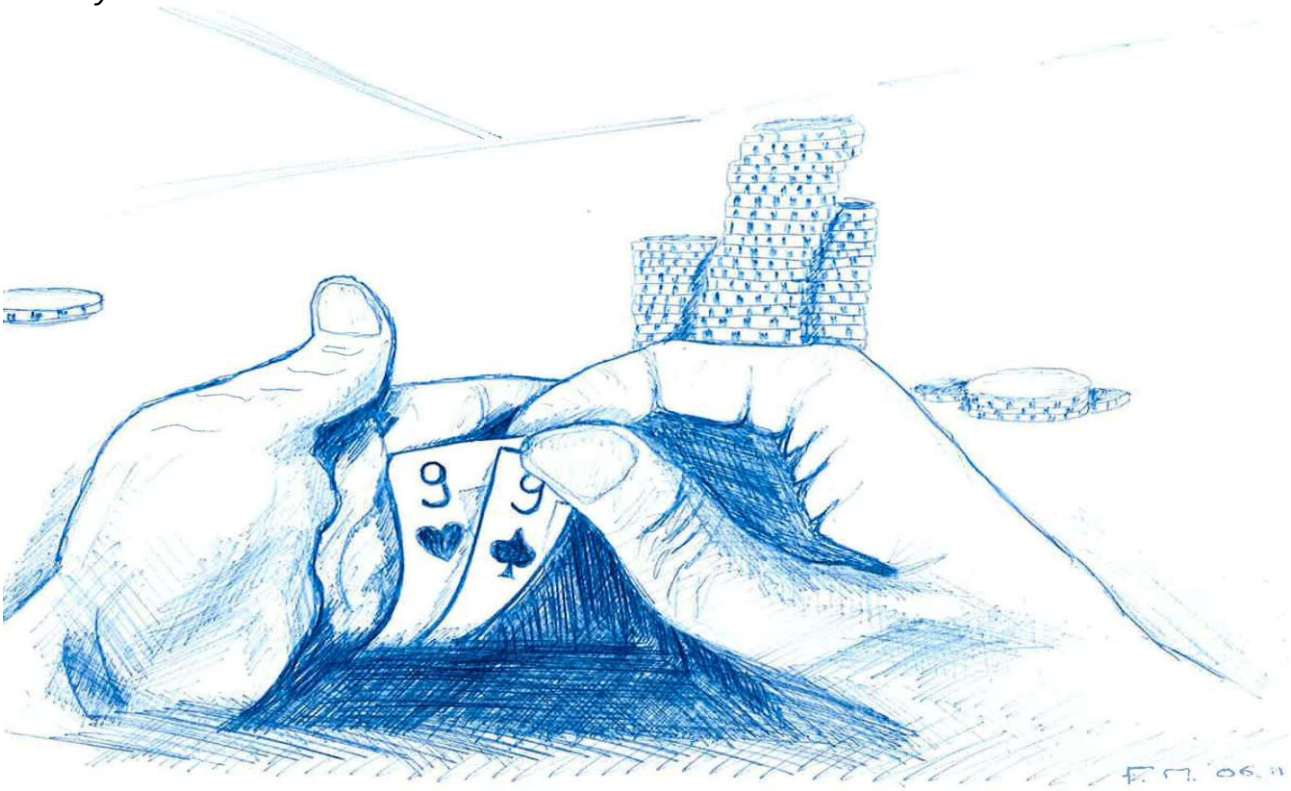
12 years under hedge accounting and IAS 39, for better or for worse?

I was recently asked a simple but nevertheless somewhat disconcerting question, "but when everything is considered, after so many years, has IAS 39 and the hedge accounting exception been beneficial for the profession of treasurer or not? IAS 39 has its good and its bad sides. Nevertheless, it has been relatively beneficial to the profession and to world finance. Its successors will be even better in ironing out a number of points that are often criticised by users.



- **The good and bad sides of IAS 39**

Even though it was resisted for a long time, then debated and each amendment challenged, even if it was listed as one of the reasons for the financial crisis (there was a need to find culprits other than just the ratings agencies which had taken too much of the blame) and even if it is still the most complex standard (IAS/IFRS), IAS 39 has done more good than harm. It paved the way for a complete revision of the approach to managing financial risk and hedging those risks. In particular, it brought more virtue and discipline back into hedging practices in non-financial corporations.

Added-Values brought by IAS 39

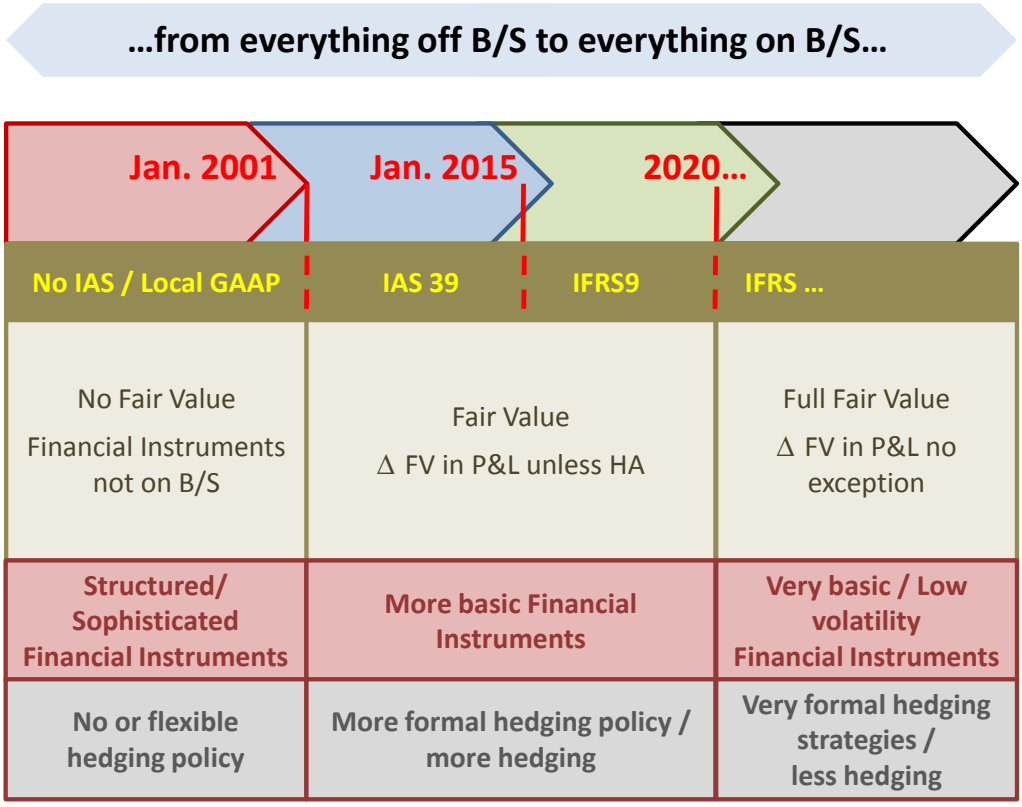
From Corporate side: RATHER POSITIVE

- \+ More transparency
- \+ « Fairer » value of hedges portfolio
- \+ More discipline among treasury teams
- \+ Less sophistication of OTC products used/simplification of strategies
- \+ Better communication with accounting
- \+ Better P&L volatility control
- \+ More virtuous behaviors from treasurers
- \+ Revisiting of FX policies and processes
- \+ Better tech (i.e. TMS) inducing more productivity
- \- Less complexity (although absorbed by expertise and TMS
- \- More reporting and more disclosures (justified by transparency increase)

From Banking side: RATHER NEGATIVE

- – Less profit-generator / high margin products (e.g. « accumulators », « reservoirs », « double barriers structures», etc…)
- – More advice requested from customers for hedge accounting compliance (while simplification of products has also reduced role of bankers from advisers to price makers/givers)
- – "Commoditization" of FX/IR products / less sophistication (together with "electronification" of dealing via platforms) and introduction of EUR, which reduced exposures)
- – Less to hedge because of hedge accounting constraints, which as consequences reduces amounts of off-B/S. commitments / Cash Flow hedged

The cruel "mark to market" sentence, a sort of wrecking bar of the P&L account, has obliged all companies to revisit their approach to risk management. Without it, there was a danger that these companies would have shown results that were unacceptably volatile for any reasonable and sensible CFO. Over a number of years an enormous additional workload was generated in learning, understanding, and implementing the standard. These same consultants now hope there will be sequels to IFRS 9 and IFRS 7 that are as complex and burdensome as possible (in the interests of their jobs) but they are also hoping for evermore numerous and tortuous regulations. On this last point they are unlikely to be disappointed.



- **"Hedge accounting", a temporary exception**

Plenty of people seem to have forgotten that the hedge accounting exemption was supposed to be only temporary. The IASB's idea is, in due course, ultimately to move towards full fair value, thus attaining a sort of accountancy Holy Grail and eventually abandoning this IAS 39, which it inherited from the IASC (its predecessor). Is this ultimate goal desirable or not? We have often debated the question and warned against going to too great an extreme in transparency. It seems to us, instead, that this intermediate step, initially temporary, would be ideal when all is said and done. It would give transparency and wipe out the profit and loss impact where a position was hedged (Cash Flow Hedge or Fair Value Hedge). In the final analysis, would this intermediate step not be desirable in the longer term? Less can sometimes be more. Provided it is properly applied and its rules are adhered to, hedge accounting is an effective and virtuous model. It may be that a further step might turn out to be a step too far. In the long run, would it not be better to accept this situation, which is relatively satisfactory when all is said and done?

- **For better or for worse?**

At the end of the day, our assessment of these twelve years of hedge accounting is rather positive. This accounting standard made us codify and structure our corporate risk management more virtuously. IAS 39 made treasurers more aware of the volatility of hedging instruments and reminded them of their consequences. IAS 39, well before the sub-prime crisis and in everything that followed it, has averted many problems. Without IAS 39, many companies would have experienced, time and again, major losses due to current market volatility. It averted many consequences that would have affected their results, had they continued to use the financial products that they were using previously. This new virtue produced by IAS 39 prevented other disasters or financial losses that we could well do without in a period of crisis. So yes, I think that we can reasonably consider that IAS 39 was a good thing for the community of corporate treasurers.

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