IFRS 9 Hedge Accounting
Impatti sulle Imprese

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Agenda

1. Introduction
2. Qualifying for hedge accounting
3. Hedging instruments
4. Hedged items
5. Hedge Accounting
6. Alternatives to hedge accounting
7. Transition to IFRS 9
8. Macro hedging

Introduction

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Timeline – IFRS 9

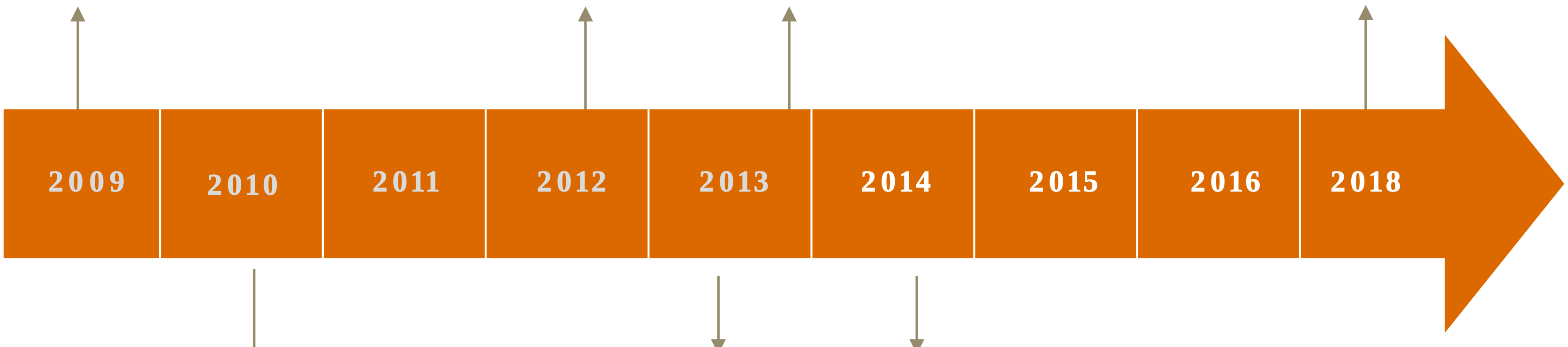
Separate project on Macro Hedging.

2009
Classification and measurement of financial assets

Nov 2012
ED on Classification and measurement:
Limited Amendments to IFRS 9

Nov 2013
IFRS 9 on Hedge Accounting is issued.
IFRS 9 mandatory effective date is removed.

IFRS 9 mandatory effective date
1 January 2018



2010
Classification and measurement of financial liabilities

March 2013
ED Financial Instruments:
Expected Credit Losses

July 2014
All phases of IFRS 9 (C&M and Impairment) finalised

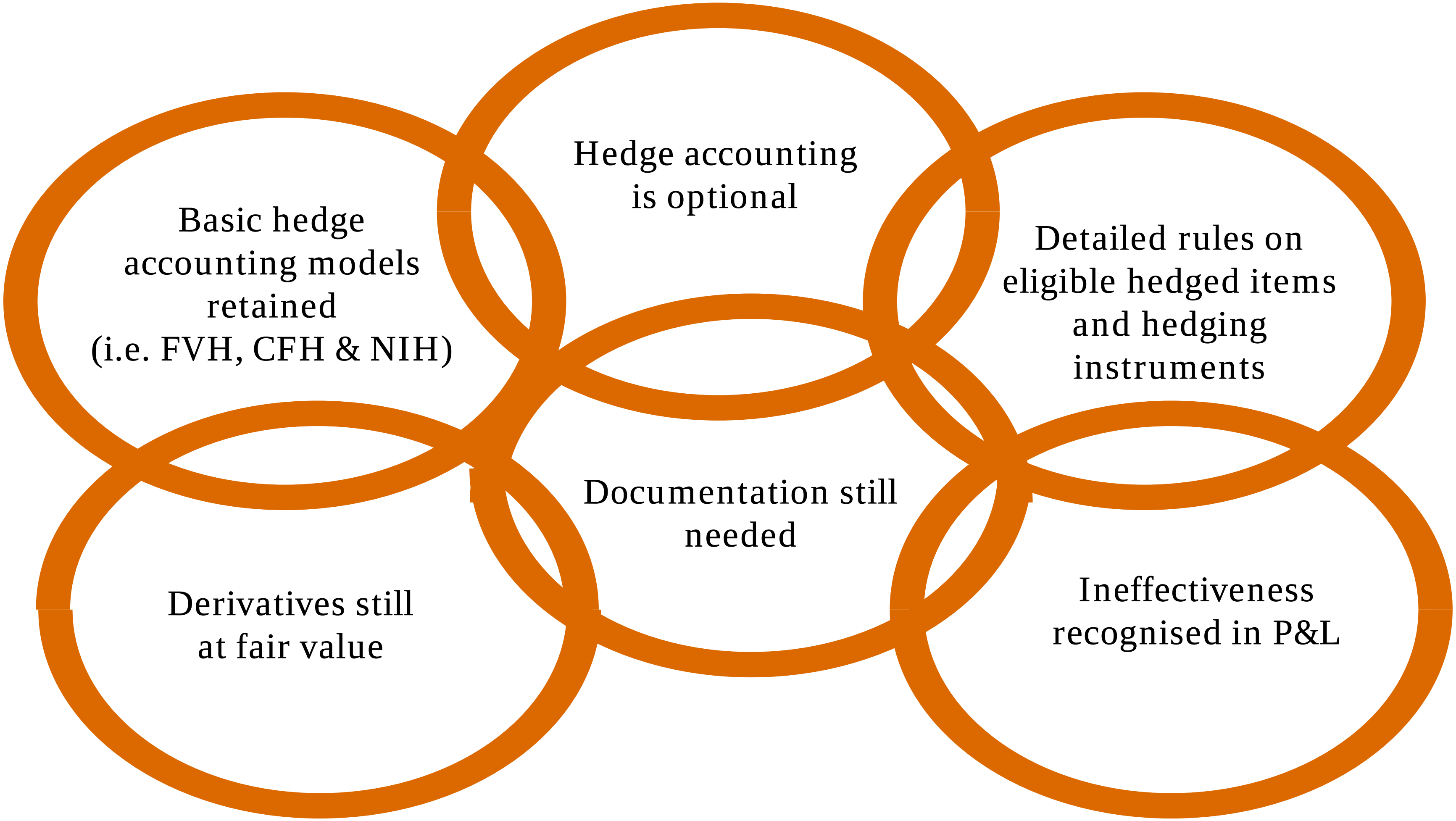
Accounting policy choice and transition rules

Accounting policy choice *to apply:*

- *IFRS 9 Hedge Accounting; or*
- *IAS 39 Hedge Accounting.*

- This accounting policy choice allows entities either to transition to IFRS 9 Hedge Accounting or to continue applying IAS 39 Hedge Accounting.
- Applicable to hedge accounting and not to the other phases of IFRS 9 (i.e. Classification and Measurement and Impairment).
- This accounting policy choice will continue to exist until the macro hedge accounting project is finalised.
- Applicable to all hedge accounting and cannot be made on a hedge by hedge basis

IFRS 9 - What has NOT changed?



Qualifying for hedge accounting

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Hedge Accounting Criteria

IAS 39	**IFRS 9: Changed or Unchanged?**
Objective: Reporting effects of hedging instrument & hedged item in P&L in the same period.	**Unchanged.**
Hedge accounting is **elective.**	**Unchanged.**
Qualifying criteria is required.	**Changed.**

Unchanged **Changed**

IFRS 9 qualifying criteria

IFRS 9 qualifying criteria

1. Formal designation and documentation

2. Only eligible hedging instruments and hedged items

3. Meets the hedge effectiveness requirements

3.1 ***Economic relationship*** between hedged item and hedging instrument gives rise to offset

3.2 Effect of ***credit risk*** does not dominate the value changes

3.3 ***Hedge ratio*** results from the quantity of hedged item hedged and hedging item used to hedge

80-125% effectiveness threshold is removed

Hedge Effectiveness

IAS 39	IFRS 9: Changed or Unchanged?
Quantitative hedge effectiveness test required: • Prospective • Retrospective. Hedge must be '**highly effective**' (80% - 125%).	**Changed.** • Quantitative test no longer required. • Effectiveness testing required only on a forward looking basis. • IFRS 9 introduces the concept of 'rebalancing'.
Hedge **ineffectiveness** measured and reported in P&L.	**Unchanged.**

Unchanged **Changed**

Hedge effectiveness – Rebalancing

Change in economic relationship between underlyings

↓

Change in risk management hedge ratio

↓

Changes result in an imbalance that would create hedge ineffectiveness (inconsistent with the purpose of hedge accounting)

Hedge effectiveness – Rebalancing example

WeLoveHedging Co. hedges a future purchase of 100 tons of coal (grade 2) with purchased coal futures (grade 1/benchmark).

Economic relationship:
T0 - Change in FV of 10 tons (coal grade 2) = Change in FV of 9 tons (coal grade 1)
T1 - Change in FV of 10 tons (coal grade 2) = Change in FV of 8 tons (coal grade 1)
T2 - Change in FV of 10 tons (coal grade 2) = Change in FV of 7 tons (coal grade 1)

	IAS 39 approach	
	Hedge ratio	Effectiveness
T0	100 tons (grade 2) 9 futures grade 1 (90 tons)	100%
T1	100 tons (grade 2) 9 futures grade 1 (90 tons)	89%
T2	**IAS 39: Discontinue** (90 tons)	78%

Rebalance

Rebalance

	IFRS 9 approach	
	Hedge ratio	Effectiveness
T0	100 tons (grade 2) 9 futures grade 1 (90 tons)	100%
T1	100 tons (grade 2) 8 futures grade 1 (80 tons)	100%
T2	100 tons (grade 2) 7 futures grade 1 (70 tons)	100%

On rebalancing , the futures that are no longer part of the hedge will be MTM through P&L.

Discontinuation of hedge accounting

IAS 39	IFRS 9: Changed or Unchanged?
Hedge **de-designation is voluntary.**	**Changed.** No longer permitted. But…. if RM objective is changed, discontinuation is required (**entirely** or a **part** of it).
When qualifying criteria no longer met hedge accounting is **discontinued** prospectively.	**Unchanged.** Assessment of qualifying criteria <u>after considering the effects of 'rebalancing'</u>.

Unchanged **Changed**

Hedging instruments

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Hedging instruments

IAS 39	IFRS 9
Embedded derivatives **allowed** as hedging instruments	Embedded derivatives **only allowed** if embedded in **financial liabilities** and separated from the host contract
Non-derivatives **only** for FX risk	Non-derivatives @FVTPL, **also for other than FX risk**
Options – changes in time value are recognised in P&L	Options – changes in aligned time value are deferred in OCI. Reclassification to P&L depends on the nature of the hedged item: • Transaction related • Time period related
Forwards - **Two alternatives** for recognising fair value changes of forward points	Forwards - **Three alternatives** for recognising fair value changes of forward points
Currency basis spreads – no specific accounting treatment.	Currency basis spreads – are considered as cost of the hedging relationship and can be recognised through OCI

Options as hedging instruments

- ✓ Bias against using options under IAS 39 because of volatility in P&L from time value
- ✓ IFRS 9 introduces a new approach for accounting for the time value (analogy to buying insurance protection). It is mandatory when an entity designates as hedging instrument the intrinsic value of the option only

Transaction related	Time period related
•Changes in 'aligned' time value are accumulated in OCI •Recycled when hedged transaction affects P&L or when hedged item results in non-financial item.	•The premium is amortized over coverage period •Other fair value changes of 'aligned' time value in OCI
Example; hedging forecast purchase of a commodity	*Example; hedging existing commodity inventory regarding price changes*

Forward points & currency basis spreads

IAS 39 (two alternatives)	IFRS 9 (three alternatives)
1) Forward points can be included in the hedging instrument; *or*	1) Forward points and currency basis spreads can be included in the hedging instrument; *or*
2) Fair value changes of forward points *are* recognised in profit or loss	2) Fair value changes of forward points and currency basis spreads *may be* recognised in profit or loss; *or*
	3) Forward points and currency basis spreads may be accounted in the same manner as it is applied to the time value of an option under IFRS 9.

Hedged items

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Hedged items

IAS 39	IFRS 9
Only possible to hedge risk components of financial items	Possible to hedge risk components of both financial and non-financial items
Derivatives not allowed as hedged items	Aggregated positions allowed
Net positions not allowed	Net positions (including net nil positions) allowed as hedged item, in certain circumstances
Equity instruments through OCI cannot be hedged item	Equity instruments through OCI can be hedged items
Use of layers as hedged item relatively restricted. Layers only for cash flow hedges	Layers allowed for both cash flow hedges, fair value hedges and groups of items

Risk components

✓Possible to hedge risk **components of both financial and non-financial items** if separate identifiable and reliably measurable.

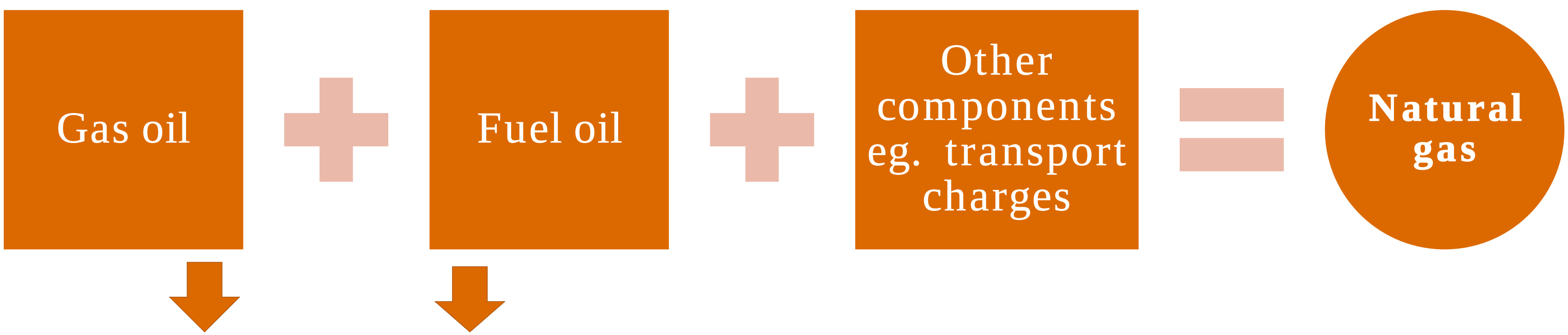
i) Eg: contract specifies a pricing formula that references a commodity;
ii) Eg: hedging jet fuel with crude oil derivatives. As price of jet fuel is crude oil plus a refining margin

✓ Risk components should be assessed in the context of the **particular market structure** to which the risk or risks relate and in which the hedging activity takes place.

Examples: Risk components of non-financial items

Example 1: Long-term supply contract for natural gas

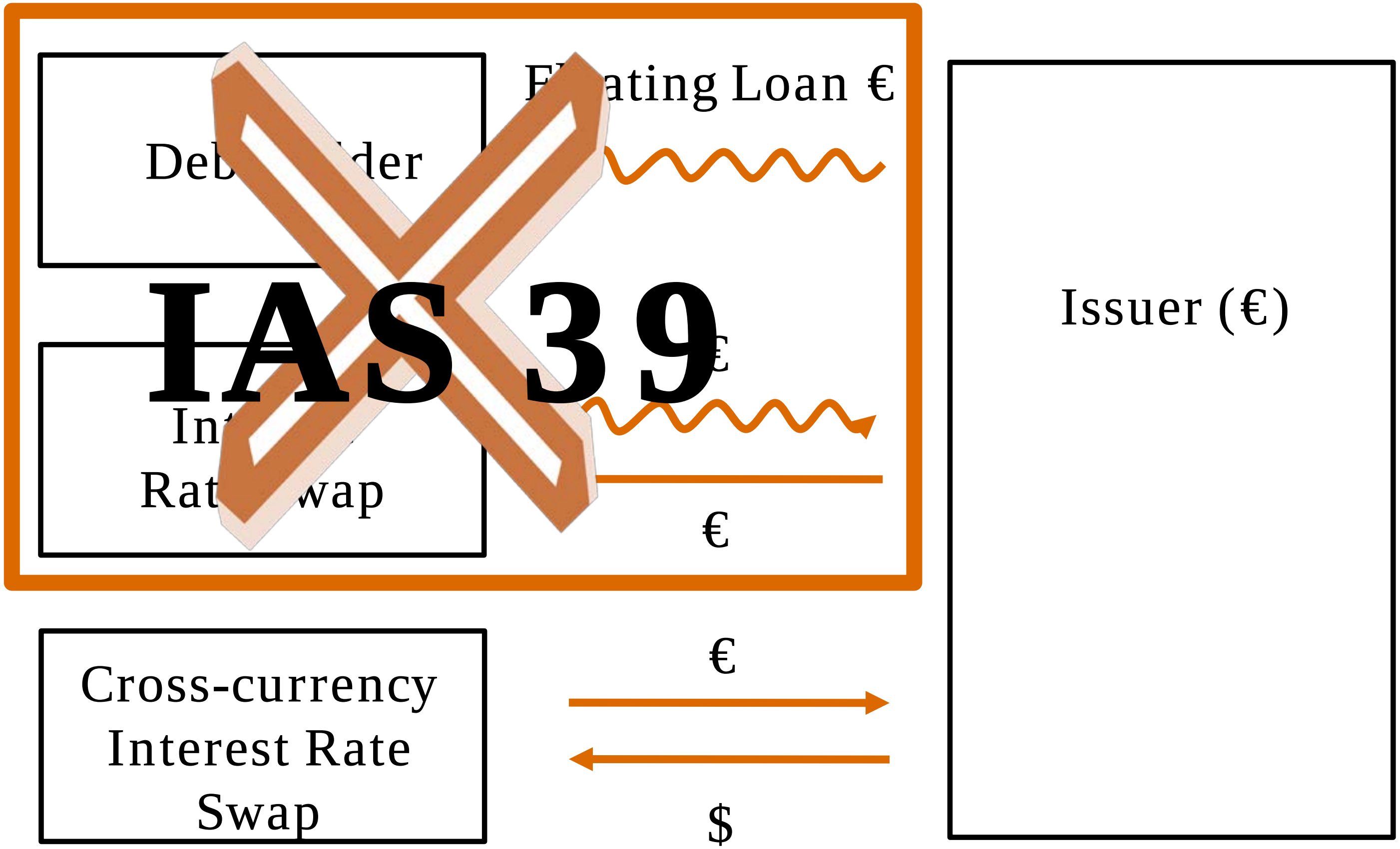
Pricing of natural gas according to contractually specified formula:



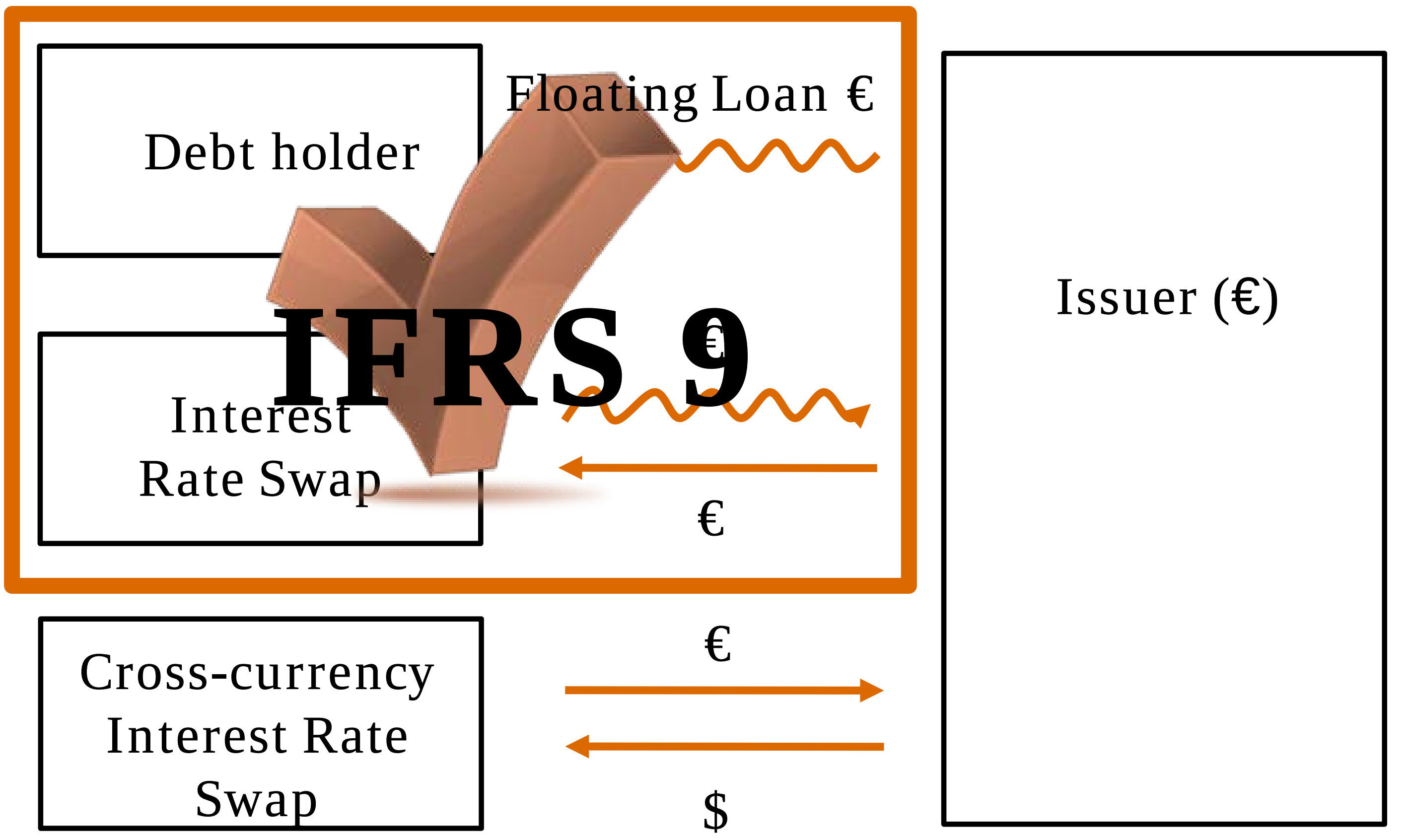
Hedged item

- **Component eligible as hedged item**

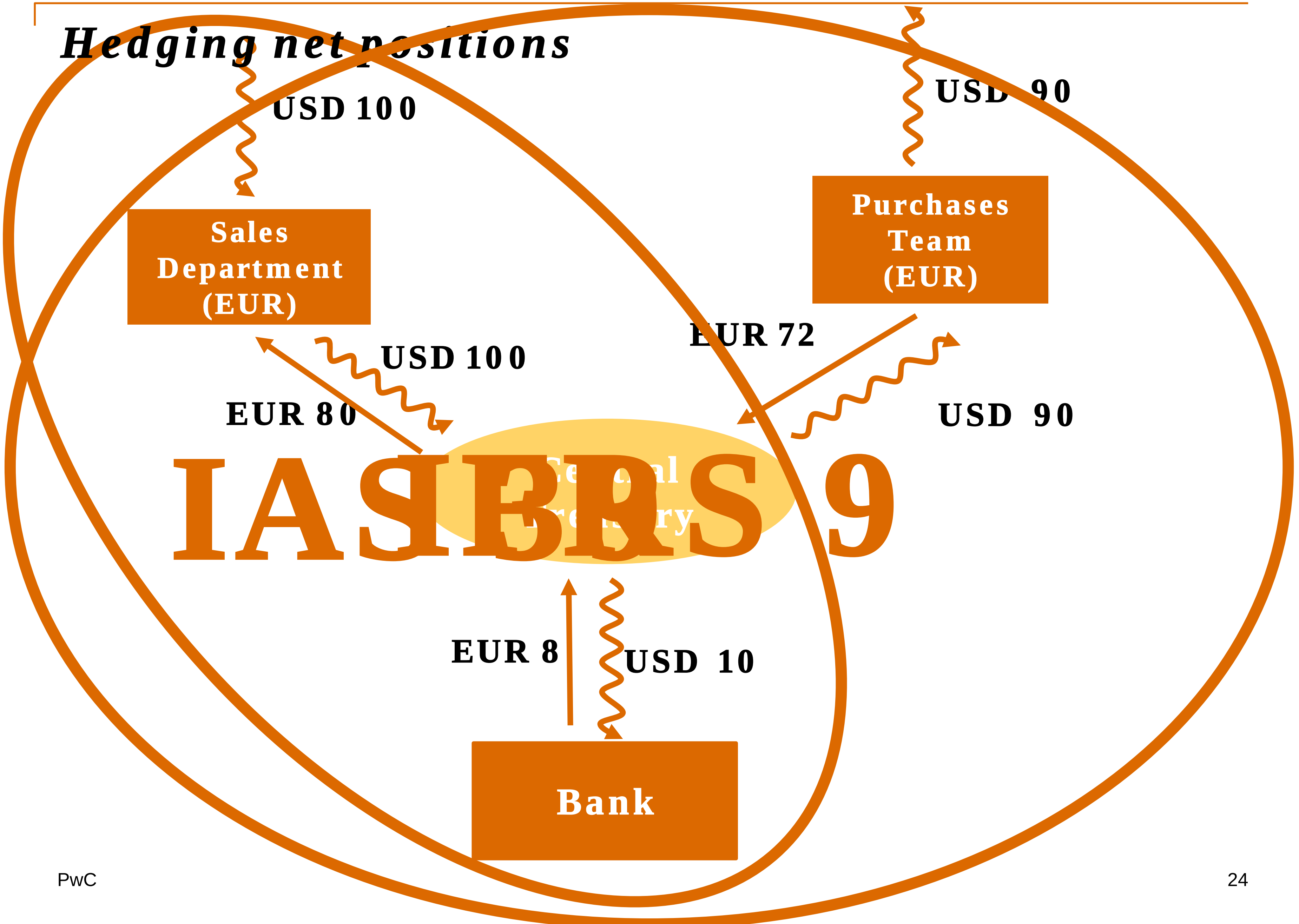
Aggregated Exposures



Aggregated Exposures



Hedging net positions



Hedge Accounting

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Hedge Accounting

IAS 39	IFRS 9: Changed or Unchanged?
Three **types of hedges:** • cash flow hedge, • fair value hedge, and • net investment hedge.	**Unchanged.**
Fair value hedges. FV changes of hedging instrument and hedged item recorded in P&L.	**Changed.** When hedging **equity instruments** accounted for @FVOCI changes in FV of hedging instrument also recorded in OCI.

Unchanged **Changed**

Hedge Accounting

IAS 39	IFRS 9: Changed or Unchanged?
Cash flow hedges. For hedges of the forecast of non-financial items or firm commitments a policy choice to account for the amount deferred in OCI: a) Reclassify to carrying amount of asset or liability ('**basis adjustment**'); or b) Reclassify to P&L when hedged item affects P&L.	**Changed.** Accounting policy choice removed and **basis adjustment required**.

Unchanged Changed

Alternatives to hedge accounting

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Option to designate a credit exposure at fair value through P&L

- ✓ Allows fair value through profit or loss accounting for a financial instrument (or a proportion of it) when hedged with a credit derivative.
- ✓ Certain criteria must be met.
- ✓ Not irrevocable.
- ✓ Disclosure requirements added.

Transition to IFRS 9

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Transition – key considerations

IAS 39	IFRS 9
Risk Management strategy & objective	Unchanged. However, **more detailed** documentation expected
Nature of the **risk** being hedged	Unchanged
Identification of **hedged item**	Unchanged
Identification of **hedging instrument**	Unchanged
How **hedge effectiveness** will be measured: • Prospective testing. • Retrospective testing. • Quantification of ineffectiveness.	• Retrospective testing no longer required. • Forward looking assessment should be documented • Additional requirements exist: a. Sources of **ineffectiveness**. b. The **hedge ratio** is determined. c. After **rebalancing**, documentation should be updated

Transition – Opportunities

Are there existing hedges (not qualifying in IAS 39) now eligible under IFRS 9?

- Entities to assess whether they have in place:
  - ✓ Economic hedges that previously failed the 'bright line' (80% - 125%).
  - ✓ Hedges of risk components of non-financial items.
  - ✓ Aggregated exposures.
  - ✓ Hedges of net positions (exposure to the same risk).

Thank you …

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