7. Multi-dimensional risk objectives
8. Valuation of floating rate instruments
9. Counterparty risk of hedging instruments
10. Internal derivatives
11. Risk limits



Least aligned
with risk
management

Most aligned
with risk
management