



EUROPEAN CENTRAL BANK

EUROSYSTEM

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Chairman  
International Accounting Standards Board  
30 Cannon Street  
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United Kingdom

Frankfurt am Main, 30 September 2014

**Discussion Paper DP/2014/1 “Accounting for Dynamic Risk Management: a Portfolio Revaluation Approach to Macro Hedging”**

Dear Mr <sup>Hans</sup> Hoogervorst,

The European Central Bank (ECB) welcomes the effort of the International Accounting Standards Board (IASB) to reform the International Financial Reporting Standards (IFRS) with respect to better reflect dynamic risk management in an entity’s financial statements. The ECB believes that this usefully contributes to transparency regarding the risks an entity is exposed to and reduces operational complexity. In this context, the ECB acknowledges the publication of the Discussion Paper “Accounting for Dynamic Risk Management: a Portfolio Revaluation Approach to Macro Hedging” on 17 April 2014.

However, some of the suggested accounting treatments give rise to concern, particularly when assessing them from a financial stability perspective. We understand that the Discussion Paper proposes the application of a Portfolio Revaluation Approach (PRA) by type of risk under two different scope alternatives: (a) a focus on the dynamic risk management or (b) a focus on the risk mitigation. While scope alternative (b) with the focus on risk mitigation does not seem to endanger financial stability, scope alternative (a) should be reviewed critically.

The scope alternative (a) focusing on the dynamic risk management foresees that all net open risk positions are revalued for dynamically managed risks if an entity is engaged in *any of the three elements*, (i) risk identification, (ii) risk analysis or (iii) risk mitigation, comprising the dynamic risk management. Consequently, the application of the PRA would be required to the entire banking book if it is managed dynamically for the interest rate risk, regardless of whether these positions are actually hedged or not. The unhedged exposures would also be revalued (to reflect changes in the risks that are being dynamically managed), while the offsetting effect from the risk management instrument(s) – derivatives – would not be available, thus leading to increased volatility in the profit and loss account without providing useful information to investors. Therefore, if the above scope alternative (a) is developed into a standard with

mandatory application, a number of European banks might have to revalue loans that are currently accounted for at amortised cost. The resulting increase in profit or loss volatility could increase procyclicality and thus might be detrimental to financial stability. This could lead to more severe downturns and more acute building up of risks, resulting in a misallocation of resources that lead to an overall welfare loss for society.

The ECB has expressed its concerns regarding increased profit and loss volatility at several occasions<sup>1</sup> and our arguments are consistent with the findings of a recent paper by the Federal Reserve Bank of Boston<sup>2</sup> which also concluded that implementing fair value accounting more broadly may not necessarily provide financial statement users with more transparent and useful reporting and may negatively impact on financial stability.

We trust that the ECB concerns on this issue will be considered by the IASB in finalising your proposals on accounting for dynamic risk management.

Yours sincerely,

A handwritten signature in black ink, consisting of a large, stylized initial 'J' followed by several vertical strokes and a long horizontal tail.

Cc:

Mr Jonathan Faull, Director General of the Directorate General for the Internal Market and Services, European Commission

Mr Didier Millerot, Head of the Accounting and Financial Reporting Unit, of the Directorate General for the Internal Market and Services, European Commission

Ms Valerie Ledure, Deputy Head of the Accounting and Financial Reporting Unit, of the Directorate General for the Internal Market and Services, European Commission

Mr Steven Maijoor, Chair of the European Securities and Markets Authority (ESMA)

Mr Gabriel Bernardino, Chair of the European Insurance and Occupational Pensions Authority (EIOPA)

Mr Andrea Enria, Chair of the European Banking Authority (EBA)

Ms Françoise Flores, Chair of the European Financial Reporting Advisory Group (EFRAG)

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<sup>1</sup> See, for example, *Opening remarks at the third conference on accounting, financial reporting and corporate governance for central banks*, speech by Vitor Constâncio, Frankfurt am Main, 4 June 2012.

<sup>2</sup> See *"Evaluating the Impact of Fair Value Accounting on Financial Institutions: Implications for Accounting Standards Setting and Bank Supervision"*, Federal Reserve Bank of Boston, December 2011.