

*Impact of IAS39 and Other
Regulatory Developments on
Bond Investment and Issuance*



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IAS 39 and Debt Issuance

- Before IAS 39
 - Carried at cost
 - Hedging instrument also on accrual basis
- After IAS 39
 - Carry at cost if plain products by nature or after separation from embedded derivatives
 - Apply hedge accounting
 - Apply fair value option and the whole instrument fair valued with the change in fair value going to P&L



Impact on Issuers

- Need to determine the accounting treatment upon initial recognition, considerations may include:
 - Capability to identify and decompose the embedded derivatives;
 - Capability to manage the risks arising from the embedded derivatives;
 - Willingness to accept P/L fluctuations arising, etc.



Issues Arising

- Need to strengthen risk management capabilities in terms of:
 - Revaluation techniques in case market quoted prices not available. This may not be easy in some cases, e.g. volatility data for option pricing
 - Risk measurement and management techniques to manage P/L arising from the embedded derivatives, to perform regular hedge effectiveness analysis, etc
 - More procedural controls to document the hedges, manage the positions, etc.



Issues Arising

- Regulators have yet to finalize treatment relating to P/L arising from the changes in credit spread of the issuer
 - Credit quality drop, credit spread increase and value of liabilities decrease
 - Credit quality increase, credit spread decrease and value of liabilities increase
 - Regulators concern on recognizing gain or loss from the use of fair value option in regulatory capital
(reference: BIS press releases dated 8 June and 15 December 2004)

