Derivatives and Hedging Activities

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1. **Definition of a Derivative**
   - A financial instrument whose value is derived from an underlying asset, rate, or index (e.g., options, futures, forwards, swaps).
2. **Common Uses**
   - **Hedging**: reducing exposure to price, interest rate, or currency risk.
   - **Speculation**: taking a position to profit from expected price movements.
3. **Types of Hedges**
   - **Fair value hedge**: hedges exposure to changes in the fair value of an asset/liability.
   - **Cash flow hedge**: hedges exposure to variability in future cash flows.
   - **Net investment hedge**: hedges exposure from a foreign operation.
4. **Accounting Treatment**
   - Derivatives are recognized at fair value on the balance sheet; gains/losses are recorded in profit or loss or OCI, depending on the hedge type and effectiveness.
5. **Hedge Effectiveness**
   - Hedge accounting is only permitted when the hedge relationship is highly effective and properly documented.
6. **Risk**
   - Poorly managed derivative positions can create large, unexpected losses - which is why disclosure and risk management policy are closely scrutinized by auditors and regulators.