

EXHIBIT 3

IAS 39 Cash-Flow Hedge Accounting Example

Bank of Paris, a fictitious French bank, has € 1 million of variable-rate demand deposit liabilities (DDL) at January 1 of Year 1. Based on prior experience, Bank of Paris anticipates these customer accounts will remain outstanding for an average of three years. The bank wishes to hedge its interest-rate exposure on these accounts by entering into an interest-rate swap. The swap has a notional amount of € 1 million and a term of three years, and net settlement in euros is required on January 1 of each year, beginning with Year 2. Under the swap, Bank of Paris receives the London Interbank Offered Rate (LIBOR) plus 1% and pays a fixed rate of 4%. Thus, Bank of Paris will have an asset (a liability) position in the swap when the LIBOR plus 1% is greater than (less than) 4%.

Assume the LIBOR rates, plus 1%, over the term of the swap are as follows:

Year 1 (average and ending)	6%
Year 2 (average and ending)	3%
Year 3 (average and ending)	5%

For reporting purposes, Bank of Paris estimates the fair value of swaps by projecting future settlement amounts using the current year's variable rate and discounting these expected future cash flows for time value using the same variable rate. The relevant present-value interest factors are as follows:

Present value of an annuity due of € 1 for 3 years at 6%	2.83339
Present value of an annuity due of € 1 for 2 years at 3%	1.97087

Year 1

Dec. 31	Interest expense	€ 60,000	
	Cash		€ 60,000
	(6% interest on € 1 million of DDLs)		
	Interest-rate swap	€ 56,668	
	Net unrealized gain/loss (equity)		€ 56,668
	[Desired balance = € 1,000,000 notional amount x (.06 - .04) x 2.83339 = € 56,668 (asset)]		
	Net unrealized gain/loss (equity)	€ 20,000	
	Unrealized gain (net income)		€ 20,000
	[To offset increase in Year 1 interest expense: € 1 million of DDLs x (.06 - .04) = € 20,000]		

Year 2

Jan. 1	Cash	€ 20,000	
	Interest-rate swap		€ 20,000
	[To record net settlement for Year 1: € 1 million notional amount x (.06 - .04) = € 20,000 receipt]		
Dec. 31	Interest expense	€ 30,000	
	Cash		€ 30,000
	(3% interest on € 1 million of DDLs)		
	Net unrealized gain/loss (equity)	€ 56,377	
	Interest-rate swap		€ 56,377
	[Desired balance = € 1 million notional amount x (.03 - .04) x 1.97087 = € 19,709 (liability)]		
	Unrealized loss (net income)	€ 10,000	
	Net unrealized gain/loss (equity)		€ 10,000
	[To offset decrease in Year 2 interest expense: € 1 million of DDLs x (.03 - .04) = € 10,000]		

Year 3

Jan. 1	Interest-rate swap	€ 10,000	
	Cash		€ 10,000
	[To record net settlement for Year 2: € 1 million notional amount x (.03 - .04) = € 10,000 payment]		
Dec. 31	Interest expense	€ 50,000	
	Cash		€ 50,000
	(5% interest on € 1 million of DDLs)		
	Interest-rate swap	€ 19,709	
	Net unrealized gain/loss (equity)		€ 19,709
	[Desired balance = € 1 million notional amount x (.05 - .04) x 1.0 = € 10,000 (asset)]		
	Net unrealized gain/loss (equity)	€ 10,000	
	Unrealized gain (net income)		€ 10,000
	[To offset decrease in Year 3 interest expense: € 1 million of DDLs x (.05 - .04) = € 10,000]		

Year 4

Jan 1.	Cash	€ 10,000	
	Interest-rate swap		€ 10,000
	[To record net settlement for Year 3: € 1 million notional amount x (.05 - .04) = € 10,000 receipt]		

Summary

	Dec. 31, Year 1	Dec. 31, Year 2	Dec. 31, Year 3
Interest expense	€ 60,000 dr.	€ 30,000 dr.	€ 50,000 dr.
Unrealized gain (net income)	20,000 cr.	10,000 dr.	10,000 cr.
Interest-rate swap	56,668 dr.	19,709 cr.	10,000 dr.
Net unrealized gain/loss (equity)	36,668 cr.	9,709 dr.	—