Straight away

17 April 2014

IASB issues discussion paper on macro hedging

Issue

The IASB has issued a discussion paper (DP) on accounting for dynamic risk management: a portfolio revaluation approach to macro hedging (‘macro hedging’).

The DP addresses the accounting for dynamic risk management strategies on open portfolios (that is, portfolios that change over time). Dynamic risk management is a *continuous* process that involves identifying, analysing and deciding on whether, and how, to mitigate a risk.

The DP presents a dynamic risk management strategy commonly used by financial institutions for illustrative purposes. The IASB’s intention, however, is to explore whether macro hedging could be applied on a broader basis – for example, by non-financial entities hedging commodity price risk.

Key proposals

The DP explores the use of a ‘portfolio revaluation approach’ (PRA). The PRA is not a full fair value approach; it identifies the risk being managed in an open portfolio, and it revalues the exposure to that risk based on a present value technique (the ‘revaluation adjustment’). The PRA does not require a one-to-one matching of the hedged item and the hedging instrument. This will reduce operational complexities as compared to the current hedge accounting requirements in IAS 39 and IFRS 9.

A conceptual challenge introduced by the PRA is the inclusion of behavioural features, rather than just contractual features. For example, demand deposits (when assessed individually) are repayable on demand; however, when assessed on a portfolio level, core demand deposits are considered by financial institutions as term fixed interest rate liabilities for the purposes of dynamic risk management.

The revaluation adjustments of the managed exposures and the fair value changes of the associated hedging instruments are accounted for in profit or loss. The DP suggests alternatives for the presentation of the revaluation adjustments in the statement of financial position and the statement of comprehensive income.

The DP asks a number of questions, mainly on whether the approach is operational, how the proposed approach could be applied to other risks (such as foreign exchange or commodity price risk), and whether it would enhance the usefulness of the information provided by the financial statements.

Am I affected?

The DP is relevant for all entities that use dynamic risk management strategies for open portfolios. The outcome of this project will replace the current fair value hedge accounting of interest rate risk in IAS 39. The DP is likely to be of particular interest to financial institutions, but it might also be of interest to entities in industries such as mining, utilities or manufacturing.

What do I need to do?

The deadline for comment is 17 October 2014. The extended comment period is to allow respondents time to provide fully considered responses to the proposals.

The feedback will help the IASB to determine the next steps in the accounting for dynamic risk management.

If you have questions or require further information, please speak to your regular PwC contact.