

## LANDESBANK BADEN-WÜRTTEMBERG | PORTFOLIO FAIR VALUE HEDGE ACCOUNTING UNDER IFRS

### Background and objectives

As the leading regional bank and capital market issuer, Landesbank Baden-Württemberg (LBBW) is obliged to publish consolidated financial statements in line with the IFRS from 2007 on. To meet the complex requirements, LBBW already launched an IFRS project early that also took account of the requirements defined in IAS 39 for portfolio fair value hedge accounting. In this context, it was possible to make reference to the approach to portfolio fair value hedge accounting implemented together with zeb/ at the Baden-Württembergische Bank.

The project awarded to zeb/ included technical and process support to the implementation and further development of portfolio fair value hedge accounting at LBBW. The objectives of the project comprise the following priorities:

- Establishment and integration of measures for controlling the profit and loss account in portfolio fair value hedge accounting and integration of the processes within the procedures of treasury
- Optimisation of the valuation methodology and effectiveness measurement with a view to breaking down the fair-value change into market interest change and pull-to-par effect
- Development of a testing scheme for plausibility checks on the monthly portfolio fair value hedge accounting runs, including cash-flow analyses

### The project's approach

Within the framework of the development of active control of the profit and loss account in portfolio fair value hedge accounting, a methodical definition of control measures was drawn up together with the treasury experts. These measures were implemented in the existing IT solution. In particular, they include:

- Identification of maturity bands with a free payer/receiver swap volume,
- Prospective simulation of swaps, and
- Targeted extraction of reverse swaps from portfolio fair value hedge accounting.

The implementation of the control measures in the related processes was supported by a series of joint workshops for accounting and treasury.

The optimisation of the valuation methodology and effectiveness measurements focused on breaking down the fair value changes by their causes (impact of market interest changes and pull-to-par effect) and their handling in booking control (see Fig. 1). Extensive tool-based simulations were performed for that purpose. They aimed at identifying the best methodology upgrade for LBBW in order to further reduce the volatility in the profit and loss account. The result was a change to a linear determination of the valuation methodology that successfully went productive after the adaptation of the existing IT solution.

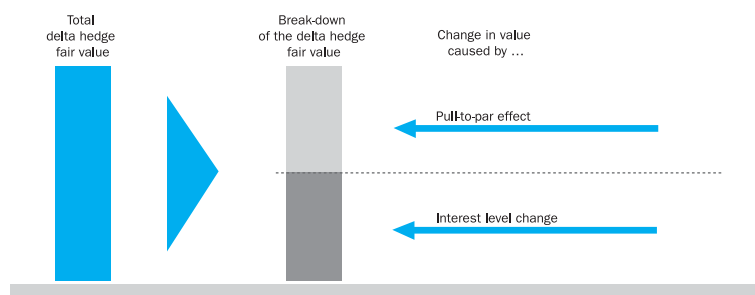


Figure 1: Break-down of the delta hedge fair value

A test scheme was developed for systematic plausibility checks of the monthly run of portfolio fair value hedge accounting. This scheme includes all the steps relevant for the analysis of the monthly hedge runs. The main emphasis was placed on analysing performance deficiencies in basic and collateral transactions.

### Project results and outlook

Overall, the methodology of the existing portfolio fair value hedge accounting solution of LBBW was further developed in line with the objectives defined. The control measures implemented allow for influencing the factors causing volatility in the profit and loss account in a targeted way. The plausibility checks on the monthly hedge accounting runs make a significant contribution to the practical application of the project work performed in portfolio fair value hedge accounting step by step. The aim for 2007 is the further functional and process

optimisation of the existing solution. This includes, in particular, the implementation of special underlying transactions, e.g. for multi-callable products, the optimisation of effectiveness measurement and the representation of special collateral deals, e.g. including ancillary agreements.



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