

DZ BANK AG |

IFRS PORTFOLIO FAIR VALUE HEDGE ACCOUNTING –

TECHNICAL IMPLEMENTATION

Background and objectives

DZ BANK AG, the central financial institution of the German co-operative sector, has applied the IFRS in financial reporting since 1 January 2006. Like most international banks, DZ Bank had to master the challenge of controlling the volatility caused by interest changes in equity and the profit and loss account. For this purpose, a combination of the fair-value option and portfolio fair value hedge accounting was identified as a suitable tool. The zeb/Hedge Engine was selected for implementing hedge accounting. The contract awarded to zeb/ included the delivery and customisation of the standard software as well as the provision of technical and expert support for its introduction in the SAP environment. The project was kicked off on 3 May 2006. A key objective was to update the entries posted for the first six months of 2006 through retroactive application in a highly timely fashion.

Project organisation and approach

In the run-up to the project, DZ Bank already identified the products in principle suitable for portfolio hedge accounting. Therefore, it was possible to embark on technical implementation directly after the project's launch. The work was divided into three parallel parts:

- Based on the data requirement catalogue of the Hedge Engine, DZ BANK extracted the data from the SAP Financial Database (FDB) with the support of its long-standing SAP implementation partner.
- zeb/ implemented an additional data pre-processing tool and adapted the zeb/Hedge Engine to realise the technical link to SAP and comply with specialised demands of DZ BANK.
- The technical calibration of the system (selection of the transactions to be designated, process parameters) to the IFRS strategy of DZ BANK was prepared together.

The objective defined by DZ BANK for portfolio hedge accounting was that, with regard to interest change risks, the real business position of DZ BANK should be reflected in the profit and loss account in accordance with the IFRS. As a result, the following activities had to be carried out:

- Input data (business risk status, risk position in the profit and loss account before hedge accounting) are imported as additional information into the zeb/Hedge Engine.
- The equity effect of the AFS positions is included into the profit and loss account by means of an AFS hedge.
- OLI and LAR hedge relations provide for balancing interest sensitivity between the IFRS-compliant profit and loss account and the business risk position.

In technical terms, the biggest challenge was to build up data supply from the SAP FDB. At monthly intervals, the data required are extracted from the FDB and transferred to the input tables of the zeb/Hedge Engine (Oracle database) using a standard process defined by DZ Bank. The Hedge Engine optimises the hedge composition with a view to the substantive objectives before the monthly process of designation and posting is performed.

Project results and outlook

The decisive milestone was reached on 30 June 2006: After the completion of component testing, all elements of the system were assembled to produce the technical results. In rapid succession, the pre-defined programme was carried out: The data for seven dates were extracted and submitted to quality assurance, the transactions to be designated were selected, the initial values were defined and the hedge accounting results were retroactively produced for the first six months. With the entries for June, the first half of 2006 was completed as early as in the beginning of August. After reaching this central project objective, the introduction of the new system was rounded off by process-related optimisation in the following months. The key success factors were the advanced, flexible Hedge Engine software, extensive technical, banking and project experiences of all the persons involved, and the perfect co-operation among all the sub-projects. The urgent wish to find solutions required swift decision-making and, in a few cases, a bit of pragmatism.



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