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Mr. Hans Hoogervorst
Chairman of the International Accounting Standards Board
30 Cannon Street

London EC4M 6XH
United Kingdom

FAS AG - Comment letter on IASB Discussion Paper 2014/1

16.10.2014

Dear Mr. Hoogervorst,

FAS AG, as a party consulting on and involved in the preparation of financial statements, appreciates the opportunity to comment on the Discussion Paper *Accounting for Dynamic Risk Management: a Portfolio Revaluation Approach to Macro Hedging*, issued by the IASB on 17 April 2014.

We would like to thank the involved persons for their work to develop the discussion paper and are looking forward on the development of a standard draft. If you believe that any of our comments require further explanations or would like to discuss any further aspects please feel free to contact us.

Yours sincerely

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<u>**General comments**</u>

We appreciate the work of the ISAB to develop a new approach which allows a better presentation of economic behavior especially within a dynamic risk management. We generally believe that financial statements are decision useful if they represent the economic situation of the reporting entity. Further we believe that any approach not in line with the economic situation will cause more complexity for the preparers of financial statements and tend to create sooner or later unintended mismatches within financial statements.

We recognize the problem that a strong link to an internal approach might reduce intercompany comparability, increase necessary efforts for audit and increase the need for users of financial statements to understand the underlying (risk) management approaches. Therefore some users and preparers of financial statements might argue that a pure reduction of accounting mismatches shall be the purpose of a standard about macro hedging approaches. However in our opinion such an approach incentives companies to put large efforts into an optimized accounting approach or even influence business decisions based on accounting rules instead of putting the effort in an optimized risk management and just present the results.

Question 1—Need for an accounting approach for dynamic risk

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?

<u>We believe that there is a need for a practicable approach to show the impact of dynamic risk management within financial statements</u> (especially for banks but also other industries like utility industry or any industry with complex foreign currency exposures might be impacted). Current hedge accounting rules (even under IFRS 9 where we recognize a much stronger consideration of economic risk management approaches) does not completely allow a replication of economic risk management practices within financial statements.

We understand that such a new approach should not break up to many of the existing rules. However we see the need to align the dynamic risk management approach in the long term with the general hedge accounting approach. On the one hand the basic approach of the revaluation approach seems easier to us than the current hedge accounting requirements. On the other hand static risk management approaches are usually easier to document and track. Further most banks have a combination of dynamic risk management strategies for portfolios and static risk management strategies for single positions (e.g. asset swaps). In our opinion the requirements for static fair value hedges should not be more complex than those for a simple dynamic portfolio.

Therefore <u>we recommend considering the analogous application of the portfolio revaluation approach for fair value hedge accounting.</u> In our opinion this would reduce the complexity of IFRS for preparers as well as for users of financial statements and would improve the opportunities to show economic performance and the impact of risk management within financial statements.

Furthermore there are some interdependencies between static and dynamic risk management approaches that could result in an unfaithful presentation:

- Some banks consider the floating leg of a micro hedge swap within the dynamic managed portfolio. In those cases the float leg and the hedged item represent a static risk management approach while the floating leg is considered as part of the dynamic managed open portfolio. Especially for presentation of interest result this approach should be considered (see our response about interest rate presentation)
- Banks do not only use static risk management approaches for external hedge relationships but also for internal deals. Since internal deals are planned to be considered within the PRA but not within general hedge accounting a presentation different from the economic situation might occur. ((see our response about internal deals)

Therefore even if no adjustment or integration of general hedge rules is planned, a standard on dynamic risk management should give guidance how to handle interdependencies between static micro hedge relationships and dynamic risk managed portfolios.

Question 2—Current difficulties in representing dynamic risk

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 we think that the main issues entities currently face when applying the current hedge accounting requirements to dynamic risk management were correctly identified. Further issues within the current portfolio hedge accounting approach are the mandatory application of the percentage layer approach which is often not in line with risk management practices and the circumstance that in some cases derivatives are used for a part of their term for hedging purposes and the remaining term to build up a strategic position without any (fair value) hedge intention.

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

In our opinion the PRA has the potential to solve most of the current problems and even the issues not explicitly mentioned within the DP are implicitly considered and can be solved within the PRA. However if those issues are really solved depends a lot on how the PRA will finally be implemented.

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 generally agree with the definition of dynamic risk management and think that the definition is comprehensive. However even if we understand the criteria in 2.1.2 as supporting criteria but not defining criteria of dynamic risk management we believe that the objective to keep a p/l figure within a targeted sensitivity to changes in market rates is not limited to interest rate risk (2.1.2 a). Further we experienced that including internal exposures within the managed exposure is a common practice (e.g. FX risk between different group entities or interest rate risk between a trading book and a banking book). Therefore we recommend removing this criterion because it either might lead to restrictions in application of the PRA which are not in line with common dynamic risk practices or does not add any benefit to the definition of dynamic risk management (2.1.2 c)
If there is any further guidance planned on distinction between dynamic and static risk management we recommend to include a clarification for cases in which an instrument is partly included in a dynamic and partly included into a dynamic risk management approach (see our example about the floating leg of micro hedge swap in our answer on question 1).

Question 4 — Pipeline transactions, EMB and behaviouralization

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).*

Generally we believe that users of financial statements benefit if the economic situation of an entity is shown within financial statements and therefore <u>pipeline transactions should be included in the PRA if this is in line with the actual risk management practice of the reporting entity</u>. Furthermore considering behaviouralization (for our opinion about this issue please see below) but not pipeline transactions in our opinion would create an inconsistency because both circumstances reflect an expected behavior of market participants. Of course we recognize the issue that pipeline transactions might not qualify as assets or liabilities as defined within the framework but we believe that a prudent presentation of the economic situation of a company has a higher priority. Further the recognition of an internal liability due to public but not legal commitment is already part of the

IFRS since IAS 37 allows the recognition of a provision for internal cost if a public commitment creates a de facto external obligation.

From an operational feasibility perspective we believe that for an entity that includes pipeline transactions into their dynamic risk management it should not create any unacceptable additional cost for implementation. If it is not part of a dynamic risk management strategy no implementation would be necessary.

However if the IASB decides for any reason not to allow pipeline transactions within the PRA, we believe that alternatively application of cash flow hedges could be possible for most companies without too many adjustments in risk management strategy.

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.*

We know about different approaches to consider equity within the interest rate risk management practice of banks. In some cases a separate portfolio of assets is allocated to the equity position and the equity model book replicates this specified portfolio. In this case an inclusion of and equity model book would not be necessary. However in other cases equity is replicated by a long term (or a bundle of long term) or even perpetual bond(s) and included into the refinancing portfolio. In those cases a one to one allocation of assets to the equity position is not possible and the application of a PRA without consideration of the synthetic bonds representing the equity position would cause a mismatch between internal and external results. In those cases an inclusion of an equity model book would improve the alignment of risk management practice and financial presentation.

However we understand that according to IAS 32 equity should not be revaluated since it is a residual amount and a PRA for a synthetic equity position would cause an implicit revaluation. Nevertheless if the ISAB decides not to include an EMB into the PRA disclosures and pro forma information about the result from an EMB should be explicitly allowed.

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.*

Generally we would prefer a consideration of market participant behavior by revaluing embedded options and believe that in many cases this is also the better risk management practice. However especially within retail portfolios there is evidence that customer behavior is not or only partly linked to market conditions. In those cases other behavior based approaches are necessary. For prepayments consideration of expected cash flows is already allowed under the current PFVH in IAS 39. Therefore a prohibition of behavior based prepayments in our opinion would be a step backward compared to the current situation.
Regarding demand deposits we understand the consideration that the fair value shall not be less than the repayment amount. However consideration of demand deposits with an expected maturity instead of contractual maturity is not only a common risk management practice and (as correctly identified within the DP) one of the main problems within the current hedge accounting approach but a main component of the business model of most banks (maturity transformation).
Furthermore our general preference for a correct presentation of the actual risk management practice as described within a) applies also for this point. Therefore in our opinion allowing behaviouralised cash flows when (and only when) this is part of the actual risk management practices would improve applicability for preparers and information quality for users.

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.

In our opinion the treatment should depend on the actual risk management approach. If options are used to offset embedded optional prepayment options a revaluation of the embedded option would be the best approach to show the effects of risk management. However if the prepayment risk is not explicitly embedded in the terms of the hedged loans we recommend to consider the option hedging approach from IFRS 9 General Hedge Accounting and amortize the time value of the option over the term as hedging cost. We are aware that the PRA does not intent to change the measurement of the hedging instruments but since we believe (as described in our answer to question 1) that static and dynamic risk management should be treated the same that approach seems to create the best information for users and makes the effort for the preparer reasonable and the outcome less arbitrary compared to a revaluation against a somehow specified index level.

Question 6—Recognition of changes in customer behavior

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

Yes we believe that <u>immediate recognition of effects form changes in customer behavior in profit or loss would be appropriate</u> since changes in customer behavior estimations also create economic effects and immediate recognition would show the correct impact from risk management practice to users of financial statements and does not result in any major implementation problems for preparers. A deferral or amortization of those effects would reduce information for users and make the preparation more complicated.

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.

<u>We believe that a bottom layer approach neither for economic risk management nor for accounting purposes is able to reflect the risk situation correctly</u>. E.g. within the example of the DP a reduced prepayment rate of only 20 would give rise to interest rate risk for the unhedged position. Further implementing a bottom layer approach would contradict a direct realization of changes in customer behavior which we favored in question 6. Beneath this we also agree that appropriate accounting treatment of a bottom layer approach in combination with the PRA would create unnecessary complexity for preparers and make it harder for users to understand the effects of risk management.

Question 8—Risk limits

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

Often risk limits are defined in sensitivity measures like a BPV. In this case it might be difficult to separate effects from risk limits and effects from non-perfect risk management activities. Further we realize that from an economic perspective net open risk positions might be created also by instruments already measured at fair value through profit and loss. In this case the PRA would either change the measurement of those instruments even if they are outside the of the PRA or the consideration of risk limits would result in different results depending on the original measurement of the instruments that create the net open position. Therefore we do not believe that risk limits should be separately considered within the PRA. We also agree on the argumentation of counterintuitive results as described in the DP as well as that an incorporation of risk limits would create a significant conceptual challenge and probably lead to an accounting approach unequal to the risk management approach.

However a disclosure which part of the net result from PRA results from open risk positions in line with the risk management strategy and which part results from unexpected changes in cash flows and other imperfections in risk management might help the users to gain a better understanding of the effects of risk management. To avoid unfeasible efforts for preparers such a disclosure should either be voluntary or completely based on existing information from risk management.

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?*

Yes we strongly believe that core demand deposits should be included in the managed portfolio on a behaviouralised basis. Choosing a different approach for core demand deposits would most likely create an outcome different from the economic result and thereby reduce the usefulness of financial statements for users. Further not considering expected behavior would be not in line with our general opinion that customer behavior should be considered within the PRA and changes is customer behavior should be recognized in profit or loss (also see our answers on question 4-6). Compared to the bottom layer approach we see the difference to consideration of behavorized core deposits in the circumstance that prepayments are excluded from revaluation only to the extent that they are refilled by new homogenous deposits. Therefore core deposits do not generally exclude an economic risk from measurement.

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 do not believe that additional guidance is necessary to determine the behaviouralised profile of core demand deposits. We agree that there are different approaches in risk management but do not believe that it should be the task of accounting standards to give guidance on appropriate risk management. Guidance on how to consider core deposits might lead to differences between risk management and the PRA. Rather more if the PRA is introduced we see the task for preparers and auditors to show resp. to verify that PRA and risk management are aligned and a sufficient documentation of this alignment exists and arbitrary use of PRA is avoided. However those requirements are not limited on the core deposit issue but apply on the whole approach. For one of the expected main applicants of the banking industry those requirements should be not too hard to fulfill since usually extensive rules and documentation requirements for risk management already exist (e.g. from a supervisory perspective)

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?*

We believe that sub-benchmark instruments should be included within the managed portfolio based on the internal risk management approach to avoid differences between economic and financial result. However from an implementation perspective approach 1 would reduce the revaluation efforts since contractual cash flows and the current benchmark rate should be generally available.

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?*

If cash flows based on internal transfers are generally used for the PRA – we believe there should be no difference between the sources of transferred or retained cash flows. Therefore we believe in this case the embedded floor can be excluded. However this exclusion may only apply if it is in line with the internal cash flow transfer and for all other instruments also the PRA is based on internal transferred cash flows.

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?*

We generally agree on the revaluation approach and agree that the approach provide a faithful representation of some dynamic risk management practices. However we acknowledge that there are simpler approaches applied. E.g. some banks use the full contractual cash flows of the managed portfolio for risk management purposes instead of cash flows derived from transfer pricing (even if there is usually a transfer pricing mechanism in place). Our understanding of the DP is that such a practice would also be covered and no splitting of cash flows for PRA purposes would be necessary if not also performed for dynamic risk management purposes.

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?*

In our opinion accounting standards shall not make any rules for the appropriate curve risk management should consider. Therefore the funding curve is the appropriate curve for PRA purposes if is for risk management purposes. Any differences between the curve applied in risk management and the curve applied within the PRA would lead to different results in profit or loss and reduce the usefulness of financial statements for users.

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)?*

Transfer pricing can provide a good proxy for the managed risk depending on the actual business practice of a bank. We strongly recommend not making a link between transfer pricing and the managed portfolio mandatory since there will be many entities (banks as well as non-banks) who apply different approaches for risk management. Rather we think that internal procedures and principles to determine the need for risk reducing instruments (e.g. derivatives) should also be the basis for the managed risk of the managed portfolio. Those procedures could be based on transfer prices but also on a total different approach. For example we know about banks which use the total banking book cash flow (including customer margin) and the internal funding rate to determine the risk position and total ALM profit or loss. Others may only apply margin free cash flows but use the

3 month swap rate. However in both cases a revaluation based on the managed cash flows and the managed interest rate curve would result in a faithful presentation of the entities effects of risk management.

If companies would be forced to use another approach to determine the revaluation effect than the internal applied approach this would most probably lead to a new mismatch between the revaluated portfolio and the risk reducing instruments.

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.*

Similar to our answer on a) we <u>do not believe that there is the one and only approach to represent dynamic risk management but rather believe that the chosen approach should reflect the actual risk management practice of the entity.</u> A standard on PRA therefore can describe the different approaches to make the options more clear but should not make any fix rules which approach shall be used. Currently IFRS 7 requires disclosures how risks arise and how they are managed. Within those disclosures it would be possible to explain the approach applied by the reporting entity and how this approach is reflected within portfolio revaluation.

However from an implementation perspective approach 1 would require a full set of individual cash flows for every instrument different from the contractual cash flow. It might cause substantial technical efforts to create and keep those cash flows. Approach 2 seems to be easy to implement in a first step but in this case rules on the treatment of day one results and their amortization might be necessary. Approach 3 would avoid those day one results but requires an instrument specific margin and an instrument specific revaluation while the two other approaches would allow a cumulative discounting of the cumulative cash flow of all instruments.

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?*

<u>We do not believe that any restrictions are necessary on the indexes or spreads applied.</u> Applying any restrictions on the internally used indexes would more less make rules for transfer pricing and risk management which is not the purpose of an accounting standard. Rather the opposite accounting standards should try to represent the economic situation and approaches. However within the audit process I would be necessary to verify that accounting and risk management practice are constantly aligned and not arbitrarily changed.

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?*

We recognize the different effects on the ALM portfolio from the different described scenarios. However as also discussed in the DP in practice it is often not even possible for ALM to identify the underlying reason for the transaction. Therefore we think that on the one hand an <u>individual treatment of the transaction between ALM and the business unit is in line the internal risk management practice</u> and on the other hand no unreasonable additional efforts for preparers are necessary to apply the PRA. <u>Therefore we do not see any need to resolve the issues.</u>

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.*

No often it will not be possible to identify one single funding index. Especially if the bank works with covered and uncovered assets and funding. In this case we would expect that the internal risk management procedures also apply different funding curves which should be considered within the PRA. However there also might be minor differences between funding indexes. If in those cases due to materiality reasons a single blended funding rate is applied for risk management this funding curve also should qualify for the PRA.

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?*

No we do not believe that criteria for selecting a suitable funding index are necessary. We believe that such criteria would set rules for risk management and that it is not the purpose for accounting standards to set such rules. Rather we prefer that documentation is required that the applied funding curve is aligned with actual risk management practice. Please also refer to our answers on question 12.

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*

Generally we expect that commodity as well as share price risks will be managed almost always based on a price index. Share portfolios are often but not always hedged on a single position basis but in some cases also on a dynamic portfolio basis. For commodity risk it is common to manage those risks dynamically on a portfolio basis.

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.*

In those cases the pricing index usually is derived from market prices respectively a market index. But no matter how the index is derived if it is applied within dynamic risk management it seems to be appropriate to apply this index for the PRA.

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?

Yes not only do we believe that application of the PRA would provide useful information about dynamic risk management activities when the pricing index is used but also believe if another index would be applicable for PRA purposes information usefulness would be reduced since the internal risk management approach is not reflected in financial statements.

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?*

Generally we believe that the PRA should be focuses in dynamic risk management rather than on pure risk mitigation. In our opinion information about effects from by purpose net open position provide useful information for users. Further work for implementation as well as chances for arbitrary manipulation of profit or loss would be reduced.

However we recognize also some problems with this approach especially if the application of the PRA is mandatory. E.g. usually banks apply dynamic risk management as defined in 2.1 of the discussion paper not only for interest risk but also for credit risk. But contrary to interest risk credit risk is usually only identified and analyzed but only in rare circumstances mitigated but rather managed by limits. If PRA would be mandatory for all risks if a dynamic risk management approach is applied this may lead to an almost full fair value approach which should not be the purpose of the PRA.

To avoid such unintended effects it is either necessary to limit the application to portfolios for which the risk management strategy generally incorporates risk mitigation if specified risk limits are exceeded or an entity may decide on risk by risk basis for which part of dynamic risk management the PRA is applied. (Please also refer to our answer on question 16)

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?*

As described in a) we believe that a valuation of net open positions within a generally hedged portfolio provides useful information for users. A focus only on risk mitigation in combination of with hedge accounting would result in reduced profit and loss volatility but would hide the economic effects taken by purpose. Furthermore such an approach might support a balance sheet steering more or less independent from economic risk management and steering approaches.

As mentioned in the discussion paper the comparability of financial statements from companies that do not perform any dynamic risk management with those that perform dynamic risk management but do not hedge might be reduced. However we believe that dynamic risk management completely without any risk mitigation will only occur in very rare circumstances and even if it occurs there is a fundamental difference if the entity decides not to manage the risk dynamically or if it decides based on the dynamic risk management not to mitigate the risk.

The sub-portfolio approach could be a practical alternative but in our opinion such a sub-portfolio approach should only apply if such sub-portfolios clearly exist within the dynamic risk management.

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?*

<u>In our opinion an approach based on dynamic risk management instead of actual risk mitigation would be much easier to implement and result in much lower operational effort.</u> In case of a pure focus on risk mitigation we expect that operational efforts would not seriously reduced compared to the current PFVH approach in IAS 39. Furthermore the frequent adjustment to changes in the hedged positions on an ongoing basis instead of a monthly basis could reduce volatility in profit or loss but will most likely even increase the operational efforts. Especially the identification and definition which assets and liabilities are actually hedged and how changes in those positions are treated and which not in case of a partial risk mitigation would be artificial and not reflect economic risk management.

If the net open risk position comprises deals already measured at fair value (e.g. due to the contractual cash flow criterion) it would be difficult to decide if and how to consider those deals within the revaluation of the hedged position.

Last but not least a problem might occur to identify in which case risk mitigation is actually performed. Most times risk mitigation is done by derivatives. However in some cases – especially but not only if it comes to FX risk – spot instruments are also used for risk mitigation purposes. In those cases it might be different to decide which instruments are original sources of risk and which are there for risk mitigation. Also there might be cases where derivatives are sold to customers as a customer service and not with a hedging purpose – even if they are included in the net risk position.

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?*

No, they would not change but e.g. in answer to question a) we already considered another risk – the credit risk. As mentioned in our answer to question c) for FX risk it might become difficult to identify which deals actually are hedging deals and which are not since for FX risk management purposes often spot deals are used for risk mitigation. Generally similar to the DP we focus on interest risk and the banking industry but always try also to consider other risks and industries.

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?*

No we do not believe that PRA should be mandatory in any case. There are several reasons for our position on this issue. First we believe a mandatory application of PRA for all types of risk which are dynamically managed could lead to unintended effects such as quasi full fair value measurement. Further we believe there would be a mismatch if hedge accounting is voluntary but PRA would be mandatory. In both cases the main goal is to represent risk management impact in financial statements and we can see no reason why the static approaches should be shown voluntary but dynamic approaches mandatory (For our general point about the need rep. the lack of need for two different approaches please see our answer on question 1). Last but not least we recognize that even if it might be possible to use a lot of existing systems and data to implement the PRA for dynamic risk management this will not be the case in all circumstances. Therefore a mandatory application might cause serious additional operational effort even in cases where the outcome is minor or immaterial.

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?*

As described in our answer to question 15 we generally prefer the application of the PRA focused on dynamic risk management instead of risk mitigation. However if the IASB decides on a focus for risk mitigation we still believe that similar to our answer to a) application should be voluntary. In case of risk mitigation the first argument of a) does not matter but the mismatch between hedge accounting and PRA as well as the additional effort argument also count for the risk mitigation approach.

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.*

As already mentioned within our answers to the previous questions we generally believe that no additional criteria are necessary if the approach would be voluntary and that alignment with risk management would be enough and that the relevant portfolio also is defined by the risk management and not by business units or other portfolio segregation criteria. However if against our argumentation for question 16 the PRA focuses on dynamic risk management would be mandatory for all types of risk we believe that further criteria would be necessary to avoid unintended effects like quasi full fair value measurement.

If application of the PRA were optional we think that starting the PRA should be a pure management decision (similar to the application of hedge accounting) but stopping PRA should not be allowed as long as dynamic risk management is applied for the portfolio (as in IFRS 9 Hedge accounting). By such an approach no entity would be forced to take additional effort to implement the PRA even in case of only minor effects but also an entity which started the PRA is not able to stop it arbitrarily.

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. (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 risk mitigation, what criteria regarding starting and stopping the application of the PRA would you propose? Please explain your reasons.*

If the IASB deiced to make the PRA focused on risk mitigation no matter if application is mandatory or optional additional criteria or clarification are necessary to identify when risk mitigation is performed and how the relevant deals to revalue are identified. If application would be optional analogous to our answer to a) starting should be only based on management decision but stopping the PRA should only be allowed if dynamic risk management is stopped for this portfolio. We believe that even if the PRA is focused on risk mitigation the stopping criteria should be the stop of dynamic risk management because a short time stop of risk mitigation as stopping criteria would make the stop of the PRA arbitrarily.

Question 18—Presentation alternatives

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

<u>We believe that a single net line item would be the best way to present the PRA in the statement of financial position.</u> A line by line gross up would increase the necessary effort to prepare financial statements without adding any significant additional information to users of financial statements. An aggregate adjustment would be easier to handle but still would influence the total balance sheet sum stronger than a single net adjustments. Since we believe the PRA should change the balance sheet sum as little as possible we prefer this approach.

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

<u>We would prefer the actual net interest presentation</u> since we believe it is easier to understand for users of financial statements. Furthermore a net stable interest income might not in all cases be the goal of dynamic risk management. Last but not least we believe that the actual interest income approach would be easier to transform in a similar way on other risks.

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.*

We do not have any recommendations for another presentation within financial position or comprehensive income. However for income presentation final standard should comprise guidance how to include interest income and valuation amounts from instruments that are part of the open net risk position but are already measured at fair value. If those instruments are not included in income presentation no matter which approach is applied the result would not be in line with dynamic risk management.

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?*

Yes we believe that inclusion of internal derivatives and therefore a gross presentation in comprehensive income enhances the usefulness of information because it gives the users of financial statements a much clearer picture of the actual risk management and trading activities of an entity. Currently often results are shown within trading results which do not belong to actual trading activities but are rather part of risk mitigation.

However as mentioned above the IASB should also consider to allow the inclusion of internal derivatives for general hedge accounting purposes since the general issue is the same.

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 the described treatment of internal derivatives enhances the operational feasibility of the PRA because without the inclusion a complex and often only partially successful proxy approach would be necessary to show the correct results of dynamic risk management.

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?*

No we do not believe that additional conditions are necessary. In our option it should be sufficient if it is ensured that no net results arise from this treatment and the internal derivatives are part of the applied dynamic risk management practice

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.*

Yes we believe that all four themes can provide useful information. However a quantitative and qualitative description of different outcomes from dynamic risk management practice and the PRA might give the users the deepest understanding of dynamic risk management and the effects from PRA. On the other hand we recognize that a complete quantitative comparison might result in unfeasible efforts – especially if the differences are immaterial.

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

We believe that all four themes can provide useful information. However especially within the qualitative description of accounting policies we believe that such a description should not repeat phrases from the standard but rather give comprehensive description of the individual choices and approaches.

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.*

There are probably a lot of additional information an entity could provide about its dynamic risk management practice and the effect of the PRA. However generally we believe that with the four themes the main information needs of users should be satisfied.

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?*

As already described above we believe that a comparison between the results from dynamic risk management on the one hand and the effects from the PRA on the other hand give important information to users of financial statements. Therefore the scope of disclosures (especially in the case that the PRA is only applied in cases of risk mitigation) should be wider than the scope of application of the PRA. However the scope of disclosures should be limited to dynamic risk management and not consider any other risks not within the scope of (dynamic) risk management.

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?*

Please refer to our answer above

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?*

Yes if this later inclusion is in line with the dynamic risk management a later inclusion into the PRA should be allowed. This could occur if a deal in a first step is part of a static risk management approach and later on is transferred into a dynamically managed portfolio.

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

Non-zero Day 1 revaluations may not only occur if a exposure is included after a party first becomes a party of a contract but also in other cases (e.g. in case 2 of 4.2.21). Therefore a treatment of those differences is required in any case but should be the same no matter if it arises from differences in cash flow and discounting or from the point of inclusion. For presentation reasons a pro rata presentation in line with the pull-too-par effect would be preferable. However we recognize that such an amortization will lead to serious additional implementation efforts. Therefore a possible solution would be to create a choice based on the treatment within internal calculations.

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 we do not agree with this criterion. We agree that in most cases an exposure will remain within the managed portfolio until derecongnition. However if for any reason an economic removal from the portfolio and e.g. inclusion into a static portfolio occurs, the exposure should no longer be considered within the PRA.

We recognize that an amortization of the revaluation amount would be burdensome but nevertheless believe that an ongoing inclusion of an exposure not anymore part of the managed portfolio also would create some operational burden and reduce the usefulness of information because PRA results would be distorted by positons not included in the managed portfolio.

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?*

Yes – please refer to our answer above.

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

Even if an amortization causes some additional burden, we believe that it gives the best presentation of the financial situation of an entity. Furthermore under the PFVH hedge adjustments are already amortized on a regular basis. Due to materiality reasons we believe that a linear amortization of any revaluation adjustment instead of an amortization based on the effective interest rate would be appropriate.

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?*

We believe that the described three scenarios are the most common practice within banks and sometimes even combination of two approaches might be applied. In any case if it is part of the dynamic risk management (approach B and C – we would consider approach A as a rather static approach) it could and should be included within the PRA.

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.*

There are two approaches to consider FX and interest rate risk together within the PRA either both risks a measured separately and results are shown separately in interest income and FX result or the relevant instruments are remeasured in one step considering changes in both risk factors. In the latter case a presentation of income would be more difficult and less easy to understand. In the first case it is necessary to ensure that no double counting of revaluation effects occurs.

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.*

Yes, we believe that the PRA should not be limited to one type of risk but rather be allowed for any risk factor for which dynamic risk management is applied. However we understand that within the non-financial industry and risk factors as FX risk or commodity price risk it is much more common to consider future transactions as exposures instead of actual assets or liabilities. In such cases the PRA would not lead to a satisfying solution.

However just because there are several cases where a cash flow hedge would result in a better presentation of risk management practice, we can see no reason not to generally allow the application of the PRA to other risks. As already mentioned within the questions above a clarification how general hedge accounting rules and the PRA should work together would be helpful.

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.*

As no explicit fact pattern is described above we skip this question.

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?

No a use of OCI would make the PRA more complex without adding any serious benefits. As already described above we believe that profit or loss volatility from actual net open risk positions that are not hedged provide useful information to users of financial statements. Rather questions would arise how to treat deals already measured at fair value through profit or loss which are also part of a net open risk position.