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IFRS Developments

The IASB decouples macro hedge accounting from the IFRS 9 project

What you need to know

When discussing macro hedge accounting at its May 2012 meeting, the IASB decided to:

- Work towards a DP, instead of directly issuing an ED
- Decouple the macro hedge accounting project from the IFRS 9 *Financial Instruments* project

And

- Continue permitting fair value hedge accounting for a portfolio hedge of interest rate risk as defined in IAS 39 *Financial Instruments: Recognition and Measurement* until the macro hedge accounting project is finalised

This will give the IASB more time to develop a macro hedge accounting model without affecting the timing of the completion of IFRS 9.

Highlights

After a series of educational sessions and outreach activities, the International Accounting Standards Board (IASB or the Board) started shaping a potential macro (or portfolio) hedge accounting model in November 2011. Discussions so far have focused on strategies to hedge the interest margin of financial institutions. The portfolio valuation approach currently being deliberated by the Board is a fundamentally new concept that is more than just a modification to the existing macro hedge accounting guidance in IAS 39 *Financial Instruments: Recognition and Measurement*. Consequently, the Board decided at its May 2012 meeting to work towards a discussion paper (DP) as the next step in its due process, instead of directly issuing an exposure draft (ED).

Developing the new macro hedge accounting model will take time, which would prevent the completion of the IFRS 9 *Financial Instruments* project in time for an application date for annual periods beginning on or after 1 January 2015. The Board has therefore decided to decouple the macro hedge accounting project from IFRS 9, allowing more time to develop a macro hedge accounting model without affecting the timely application of the other elements of IFRS 9.

The Board also decided that entities could still make use of fair value hedge accounting for portfolio hedges of interest rate risk as defined in IAS 39 until the macro hedge accounting project is finalised and becomes effective.

Working towards a DP

By issuing a DP, the IASB can enter into a formal discussion with its constituents on some broader and more fundamental questions of how a potential macro hedge accounting model would work. The Board also made it clear that the DP will have a much broader scope than an ED and may ask constituents on their views for more than one alternative where appropriate. As macro hedge accounting is an accounting concept that is not known to many constituents, especially non-financial institutions, the Board also plans to include in the DP thorough explanations of what would constitute a macro hedging strategy.

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How we see it

As per the current deliberations, the potential new macro hedge accounting model will be substantially different from what is currently described as macro hedging under IAS 39. Fundamental changes to accounting concepts require a broad discussion with all constituents, which, in our view, can be best achieved by issuing a DP. Therefore, we support the IASB's decision.

Potential implications of grandfathered IAS 39 portfolio hedging

As a consequence of decoupling macro hedge accounting from the IFRS 9 project, the Board decided to allow entities to continue to use the fair value portfolio hedging rules in IAS 39 until the macro hedge accounting project is finalised and becomes effective. Once IFRS 9 becomes applicable, the provisions of IAS 39 that relate to the fair value hedge accounting for a portfolio hedge of interest rate risk would be retained.

In the agenda paper[1] presented at the May 2012 IASB meeting (and confirmed at the meeting), the IASB only mentioned grandfathering of fair value macro hedge accounting. However, the *Implementation Guidance* for IAS 39 contains specific guidance for the application of cash flow hedge accounting when interest rate risk is managed on a net basis (IAS 39 IG F.6.2 and F.6.3). Hence, it would appear that the IASB's view would allow an entity to continue applying cash flow hedge accounting for its macro hedging strategies when applying the IFRS 9 general hedge accounting principles.

How we see it

Entities currently applying macro cash flow hedge accounting under IAS 39 are presumably awaiting the Review Draft on IFRS 9 *General Hedge Accounting* with interest to see whether their current risk management practices would still qualify for hedge accounting under the new standard.

It is currently unclear how the IASB's tentative decisions to grandfather IAS 39 macro fair value hedge accounting would apply to entities that were not subject to these IAS 39 provisions, e.g., because they are first-time adopters or they are subject to local versions of IAS 39.

Looking ahead

Over the coming months, the IASB will continue deliberating the potential macro hedge accounting solution for hedges of the interest margin of financial institutions. The Board will then extend the macro hedge accounting model to other types of risks and other industries and start outreach activities to discuss and field test some of the proposed mechanics. The DP is expected to be issued in the second half of 2012.

[1] Agenda paper 4 – Macro Hedge Accounting – Next due process step: Discussion paper versus exposure draft (May 2012)

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