



Club de Gestión
de Riesgos de España

IX JORNADA
ANUAL
DE RIESGOS

Hedging Commodity Risk with IAS Accounting Rules

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delta- [R]
TECNOLOGÍA DE ENERGÍA



Deloitte

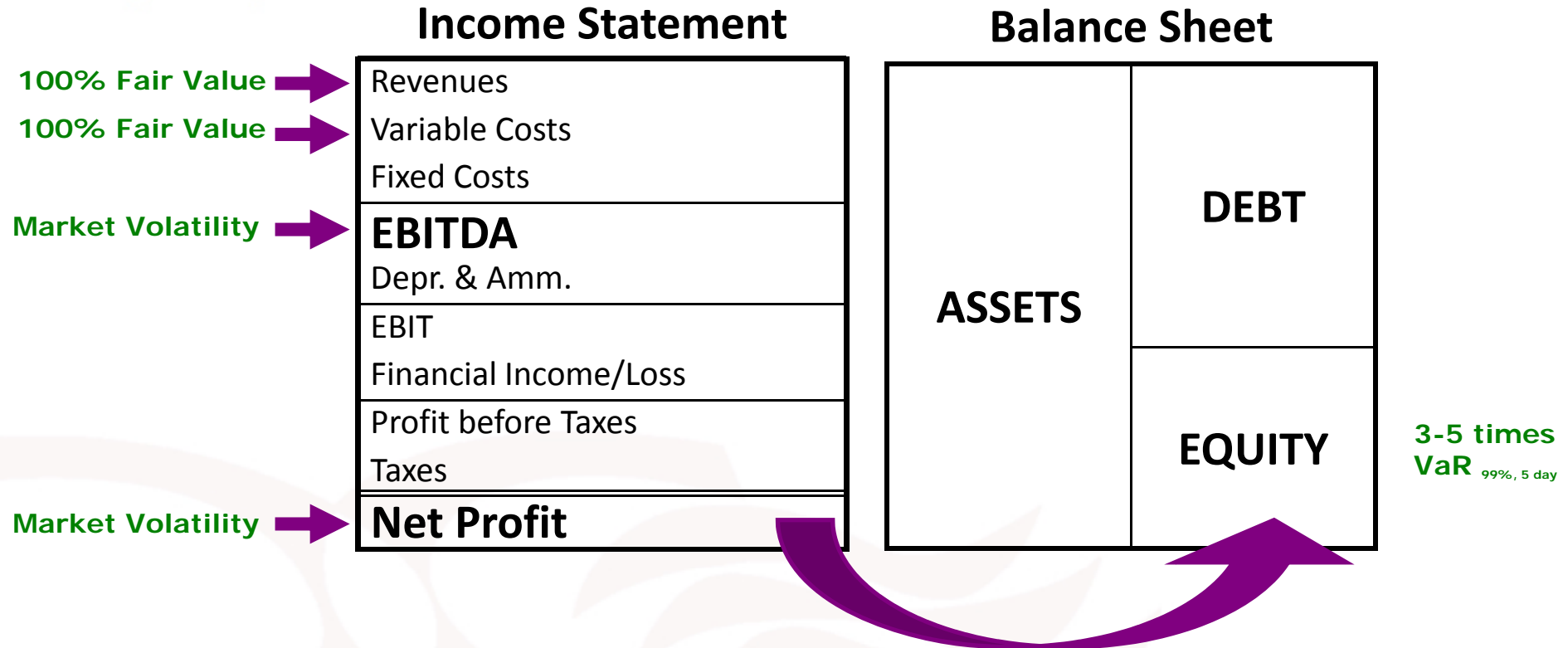


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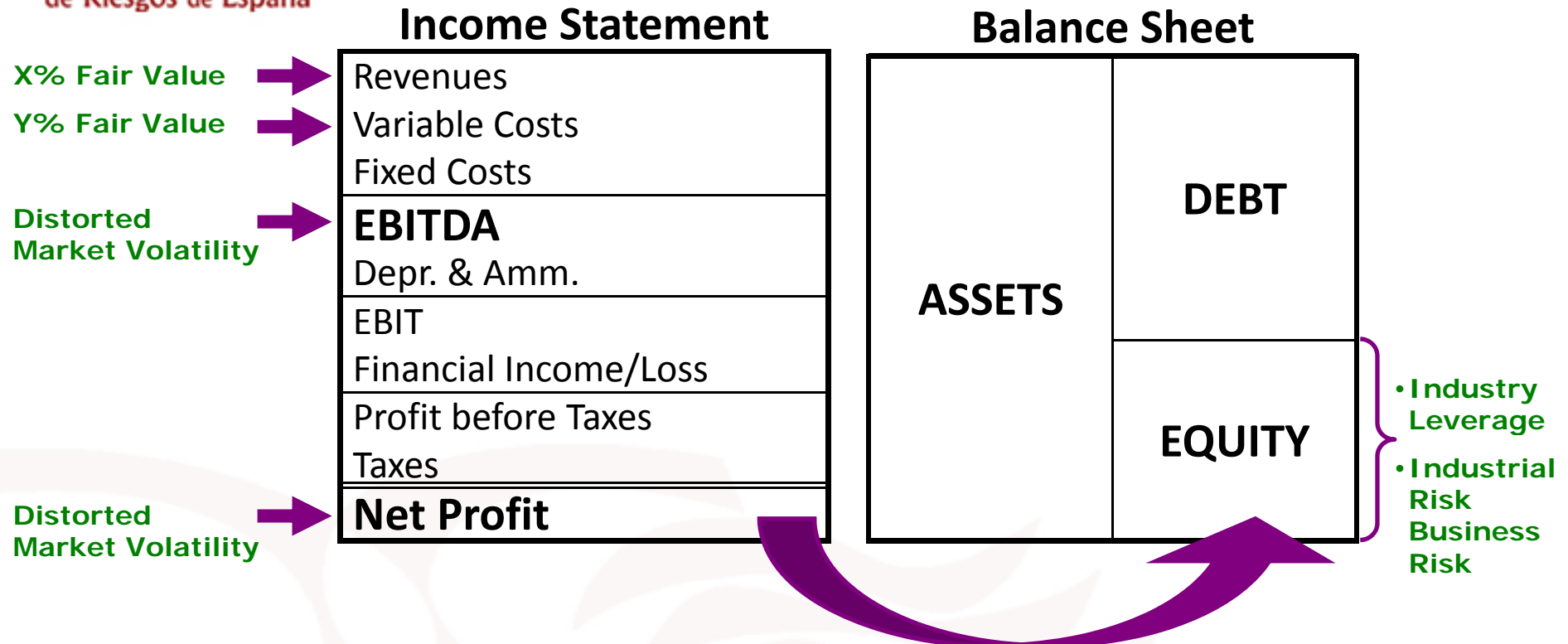
PURE FINANCIAL TRADING COMPANY



Market risk volatility is **properly** represented on Balance Sheet:

- 100% Revenues and Variable Costs are mark to marked at Fair Value
- Delta Fair Value reflected directly in EBITDA and Net Profit
- Equity sized accordingly as a multiple of VaR (Basel II), in order to support delta fair value associated to extreme market scenarios

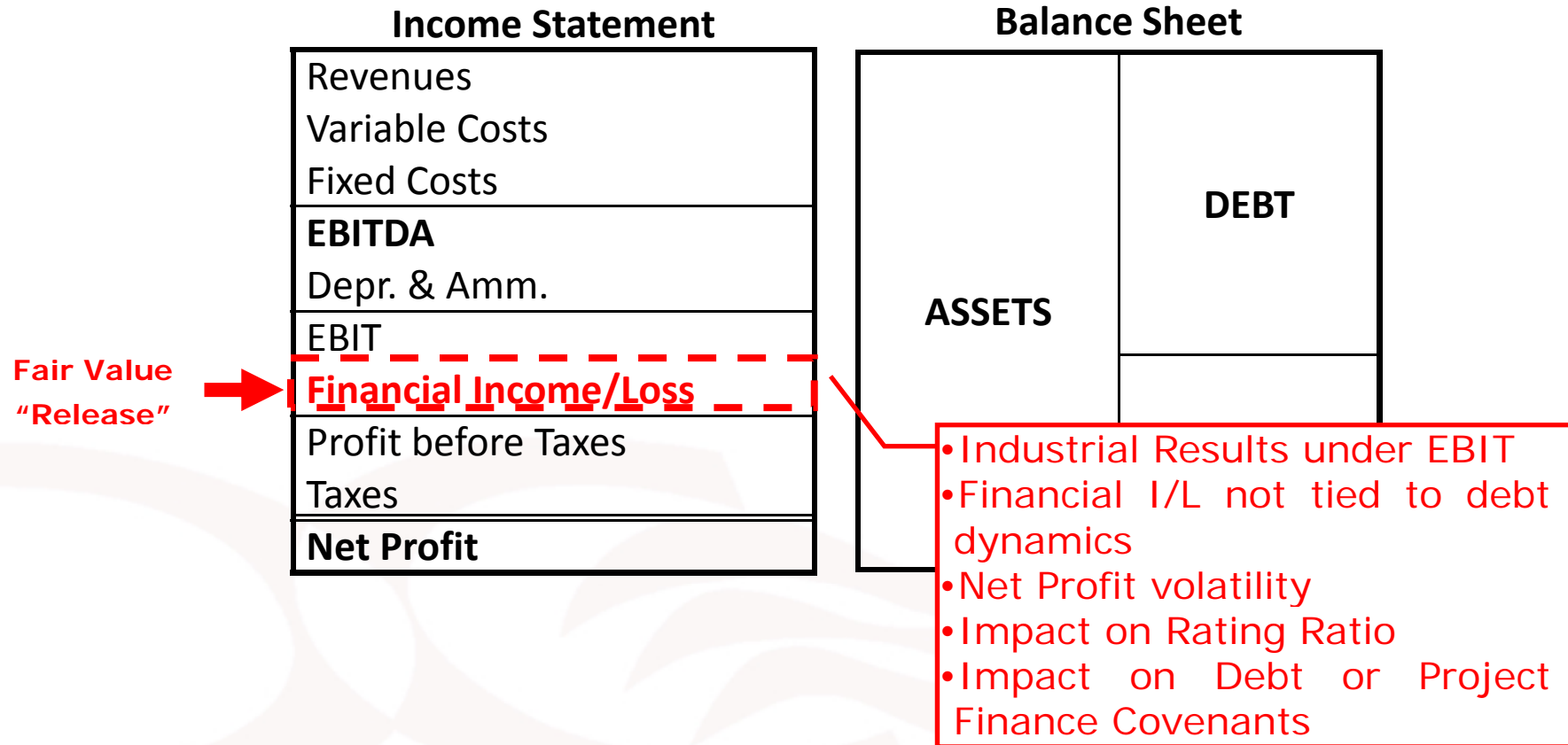
“ASSET BASED” UTILITY



Market risk volatility is **not properly** represented on Balance Sheet:

- Only proprietary trading and financial derivatives are marked to market at Fair Value (not the hedged items).
- Delta Fair Value reflected in a distorted way on Profit & Loss
- Equity not sized accordingly to market scenarios and risks

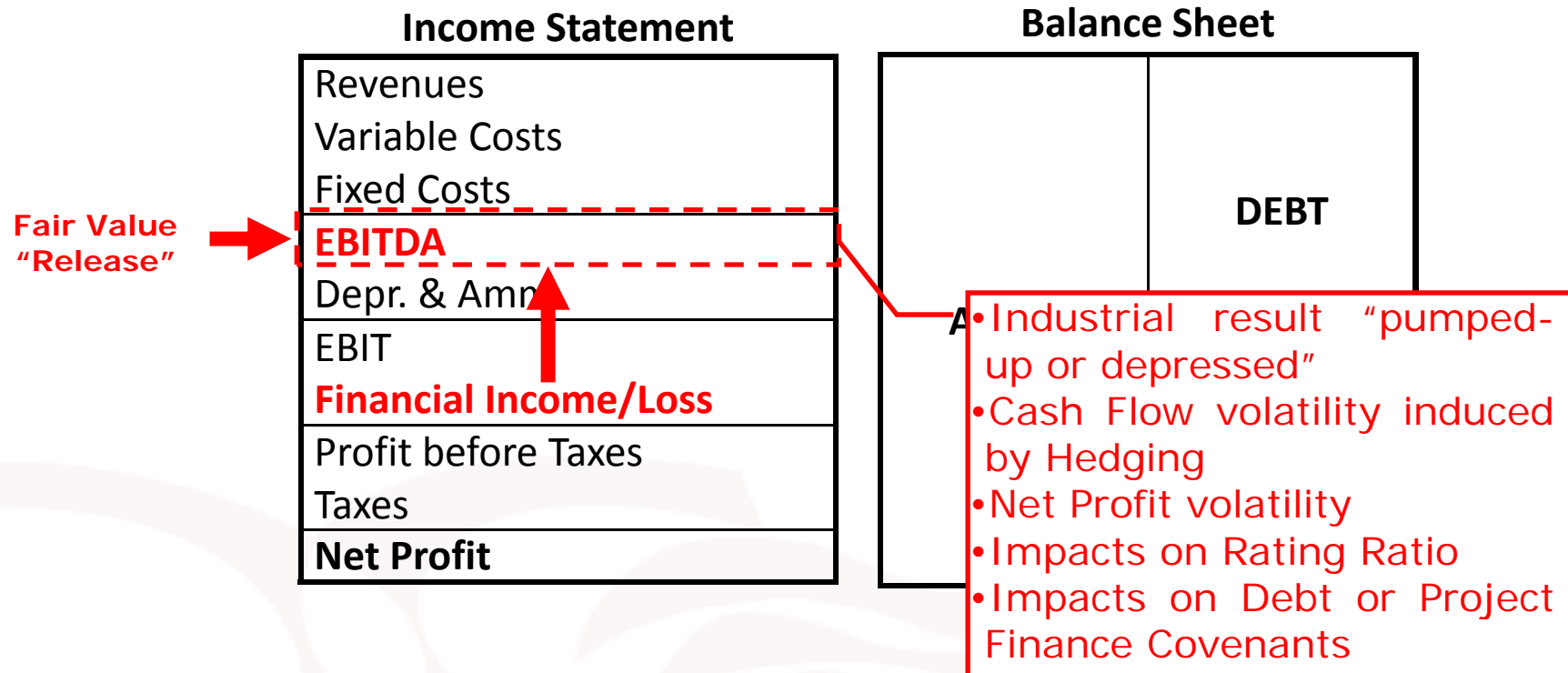
THE “FAIR VALUE CYCLE” ON BALANCE SHEET



First step “transition to IAS”

- Hedging (and Trading) activities perceived as financial management
- “Cultural” immaturity to new standards

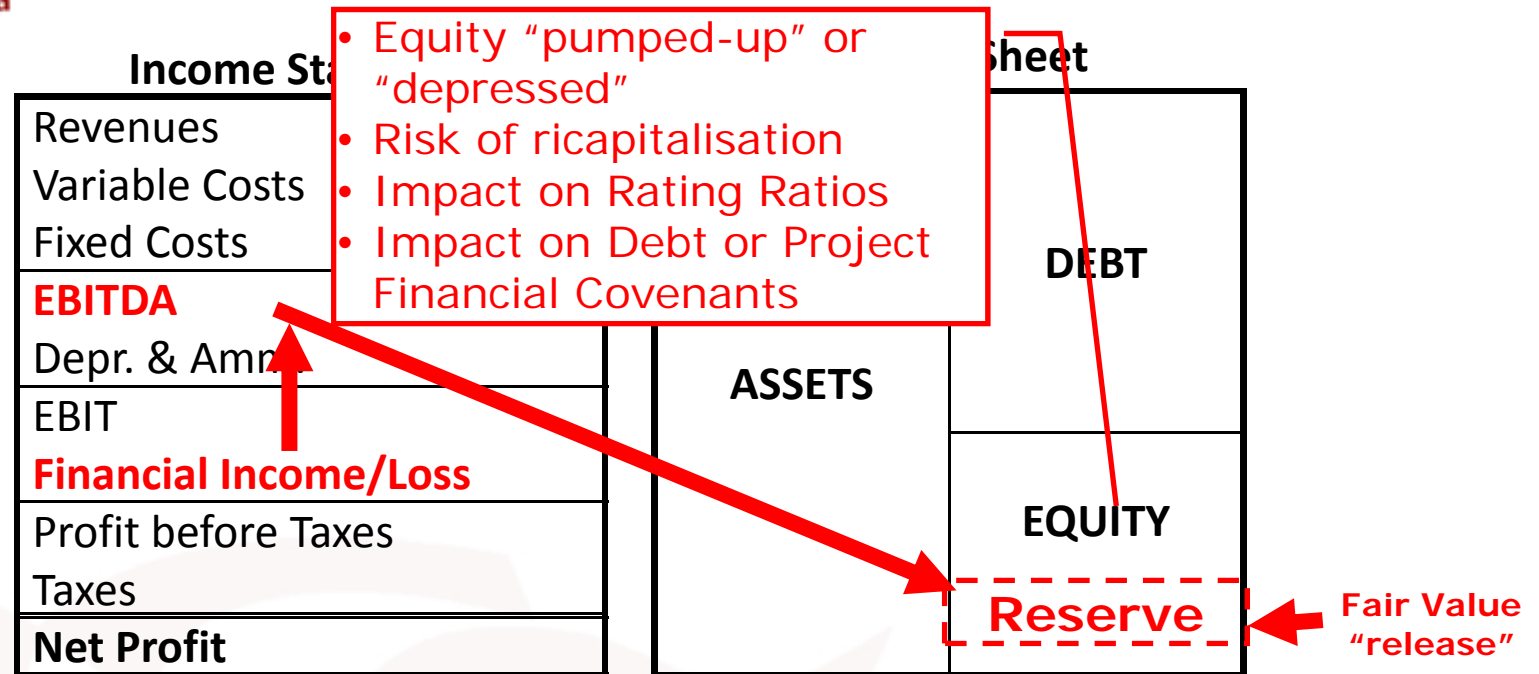
THE “FAIR VALUE CYCLE” ON BALANCE SHEET



Second step “linking hedged items together with hedging instruments”:

- Hedging as EBITDA management
- Lack in Hedge Accounting systems and procedures
- Poor communication between Front Office and Administration Dept
- Corporate Risk Management at initial stage

THE “FAIR VALUE CYCLE” ON BALANCE SHEET



Third step “to gradually move to Balance Sheet the P&L of hedging”:

- Fair value suspended to Equity Reserve until it is realised
- Development of systems and procedures for hedge accounting
- Development of Corporate Risk Management as “intermediary” between Front Office’s business point of view and Administration Dept’s accounting rules

IS HEDGE ACCOUNTING REALLY THE SOLUTION?

Examples:

- Commercial or Energy Trading companies owned by integrated Groups created for accounting, organisational or legal unbundling with minimum capitalisation could easily face high recapitalisation need due to reserve fluctuation associated to internal and/or external hedging
- Also Balance Sheets of the most robust companies could face problems due to negative fluctuations of fair value (we are talking about several hundreds Mln € fluctuations)

There is a potential big systemic risk on balance sheets of power utilities

CASH FLOWS OR BALANCE SHEET VOLATILITY?

Companies are facing a “trade-off dilemma”:

- To cover cash flows’ volatility generating exposure on Balance Sheet



- To leave cash flows un-hedged in order to avoid Balance Sheet’s impacts



EXAMPLE OF BALANCE SHEET'S EXPECTED VOLATILITY'S EXTIMATION

A Company produces power from an 800 MW CCGT plant, feed with gas through a long term gas import contract, and sells power to its customers at a fixed price:

