HEDGE ACCOUNTING – NEW FASB GUIDANCE

Also corporates might want to consider the new FASB guidance …

Effects of hedging instruments

- Parts of hedging instrument constituting a fair value hedge can be excluded from hedge effectiveness assessment
- Excluded items recognized in earnings (resp. change of FV vs. amount amortized recognized in 'other items recognized')

Discontinued hedge relationships recognized in earnings

Component hedging of risk

- Parts of price risk can be hedged when link to a liquid price index is established (not necessarily in location of delivery e.g. of a commodity)
- Risk mitigation through non-financial products recognized

Higher hedge accounting ratio ('non-effectiveness' avoided)

Interest rate – Fair value hedge

- Only portion of CF required to be hedged
- Change in 'benchmark IR' for repayable hedge instrument sufficient
- For partial-term hedge: same maturity as for designated derivative can be assumed

Complexity decreased; prepayment risk can be ignored

Assessment of effectiveness

- Hedge effectiveness only to be assessed by end of quarter
- Qualitative assessment sufficient (unless facts contradict)
- Transaction within 31 days: Critical terms match method
- In case of inappropriate shortcut: Long-haul method

Less effort, better planning of admin capacity

- **Easier application** of 'hedge accounting'– less stringent definition of 'hedge effectiveness', less effort, less quantitative analytics required ...
- **There is still time to evaluate feasibility** given implementation lead time
  - Public companies: with fiscal year start after 15 Dec 2018
  - All other entities: with fiscal year start after 15 Dec 2019 and interim periods after 15 Dec 2020
- **Higher potential relevance of applying hedge accounting** compared to past FASB guidance as it better aligns with risk management realities
- **Early adoption permitted**

Source: FASB: Accounting Standards Update, Derivatives and Hedging (Topic 812), No. 2017-12, August 2017, FASB: Understanding costs and benefits, 28 August 2017, Silverbergh