LEADING TREASURY PROFESSIONALS

The Association of Corporate Treasurers

Comments in response to
Accounting for Dynamic Risk management: a Portfolio Revaluation Approach to macro Hedging
International Accounting Standards Board, April 2014

October 2014

The Association of Corporate Treasurers (ACT)

The ACT is a professional body for those working in corporate treasury, risk and corporate finance. Further information is provided at the back of these comments and on our website www.treasurers.org.

Contact details are also at the back of these comments.

We canvas the opinion of our members through seminars and conferences, our monthly e-newsletter to members and others, *The Treasurer magazine*, topic-specific working groups and our Policy and Technical Committee.

General

The ACT welcomes the opportunity to comment on this matter.

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The ACT commends the IASB for the approach that it has taken on the topic of macro hedging i.e. using the discussion paper (DP) as a basis for learning more before progressing to drafting an exposure draft (ED) and finally issuing an accounting standard. The ACT represents the professional voice of corporate treasury and as such our comments below are from the perspective of the non-financial corporate. Our research on accounting for macro-hedging amongst corporate treasurers highlights there is much confusion on this topic, indeed there isn't a clear understanding of what macro-hedging is. Back in 2011 when we asked the IASB for clarification on what macro hedging was we were provided with the following definition:

Key characteristics of a macro hedging strategy as follows:

1. The exposure managed is a whole portfolio as such (instead of items individually)
2. "Behaviour-ised" estimates play an important part (expected prepayments of prepayable items, expected use/volumes under fixed price but variable volume contracts [e.g. in the utility industry], etc.)
3. The exposure changes frequently resulting in frequent adjustments of the hedge book
4. There are no 1:1 relationships between hedges and exposures but the hedge book is adjusted in response to an open portfolio position (instead of changes of an individual item); hence, tracking of relationships between specific hedging instruments and hedged items over time does not really work (because of the churn on both sides of the hedging relationship).

The IASB's proposed accounting model in the DP, the Portfolio Revaluation Approach (PRA), is based on fair value hedge accounting. The IASB has made it clear that the DP is not intended for interest rate risk only and not solely for banks. As far as interest rate risk is concerned we are not aware of any corporates who manage their interest rate risk as dynamically as banks. If for example a company has an interest rate policy to manage 40-60% of their debt at a fixed rate for at least X years they may only review their portfolio and re-adjust the proportions through swaps on say a quarterly basis. This may not fall within the IASB's definition of "frequent" in point 3 of their definition above. We would also estimate only a very small number of corporates would dynamically hedge other risks such as FX or commodity risk.

When the ACT polled a number of our members back in November 2011 on whether they macro hedged, 10% replied "yes" for FX risk. On further investigation we believe many of these were managing their forecast FX risk on a net basis by currency and not necessarily dynamically managing their FX risk in the same way a bank would manage its interest rate risk portfolio. Forecast FX risks are cash flow hedges and not fair value hedges under IAS 39 and IFRS 9. The current hedge accounting requirements in IAS 39 and IFRS 9 make it difficult for corporates to manage forecast FX risk on a portfolio basis with one-to-one linkage required between what is being hedged and the hedging derivative and risks managed on a net basis requiring gross designation. Hence for an accounting standard on macro hedging to be more relevant for corporates we would recommend that a model is developed for cash flow hedge accounting.

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The Association of Corporate Treasurers

The Association of Corporate Treasurers (ACT) is the leading professional body for international treasury operating in the public interest under Royal Charter. We provide the widest scope of benchmark qualifications for those working in treasury, risk and corporate finance. Membership is by examination. We define standards, promote best practice and support continuing professional development. We are the professional voice of corporate treasury, representing our members.

Our 4,400 members work widely in companies of all sizes through industry, commerce and professional service firms.

For further information visit www.treasurers.org

Guidelines about our approach to policy and technical matters are available at http://www.treasurers.org/technical/manifesto.

Contacts: John Grout, Policy & Technical Director (020 7847 2575; jgrout@treasurers.org) Michelle Price, Associate Policy & Technical Director (020 7847 2578; mprice@treasurers.org) Colin Tyler, Chief Executive (020 7847 2542 ctyler@treasurers.org)	The Association of Corporate Treasurers 51 Moorgate London EC2R 6BH, UK Telephone: 020 7847 2540 Fax: 020 7374 8744 Website: http://www.treasurers.org

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