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IASB Discussion Paper Accounting for Dynamic Risk Management: a Portfolio Revaluation Approach to Macro Hedging

Dear Mr. Hoogervorst,

The European Association of Co-operative Banks (EACB) appreciates the International Accounting Standards Board (IASB) initiative to discuss an alternative approach to macro-hedge accounting, as presented in its Discussion Paper (DP) "Accounting for Dynamic Risk Management: a Portfolio Revaluation Approach to Macro Hedging". We indeed believe that a hedge accounting model for open portfolios should be developed. The approach proposed reflects a good understanding of issues at stake and represents a good start for developing a macro hedging model.

General views on the proposed Macro hedging model

In general, the EACB Members believe that the goal of a future macro hedging standard should be the elimination of accounting mismatches. In this vein, we support an approach based on risk mitigation. We do not believe that the proposed focus on dynamic risk management is a good option, since the standard should not be based on a full revaluation of the banking book interest rate positions. Furthermore, we think that the DP explores wider objectives that are not always appropriate as they could create unacceptable side effects such as increasing volatility in P&L unconnected with the entity's performance or business model.

Regarding the proposed Portfolio Revaluation Approach (PRA) presented in the DP, some of the EACB Members consider that it has flaws that would lead to increased volatility and should therefore be disregarded. However, other Members see merit in some of the proposals, but would still like to suggest improvements. In this light, the following comments and subsequent answers to the specific questions reflect those views common to all the EACB Members.

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Among the different points in the DP, we particularly welcome the following:

- The affirmation that the scope of the managed interest rate exposure may include behaviouralised exposures, core demand deposit portfolios and sub-benchmark rate exposures, equity model book (EMB) and pipeline transactions;
- The assumption that the managed exposure is not “market-rational” but behaviouralised, which requires assets & liabilities managers to dynamically manage risks on the basis of behaviouralised rather than contractual cash flows and to implement “underhedging” strategies;
- The recognition by the IASB that a “number of [] valid techniques [exist] to manage interest risk” (page 13 of DP). As far as our members are concerned, a common practice consists in focusing on gap and sensitivity analysis, in order to demonstrate that macro hedging derivatives mitigate the sensitivity of the interest rate margin.

Macro hedging model aligned with risk management

We would also like to emphasize our view that a future macro hedging model should be aligned with actual risk management (scope and monitoring tools). Indeed, a model not fulfilling this criteria will force entities to continue their current practices under IAS 39, i.e. adoption of proxy-hedging¹ for both:

- for the *hedged risk*: designation of fair value hedges or cash flow hedges for accounting purposes, even if the managed risk is neither the fair value nor the variability of cash flows but the interest income’s sensitivity;
- for the *hedged items*: designation of gross exposures (excluding ineligible instruments) instead of the net position at risk.

An approach not aligned with the risk management practices would penalize those entities mitigating their risks in relation to those which do not (no economic hedging at all). While such approach is absent, amending IAS 39 in order to allow entities to continue their current practices developed in Europe or in other countries would be the most efficient fallback solution.

Risk mitigation approach: an alternative proposal for a revaluation method

While we support a risk mitigation approach for a future macro hedge model, we would like to propose an alternative method for the calculation of the revaluation effect. This alternative would allow to calculate the revaluation adjustments for the hedged items on the basis of valuation of hedging derivatives. Fair value changes of the (internal and external) hedging derivatives adjusted by effects not related to interest rate risk (e.g. CVA and DVA) should represent the managed risk and be used as a basis for the revaluation adjustments. The effects from CVA/DVA will be recorded in P&L without compensating effects resulting from the hedged items.

This approach would also be less operationally burdensome compared to the specific model presented in the DP. The key condition for the usage of this approach is evidence

¹ Under IAS 39, banks are led proxy-hedge because some managed exposures (e.g. core demand deposits, sub-LIBOR instruments, equity book...) are not eligible underlying items for hedge accounting.



of the risk mitigation effect resulting from hedging derivatives. This evidence could be provided demonstrating the reduction of the interest rate sensitivity with regard to considered portfolios (sensitivity test). Limits for the sensitivity analysis would be defined in the entity's internal risk management policy. This test could be supplemented by a backstop measure such as demonstrating that the interest rate sensitivity is within the entity's risk limits. Such demonstration could be interesting for investors, not only when entities use macro hedging derivatives, but also for cash interest rate exposures.

Treatment of derivatives in the Macro hedging model

Finally, we believe that those macro hedging derivatives not contributing to risk mitigation should be treated as trading derivatives. The process to identify the portion of "non-mitigating" derivatives should be determined and locked in a Group policy (e.g. first-in, first-out; last-in, first-out; proportion of all derivative; etc.). This information should also be disclosed in the notes to the financial statements. In this regard, we think that disclosures should be enhanced in order to:

- explain to users how interest rate risk is managed: this will be the only way to render entities comparable, as the instruments within the banking books are different from a country to another, leading to managing different risks from an entity to another;
- explain to users what kind of test is performed to qualify macro-hedging derivatives as "mitigating" derivatives.

We expect that our input will contribute to the discussion launched by the IASB in view of developing a macro hedge accounting model.

Yours sincerely,



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The **European Association of Co-operative Banks** (EACB) is the voice of the co-operative banks in Europe. It represents, promotes and defends the common interests of its 28 member institutions and of co-operative banks in general. Co-operative banks form decentralised networks which are subject to banking as well as co-operative legislation. Democracy, transparency and proximity are the three key characteristics of the co-operative banks' business model. With 3.700 locally operating banks and 71.000 outlets co-operative banks are widely represented throughout the enlarged European Union, playing a major role in the financial and economic system. They have a long tradition in serving 215 million customers, mainly consumers, retailers and communities. The co-operative banks in Europe represent 56 million members and 850.000 employees and have a total average market share of about 20%.

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Answers to specific questions

Question 1—Need for an accounting approach for dynamic risk management: Do you think that there is a need for a specific accounting approach to represent dynamic risk management in entities' financial statements? Why or why not?

As stated in our general comments, we believe that a hedge accounting model for open portfolios should be developed. We also believe that the IASB has adequately reflected a good understanding of the issue, which makes of the DP a good starting point to develop a macro-hedging model.

While we believe in the necessity of developing such a model, we think that it should stick to achieving its main goal, i.e. the elimination of accounting mismatches. Therefore, it is important to discard objectives that go beyond this main goal, since they could induce additional P&L volatility.

Question 2—Current difficulties in representing dynamic risk management in entities' financial statements:

(a) Do you think that this DP has correctly identified the main issues that entities currently face when applying the current hedge accounting requirements to dynamic risk management? Why or why not? If not, what additional issues would the IASB need to consider when developing an accounting approach for dynamic risk management?

Yes, the DP provides a detailed analysis which reflects the difficulties which our members face when applying hedge accounting.

(b) Do you think that the PRA would address the issues identified? Why or why not?

We think that the DP has identified many of the main issues. However, it does not provide a solution fully consistent with the risk management practices which the DP identifies as "mainly used by banks" (i.e. based on analysis of the sensitivity of the net interest margin and "gap analysis".)

Question 15—Scope

(a) Do you think that the PRA should be applied to all managed portfolios included in an entity's dynamic risk management (ie a scope focused on dynamic risk management) or should it be restricted to circumstances in which an entity has undertaken risk mitigation through hedging (ie a scope focused on risk mitigation)? Why or why not? If you do not agree with either of these alternatives, what do you suggest, and why?

We are of the opinion that the macro hedging model should be applied to the portfolios for which an entity has undertaken *risk mitigation* using hedging instruments (focus on risk mitigation).

The original purpose of hedge accounting was to eliminate the accounting mismatches that result from the divergent measurement of the different categories of the financial instruments (mixed model). Therefore, hedge accounting is desirable only in the areas where not justifiable measurement inconsistencies arise.



(b) Please provide comments on the usefulness of the information that would result from the application of the PRA under each scope alternative. Do you think that a combination of the PRA limited to risk mitigation and the hedge accounting requirements in IFRS 9 would provide a faithful representation of dynamic risk management? Why or why not?

A macro hedge accounting standard with a focus on dynamic risk management would cause a revaluation of the large part of the financial institutions' banking book transactions with regard to the interest rate risk (and possibly to other managed risks). This would result in a "fair value-like" measurement of the assets and liabilities, limited to interest rate component. According to IAS 39 or IFRS 9, such assets and liabilities are measured at amortised costs only due to the fact that the risks associated with these are monitored on a regular basis.

A scope focussed on risk mitigation, on the other hand, reflects one of the goals of dynamic risk management in protecting net interest income sensitivity.

(c) Please provide comments on the operational feasibility of applying the PRA for each of the scope alternatives. In the case of a scope focused on risk mitigation, how could the need for frequent changes to the identified hedged sub-portfolio and/or proportion be accommodated?

We believe that the proposed macro hedging model presents operational challenges regardless of the scope chosen. An alternative approach to qualify macro hedging derivatives based on ALM indicators would be less burdensome.

(d) Would the answers provided in questions (a)–(c) change when considering risks other than interest rate risk (for example, commodity price risk, FX risk)? If yes, how would those answers change, and why? If not, why not?

Above considerations are also valid with regard to commodity price risk and FX risk.

Question 3—Dynamic risk management: Do you think that the description of dynamic risk management in paragraphs 2.1.1–2.1.2 is accurate and complete? Why or why not? If not, what changes do you suggest, and why?

We agree that the description seems to cover the main characteristics of risk management within banks. We also expect that macro hedging model could also be of interest to insurance industry.

Paragraph 2.1.2 (c) of the DP states that only risk arising from external exposures is included in the managed portfolio. The interest risk management of a banking book typically includes internal derivatives as the interest rate risk is transferred to trading book, which externalises the net interest rate exposure on a macro basis. Therefore, internal derivatives should be included in the managed portfolio.

Question 4—Pipeline transactions, EMB and behaviouralisation.

Pipeline transactions:

(a) Do you think that pipeline transactions should be included in the PRA if they are considered by an entity as part of its dynamic risk management? Why or why not? Please explain your reasons, taking into consideration operational



feasibility, usefulness of the information provided in the financial statements and consistency with the Conceptual Framework for Financial Reporting (the Conceptual Framework).

We believe that fixed rate pipeline transactions as well as all other variable rate forecasted transactions should be included in the macro hedge accounting standard if they are considered as part of the entity's dynamic risk management. This would better reflect the managed risk.

The DP states that there is a conceptual difficulty in recognising an asset or a liability in the statement of financial position before an entity becomes a party to the transaction. We do not regard pipeline transactions very differently from loan commitments that may be included in the standard. Moreover, the off-balance sheet time of pipeline transactions is expected to be relatively short before the actual transactions are recognised in the statement of financial position. Therefore, the inclusion of pipeline transactions is not critical if the conceptual difficulties cannot be reasonably overcome.

Equity Model Book (EMB)

(b) Do you think that EMB should be included in the PRA if it is considered by an entity as part of its dynamic risk management? Why or why not? Please explain your reasons, taking into consideration operational feasibility, usefulness of the information provided in the financial statements and consistency with the Conceptual Framework.

Firstly the EMB should be included if it is part of internal risk management in the banking book.

Secondly, the recent legal developments regarding capital requirements have led to a dramatic increase in the required equity. Therefore, the inclusion of EMB is a condition of reflecting adequately the current risk.

Lastly, we believe that EMB, whether it is modelled as fixed or variable rate, should be included in the PRA. As liabilities are part of the macro-hedging model, equity should also be included so that there should be no difference whether the entity is funded by equity or by liabilities.

Behaviouralisation

(c) For the purposes of applying the PRA, should the cash flows be based on a behaviouralised rather than on a contractual basis (for example, after considering prepayment expectations), when the risk is managed on a behaviouralised basis? Please explain your reasons, taking into consideration operational feasibility, usefulness of the information provided in the financial statements and consistency with the Conceptual Framework.

We agree that the cash flows could be based on a behaviouralised basis if the risk is also managed dynamically on a behaviouralised basis. However this should not be mandatory, as customer behaviour will have a smaller effect on the present value of cash flows from variable rate than fixed rate exposures. Moreover, we do not believe that a detailed guidance would be needed as the customer behavior is different between territories and banks.



Question 5—Prepayment risk: When risk management instruments with optionality are used to manage prepayment risk as part of dynamic risk management, how do you think the PRA should consider this dynamic risk management activity? Please explain your reasons.

We believe that prepayment risk should be behaviouralised and included in the expected cash flows if this is in accordance with the internal risk management. If options are used in risk management to hedge against interest rate decline (one sided risk), they should be included in the macro-hedging model..

Question 6—Recognition of changes in customer behaviour: Do you think that the impact of changes in past assumptions of customer behaviour captured in the cash flow profile of behaviouralised portfolios should be recognised in profit or loss through the application of the PRA when and to the extent they occur? Why or why not?

We believe that changes in the customer behaviour should be reflected in the expected cash flows when they occur. Changes in the assumption of customer behaviour should be recognised in full in profit and loss at the moment when it occurs only if those changes lead to overhedging.

Question 7—Bottom layers and proportions of managed exposures: If a bottom layer or a proportion approach is taken for dynamic risk management purposes, do you think that it should be permitted or required within the PRA? Why or why not? If yes, how would you suggest overcoming the conceptual and operational difficulties identified? Please explain your reasons.

We would prefer to refer to underhedging instead of bottom layer approach, as it seems more appropriate to a net interest rate position. The bottom layer approach is adequate when relating to gross positions.

We agree that a bottom layer approach could be used in dynamic risk management. However, there should be no requirements for tracking and amortisation if a constant level of a bottom layer can be demonstrated. Only if the bottom layer is breached, the breached amount should affect PRA revaluation and P&L.

We disagree with the understanding of paragraph 3.7.6. Hedging the proportion of the exposure doesn't require tracking because the proportion comes from the whole hedged portfolio. We note that the change in the hedged proportion can also be due to the change in customer behaviour.

Question 8—Risk limits Do you think that risk limits should be reflected in the application of the PRA? Why or why not?

We see risk limits as an internal control mechanism that should not affect hedge accounting as such. However, risk limits could be used to demonstrate that the entity is mitigating the risk.

Question 9—Core demand deposits :
(a) Do you think that core demand deposits should be included in the managed portfolio on a behaviouralised basis when applying the PRA if that is how an entity would consider them for dynamic risk management purposes? Why or why not?



We believe that core demand deposits should be included in the managed portfolio on a behaviouralised basis when applying the macro hedge accounting standard if that is how an entity would consider them for dynamic risk management purposes. The determination of the core demand deposits is generally associated with a wide scope of discretion.

(b) Do you think that guidance would be necessary for entities to determine the behaviouralised profile of core demand deposits? Why or why not?

We believe that there is no need for detailed guidance for determining behaviouralisation because it may vary from country to country. Furthermore, this may have a limitation effect on the risk management. We think that the required transparency could be ensured through appropriate disclosures.

Question 10—Sub-benchmark rate managed risk instruments:

(a) Do you think that sub-benchmark instruments should be included within the managed portfolio as benchmark instruments if it is consistent with an entity's dynamic risk management approach (ie Approach 3 in Section 3.10)? Why or why not? If not, do you think that the alternatives presented in the DP (ie Approaches 1 and 2 in Section 3.10) for calculating the revaluation adjustment for sub-benchmark instruments provide an appropriate reflection of the risk attached to sub-benchmark instruments? Why or why not?

In our opinion sub-benchmark instruments should be included in the managed portfolio as benchmark instruments if it is consistent with an entity's dynamic risk management approach (ie. change of the benchmark rate is hedged).

We believe that any positive or negative customer margin should be equally treated in entity's risk management. Consequently, we support approach 3. Otherwise a not economically justified P&L-volatility will arise.

(b) If sub-benchmark variable interest rate financial instruments have an embedded floor that is not included in dynamic risk management because it remains with the business unit, do you think that it is appropriate not to reflect the floor within the managed portfolio? Why or why not?

Yes, it is appropriate not to reflect the floor, as mentioned above.

Question 11—Revaluation of the managed exposures:

(a) Do you think that the revaluation calculations outlined in this Section provide a faithful representation of dynamic risk management? Why or why not?

(b) When the dynamic risk management objective is to manage net interest income with respect to the funding curve of a bank, do you think that it is appropriate for the managed risk to be the funding rate? Why or why not? If not, what changes do you suggest, and why?

n/a



Question 12—Transfer pricing transactions:

(a) Do you think that transfer pricing transactions would provide a good representation of the managed risk in the managed portfolio for the purposes of applying the PRA? To what extent do you think that the risk transferred to ALM via transfer pricing is representative of the risk that exists in the managed portfolio (see paragraphs 4.2.23–4.2.24)?

(b) If the managed risk is a funding rate and is represented via transfer pricing transactions, which of the approaches discussed in paragraph 4.2.21 do you think provides the most faithful representation of dynamic risk management? If you consider none of the approaches to be appropriate, what alternatives do you suggest? In your answer please consider both representational faithfulness and operational feasibility.

(c) Do you think restrictions are required on the eligibility of the indexes and spreads that can be used in transfer pricing as a basis for applying the PRA? Why or why not? If not, what changes do you recommend, and why?

(d) If transfer pricing were to be used as a practical expedient, how would you resolve the issues identified in paragraphs 4.3.1–4.3.4 concerning ongoing linkage?

n/a

Question 13—Selection of funding index

(a) Do you think that it is acceptable to identify a single funding index for all managed portfolios if funding is based on more than one funding index? Why or why not? If yes, please explain the circumstances under which this would be appropriate.

(b) Do you think that criteria for selecting a suitable funding index or indexes are necessary? Why or why not? If yes, what would those criteria be, and why?

n/a

Question 14—Pricing index

(a) Please provide one or more example(s) of dynamic risk management undertaken for portfolios with respect to a pricing index.

(b) How is the pricing index determined for these portfolios? Do you think that this pricing index would be an appropriate basis for applying the PRA if used in dynamic risk management? Why or why not? If not, what criteria should be required? Please explain your reasons.

(c) Do you think that the application of the PRA would provide useful information about these dynamic risk management activities when the pricing index is used in dynamic risk management? Why or why not?

n/a



Question 16—Mandatory or optional application of the PRA

(a) Do you think that the application of the PRA should be mandatory if the scope of application of the PRA were focused on dynamic risk management? Why or why not?

We oppose a macro hedge accounting standard focused on dynamic risk management. In principle, we favor a risk mitigation approach.

(b) Do you think that the application of the PRA should be mandatory if the scope of the application of the PRA were focused on risk mitigation? Why or why not?

The application of a macro hedge accounting standard focused on risk mitigation should be optional. A mandatory application would make barely sense, if the dynamic hedging performed by an entity is based on the natural hedges without or, alternatively, with a very little use of the derivative hedging instruments. In these entities, risk exposures result in large part from the assets and liabilities that are measured at amortized cost and do not give rise to any accounting mismatches. Its application would require the revaluation of those assets and liabilities and may cause volatilities which would not provide information relevant for users of the financial statements.

Moreover, mandatory application would cause in many cases costs that will by far outweigh the possible resulting benefits. Furthermore, due to the existing diversity in dynamic risk management approaches the comparability will hardly be achieved.

Question 17—Other eligibility criteria

(a) Do you think that if the scope of the application of the PRA were focused on dynamic risk management, then no additional criterion would be required to qualify for applying the PRA? Why or why not?

(i) Would your answer change depending on whether the application of the PRA was mandatory or not? Please explain your reasons.

(ii) If the application of the PRA were optional, but with a focus on dynamic risk management, what criteria regarding starting and stopping the application of the PRA would you propose? Please explain your reasons.

We oppose a macro hedge accounting standard focused on dynamic risk management.

(b) Do you think that if the scope of the application of the PRA were to be focused on risk mitigation, additional eligibility criteria would be needed regarding what is considered as risk mitigation through hedging under dynamic risk management? Why or why not? If your answer is yes, please explain what eligibility criteria you would suggest and, why.

In our view, the portfolios to which general hedge accounting (IFRS 9) is applied should be excluded from the scope of macro hedge accounting. Moreover, it should be possible to exclude the portfolios or positions due to missing accounting mismatches. This concerns especially natural hedges (offsetting of the fair value changes in a portfolio of assets and liabilities without use of the hedging derivatives).



We would also like to point out a possible set of problems resulting from the use of hedge accounting in a group of consolidated entities with different business models and, consequently, different risk management approaches.

Those problems arise especially in the situation when risk management as well as hedge accounting are conducted primarily on the level of each single group entity. In this setup, the risk management of each group entity considers risk exposures resulting from both intragroup transactions and transactions with non-group counterparts (external transactions). For risk management purposes, both intragroup and external derivative transactions can be made. Moreover, there is no portfolio management on the group level. It is not quite clear how the proposed approach will ensure a faithful representation of dynamic risk management performed on the entity level.

According to Section 2.1 of the DP, only risk arising from external exposures is included within the managed portfolio. An exclusion of the intragroup exposures (e.g. intragroup funding and/or intragroup derivative transactions) would result in an incomplete representation of the dynamic risk management in the financial statements as well as in P&L volatility. The elimination of these valuation inconsistencies could be theoretically ensured on the group level. However, this would require a fundamental change of the entire risk management organization. In our view, the new macro hedge accounting requirements should not imply any constraints with regard to the risk management setup.

(i) Would your answer change depending on whether the application of the PRA was mandatory or not? Please explain your reasons.

We do not support mandatory application of the macro hedge accounting standard.

(ii) If the application of the PRA were optional, but with a focus on risk mitigation, what criteria regarding starting and stopping the application of the PRA would you propose? Please explain your reasons.

n/a

Question 18—Presentation alternatives

(a) Which presentation alternative would you prefer in the statement of financial position, and why?

We support the single net line item presentation (net revaluation adjustment for all exposures) in the statement of financial position as it best represents the nature on a net position being hedged. Other alternatives (line-by-line gross up and separate line items for all assets and all liabilities) would require more tracking and may be operationally burdensome, whilst not providing additional relevant information for users of the financial statements that could improve their understanding of an entity's dynamic risk management.

(b) Which presentation alternative would you prefer in the statement of comprehensive income, and why?

We support the actual net interest income approach in the statement of comprehensive income as it provides a reasonable presentation of the effects from risk management.



We do not consider that the stable net interest income approach is adequate, since it is based on the expected values and not on the actual outcomes. Under this approach, the profit or loss line "Revaluation effect from dynamic risk management" would be difficult to interpret.

(c) Please provide details of any alternative presentation in the statement of financial position and/or in the statement of comprehensive income that you think would result in a better representation of dynamic risk management activities. Please explain why you prefer this presentation taking into consideration the usefulness of the information and operational feasibility.

n/a

Question 19—Presentation of internal derivatives

(a) If an entity uses internal derivatives as part of its dynamic risk management, the DP considers whether they should be eligible for inclusion in the application of the PRA. This would lead to a gross presentation of internal derivatives in the statement of comprehensive income. Do you think that a gross presentation enhances the usefulness of information provided on an entity's dynamic risk management and trading activities? Why or why not?

We agree that internal derivatives within a consolidated group (transactions between the group companies as well as intra-entity transactions) should be included in the macro hedge accounting standard. Therefore, we support the gross presentation of internal derivatives in the income statement. We believe that gross presentation is useful as net interest income reflects managed risk and the possible open risk are reported in trading profit or loss.

(b) Do you think that the described treatment of internal derivatives enhances the operational feasibility of the PRA? Why or why not?

We believe that proposed treatment of internal derivatives enhances the operational feasibility of the proposed macro hedge accounting standard as long as there are no externalisation requirements that would add operational complexity and tracking. We believe that externalisation requirements are not necessary because it is unlikely that banks would not transact any external derivatives and leave the risk open (i.e no risk limits).

(c) Do you think that additional conditions should be required in order for internal derivatives to be included in the application of the PRA? If yes, which ones, and why?

Internal derivatives are used to transfer risks from banking book to trading unit.

Question 20—Disclosures

(a) Do you think that each of the four identified themes would provide useful information on dynamic risk management? For each theme, please explain the reasons for your views.

(b) If you think that an identified theme would not provide useful information, please identify that theme and explain why.



(c) What additional disclosures, if any, do you think would result in useful information about an entity's dynamic risk management? Please explain why you think these disclosures would be useful.

We agree with the themes identified but we do not support extensive disclosure requirements. Furthermore, there may be some overlap with the disclosures being considered and those already required by IFRS 7.

Question 21—Scope of disclosures

(a) Do you think that the scope of the disclosures should be the same as the scope of the application of the PRA? Why or why not?

(b) If you do not think that the scope of the disclosures should be the same as the scope of the application of the PRA, what do you think would be an appropriate scope for the disclosures, and why?

We believe that the scope of the disclosures should be the same as the scope of the application of the macro hedge accounting standard.

Question 22—Date of inclusion of exposures in a managed portfolio:

Do you think that the PRA should allow for the inclusion of exposures in the managed portfolios after an entity first becomes a party to a contract? Why or why not?

(a) If yes, under which circumstances do you think it would be appropriate, and why?

We believe that exposures could be included in the macro hedge accounting standard also at a later stage due to the dynamic nature of open portfolios. In addition, the amount of risk and related risk management activities may change over time.

(b) How would you propose to account for any non-zero Day 1 revaluations? Please explain your reasons and comment on any operational implications.

The day 1 revaluations should be recognised in P&L to avoid amortisation and tracking. This would cause volatility but we believe it can be measured and explained.

Question 23—Removal of exposures from a managed portfolio

(a) Do you agree with the criterion that once exposures are included within a managed portfolio they should remain there until derecognition? Why or why not?

No, they should not. We believe that it should be allowed to remove exposures from a hedged portfolio prior to maturity or proceed to earlier derecognition due to the dynamic nature of risk management (e.g. a change in the hedging strategy).



(b) Are there any circumstances, other than those considered in this DP, under which you think it would be appropriate to remove exposures from a managed portfolio? If yes, what would those circumstances be and why would it be appropriate to remove them from the managed portfolio?

n/a

(c) If exposures are removed from a managed portfolio prior to maturity, how would you propose to account for the recognised revaluation adjustment, and why? Please explain your reasons, including commenting on the usefulness of information provided to users of financial statements.

Revaluations of removed portfolios should be recognised in P&L depending on the aim of the removal. If the removal results from a decision not to hedge anymore the existing portfolio, the revaluation of the previously hedged portfolio should be amortised. However, as the amortisation could cause operational difficulties it should also be allowed to recognise the full effect in P&L at the time of the removal. On the contrary, if the removal of the portfolio results from a sale of the portfolio (to a securitisation for instance), the gain or loss resulting from the sale should be taken flat in P&L.

Question 24—Dynamic risk management of foreign currency instruments

(a) Do you think that it is possible to apply the PRA to the dynamic risk management of FX risk in conjunction with interest rate risk that is being dynamically managed?

(b) Please provide an overview of such a dynamic risk management approach and how the PRA could be applied or the reasons why it could not.

We agree that in many cases it would be possible to apply the macro hedge accounting standard to the dynamic risk management of FX risk in conjunction with interest rate risk that is being dynamically managed. However, interest rate risk and FX risk are sometimes managed separately. Hence, a separate macro hedge standard application for interest rate risk and for FX risk should be feasible.

Question 25—Application of the PRA to other risks:

(a) Should the PRA be available for dynamic risk management other than banks' dynamic interest rate risk management? Why or why not? If yes, for which additional fact patterns do you think it would be appropriate? Please explain your fact patterns.

(b) For each fact pattern in (a), please explain whether and how the PRA could be applied and whether it would provide useful information about dynamic risk management in entities' financial statements.

We believe that the macro hedge accounting standard described in the discussion paper is not reasonably applicable to all non-bank-specific business models. This concerns especially insurance companies that typically use the liability oriented investment strategies.



Question 26—PRA through OCI:

Do you think that an approach incorporating the use of OCI in the manner described in paragraphs 9.1–9.8 should be considered? Why or why not? If you think the use of OCI should be incorporated in the PRA, how could the conceptual and practical difficulties identified with this alternative approach be overcome?

We do not support a macro hedge accounting standard with the revaluation effects presented in OCI. The OCI presentation, which would consist of the “Net effect of the revaluation of the future cash flows from the managed portfolio with respect to the managed risk and the remeasurement of derivatives”, will lead to operating tracking burden in order to identify amounts to recycle to P&L.