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Paris, 7th November 2014

N°33

M. Hans HOOGERVORST
Chairman
International Accounting Standards Board
30, Cannon Street
LONDON EC4M 6XH
UNITED KINGDOM

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

Dear Sir,

I am writing to communicate the views expressed by the Board of the Autorité des Normes Comptables (ANC) on 6th November 2014 on the above-mentioned Discussion Paper (DP). These views result from the ANC’s due process which has involved extensive discussions with all types of constituents within its dedicated working group and an examination by its IFRS Commission.

The ANC is supportive of the IASB's initiative to analyse and to describe hedging mechanisms for open portfolios, to consider and portray interest rate risk management practices, and the operational complexity of different proposed solutions. In particular, the ANC welcomes the IASB’s efforts to find a solution to such issues that are neither resolved by the general accounting model in IAS 39 nor by that of IFRS 9.

The proposals of the DP have been confronted to practices as per the interest rate risk managers. The ANC view as exposed hereafter has therefore been informed by this analysis.

General position of the ANC as regards the proposals in the DP

A view supporting the business model:

The ANC strongly supports any accounting model based on the business model to adequately reflect an entity's operations and utilisation of assets and liabilities.

A view based on the economic context in which French banks operate :

- Mortgages, which constitute the major part of macro-hedged assets, generally bear a fixed interest rate. In addition, these contracts embed early redemption options. Customer deposits are also primarily fixed rate contracts in the form of interest free demand deposits or time deposits at a fixed interest rate.
- Equity has significantly increased since the financial crisis and requirements coming from banking regulations; it constitutes a financial resource integrated as a component of interest rate risk exposure alongside core demand deposits and other items.
- French banks, consistent with, in other areas, any type of cash flow projection, manage their interest rate risk exposure by taking into account :
 - the early redemption behaviour of borrowers ; and
 - the stability of their funding coming from equity and core demand deposits.
- We understand that interest rate risk management consists in reducing the sensitivity of the net interest margin of the banking book. The hedging of interest rate risk involves primarily derivative contracts.

The ANC would support any accounting solution based on the business model to start from the hedged item, as opposed to the DP proposals which start from the hedging instruments. The DP's proposals present a number of major issues, especially as regards:

- The accounting of the fair value of the interest rate risk on the banking book to avoid the mismatch coming from using derivatives as hedging instruments ;
- As a consequence, financial communication is more difficult to articulate, as it would result from the use of proxies to document accounting treatment, far from management practices.

Based on the above, the ANC is not favourable to pursuing the DP's proposals further as these are not in line with the business model:

- Decisions of management are currently based on notional exposures, and not on the fair value of these exposures, as proposed in the DP ;
- Many of the DP's proposals would lead to the financial statements not faithfully representing entities' performance in that they would not portray the way in which companies manage their risks ;
- In addition, should the DP's proposals be implemented, this bears the risk of entities potentially being inclined to developing strategies to transfer interest rate risks to customers, which, in our view is contrary to the neutrality underlying principle of accounting. Such consequence would be detrimental to the economy in which banks have a role of interest risk transformation.

ANC position regarding specific aspects included in the DP

The ANC's position on the main questions of the DP is summarised hereafter:

- The ANC is not supportive of the underlying assumption that all risk management practices are to be reflected in the financial statements: if interest rate risk is a good candidate for that, very few other types of risks are capable of being recorded in the financial statements, including the largest of any such risks, being the liquidity risk.
- The DP proposes two accounting models (question 15). The first one is based on a revaluation restricted to the net hedged exposure (Risk Mitigation Approach - RMA), the second one is based on a revaluation of all elements managed (gross assets, gross liabilities):
 - The ANC could consider the RMA, with a strictly limited application to the revaluation applied to the hedged item, which is more consistent with the general model of hedging in IFRS 9 and closer to taking into account the business model ;
 - The ANC would however like to highlight to the Board the risks generated by the second model by increasing the volatility of banks' performance: the Dynamic risk management model (DRM) leads to recording the Fair Value of interest rate risk of the banking book. Furthermore, DRM does not resolve major conceptual issues such as the revaluation of the hedged part on interest rate risk of equity or core demand deposits.
- Given the fact that the ANC considers that the DP does not fully effectively portray the business model, the ANC supports optionality of the model of the DP (question 16).
- The ANC supports resorting to the bottom layer mechanism (question 7), as it is operational regarding open portfolio hedges, and is consistent with the business model.
- The ANC supports taking into account early redemption behaviours (question 5), core demand deposits (question 9), equity and pipeline transactions (question 4).

As mentioned in the beginning of this letter, the ANC supports initiatives attempting to resolve current accounting issues regarding the hedging of open portfolios. However, pending the development of a solution it would be supportive of, the ANC considers that the IAS 39 paragraphs related to macro-hedging should remain part of the IFRS literature.

Extension of the DP's proposals to other activities, especially to the insurance industry

In addition to working on resolving the issues for the banking industry, we consider that it would be appropriate for the IASB to also look at how such a model could cater for the needs of other industries, amongst whom the insurance industry, who equally manage risks related to open portfolios in a dynamic way in the context of their asset/liability management activities. We note however that :

- The DP was developed in an amortised cost environment whereas the macro hedging activities of insurers may include both insurance liabilities which should be measured at current value under the future standard for insurance contracts and their underlying assets which may be measured at amortised cost or at fair value through profit or loss or through OCI ;
- Insurers manage other types of risk than the interest risk such as duration risks.

We understand that in the case of insurance activities, such analysis is, at this point in time, complicated by the fact that IFRS 4 is unfinished whilst IFRS 9 has been finalised and that much,

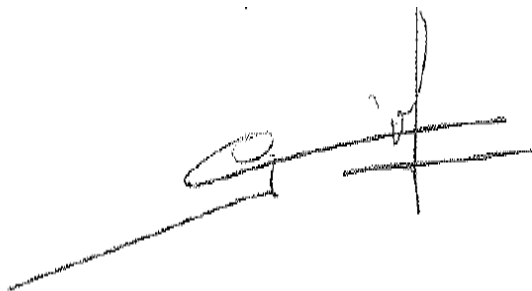
including macro-hedging in the insurance industry, will depend on the interactions between those two standards.

Considering the importance of the topic for its constituents, the ANC encourages the Board to pursue its work on coming to a consistent model for the hedging of open portfolios taking account the aforementioned features and principles. We consider in addition that any future proposal has to be given sufficient time for extensive testing, especially as regards all calculation issues.

Specific comments regarding the individual questions included in the DP are provided in Appendix 1.

We hope you find these comments useful and would be pleased to provide any further information you might require.

Yours sincerely,

A handwritten signature in black ink, appearing to be 'Gérard Gil', written over a horizontal line. The signature is stylized with a large loop on the left and a vertical stroke on the right.

Gérard Gil
ANC Board Member
ANC IFRS Commission Chair

Appendix 1 : Specific answers to the Discussion Paper's 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?

The ANC considers that developing an accounting approach for dynamic risk management is appropriate for the following reasons:

- It is consistent with the objective of IFRS 9 to represent the effect of an entity's risk management activities that use financial instruments to manage exposures arising from particular risks;
- Certain risks are managed solely in a dynamic manner. Due to the materiality of their corresponding financial impact, we believe that, assuming IFRS 9 would not include the basis necessary to develop a macro-hedging standard, it would be necessary to complement and adapt existing hedging principles in IFRS 9 : these are designed for specified individual relationships or closed portfolios for which the risk management process is limited or exceptional and, as such, are not suitable for relationships that evolve frequently.

However, we believe that the scope of the accounting approach for dynamic risk management should be limited to financial risks that are hedged and to the corresponding hedged portfolio (refer to Questions 2 and 15).

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

The ANC acknowledges that the DP has appropriately identified the operational difficulties arising from the IFRS 9 general hedging model, which requires onerous processes of designation and de-designation, tracking of hedged items and amortisation.

In addition, the DP has appropriately identified the unsuitability of IFRS 9 hedge accounting principles to address the hedging of certain exposures such as :

- demand deposits;
- portions of portfolios containing prepayable loans;
- bottom layer practices;
- eligibility of equity, sub-libor liabilities and pipeline transactions as hedged items.

We note that, through the revaluation of all managed exposures, the IASB is willing to address at least all operational issues identified. However, by expanding significantly the scope of a project initially called “macro hedging project”, the DP carries conceptual weaknesses (extended use of fair value) which, in our view, cannot be justified by the operational benefits, such as non-tracking or non-amortisation of the change in fair value of hedged items.

Consequently, the ANC strongly disagrees with the PRA approach applied to all managed portfolios.

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 understand from risk managers in the banking industry that traditional Asset and Liability Management (ALM) techniques neither calculate nor monitor the value of hedged assets and liabilities portfolios. Rather, ALM techniques are focused on the sensitivity of the net interest margin: risk indicators include primarily a sensitivity analysis of the undiscounted net interest margin arising from the hedged interest position and the hedging instruments which mostly constituted of derivatives, but may also be non derivatives instruments.

On the contrary, the approach in the DP is a balance sheet approach as it focuses on calculating and recording independent valuations, on a basis that is different from the way the risk is managed. This is not aligned with risk management practices which are the starting point of both the IFRS 9 general hedging model and what we understood the DP was about .

The ANC therefore recommends that the Board give further consideration to risk management practices, so as to derive a robust accounting solution from such practices.

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).*

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 account operational feasibility, usefulness of the information provided in the financial statements and consistency with the Conceptual Framework.*

BEHAVIOURALISATION

- (c) *For the purposes of applying the PRA, should the cash flows be based on a behaviouralised rather than 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.*

Pipeline transactions and equity are two significant components of the interest rate position and are accordingly hedged on the market.

In order to reflect risk management practices, the ANC recommends that the Board bases any further developments on the consideration of the net hedged risk exposure as a specific asset or liability in the financial statements. The unit of account of the macro hedge accounting model would therefore consist in the net risk position and no longer in its various components (assets, liabilities, equity and other commitments), because all these components are fungible considering the interest rate risk issue.

More detailed answers are as follows:

- (a) The ANC supports the inclusion of pipeline transactions as eligible mitigated risks items as long as pipeline transactions are recognised as a risk exposure and as such are included in the dynamic risk management. Consequently, the ANC recommends that a restrictive definition of pipeline transactions be considered.
- (b) The ANC supports the integration of EMB in the eligible mitigated risks items, mainly for two reasons :
- It is in line with ALM practices and with the business model;
 - This issue becomes even more significant with regulatory constraints that lead to deeply increase the bank's own funds, sometimes by assimilation of certain structured financial instruments such as equity (subordinated debt).
- (c) The ANC supports the integration of cash flows based on a behaviouralised rather than a contractual basis as long as it is consistent with risk management. We note this approach is compliant with other principles set forth in IFRS 9 such as the determination of the effective interest rate based on the expected life of financial instruments.

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.

As the ANC does not support the Dynamic Risk Management Approach, our response is limited to comments regarding the Risk Mitigation Approach where the revaluation adjustment (Revaluation Adjustment) only applies to hedged positions (refer to Question 15).

We believe the Revaluation Adjustment calculation should be in line with the designated hedged risk. Consequently, if the designated hedged risk is a one-sided risk such as the change in value of the net risk position arising from a decrease in interest rates, then the Revaluation Adjustment shall also incorporate the one-sided risk, including its time value.

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?

As the NC does not support the Dynamic Risk Management Approach, our response is limited to comments regarding the Risk Mitigation Approach where the revaluation adjustment (Revaluation Adjustment) only applies to hedged positions (refer to Question 15).

Assuming the hedged position is below the cash flow profile of behaviouralised portfolios, when applying the Risk Mitigation Approach, the accounting model should not lead to any P&L effect due to changes in customer behaviour.

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 believe 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.

As the ANC does not support the Dynamic Risk Management Approach, our response is limited to comments regarding the Risk Mitigation Approach where the revaluation adjustment (Revaluation Adjustment) only applies to hedged positions (refer to Question 15).

The ANC supports the use of the bottom layer technique which consists in considering interest rate risk up to the portion of core demand deposits which are considered to be stable over time.

Question 8 – Risk limits

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

As the ANC does not support the Dynamic Risk Management Approach, our response is limited to comments regarding the Risk Mitigation Approach where the revaluation adjustment (Revaluation Adjustment) only applies to hedged positions (refer to Question 15).

The ANC does not consider that risk limits should be reflected by any accounting model.

Risk limits should not be an accounting issue when applying RMA, the revaluation adjustment being limited to the net hedged exposure.

Question 9 – Core demand deposits

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

(a) The ANC supports the inclusion of core demand deposits in the managed portfolio on a behaviouralised basis :

- Core deposits constitute stable funding, a major component of interest rate exposure for many banks, and a major aspect of banks' intermediation model.

(b) The ANC does not believe it is useful to provide guidance on the determination of the behaviouralised profile of core demand deposits :

- We understand that several business models might exist, without one or the other prevailing, and that these are, to some extent, dependent on specific local regulation. The ANC therefore places more emphasis on providing clear and relevant disclosures on the inclusion of core demand deposits in interest rate risk management (similar to IFRS 7 liquidity risk disclosures), especially concerning the expected maturity of such financial resources, and any change in this expected maturity.
- We therefore do not believe such guidance should be under the remit of the standard setter. We do however understand that this matter may lead to further developments by banking regulators.

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 (i.e. Approach 3 in Section 3.10)? Why or why not? If not, do you think that the alternatives presented in the DP (i.e. 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?*
- (b) *If sub-benchmark variable 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?*

As the ANC does not support the Dynamic Risk Management Approach, our response is limited to comments regarding the Risk Mitigation Approach where the revaluation adjustment (Revaluation Adjustment) only applies to hedged positions (refer to Question 15).

Sub-benchmark financial instruments at a fixed rate such as interest-free demand deposits are components of the net interest position and as such shall be included in the managed portfolio under the Risk Mitigation Approach.

As mentioned in our response to Question 3, the objective of ALM techniques in the banking industry is to stabilise the net interest margin between fixed and variable interest rate exposures. The risk being hedged for sub-benchmark financial instruments is the variability of the benchmark interest rate as evidenced by the transfer pricing transactions (Refer to Question 11).

Under the Risk Mitigation Approach limited to the risk being hedged, the Revaluation Adjustment shall be estimated based on hedging derivatives as explained in our response to Question 11. The calculation of the Revaluation Adjustment is therefore equivalent to Approach 3 in Section 3.10.

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?*

As the ANC does not support the Dynamic Risk Management Approach, our response is limited to comments regarding the Risk Mitigation Approach where the revaluation adjustment (Revaluation Adjustment) only applies to hedged positions (refer to Question 15).

When considering the Risk Mitigation Approach, we note that the calculation methodology of the Revaluation Adjustment primarily aims at determining a value of the risk being hedged in order to offset in the income statement the fair value changes of the hedging instruments. Accounting should recognise, as the hedged risk, the consequence of a hedging strategy which maximises the offsetting in order to disclose a faithful transcription of the transaction put in place.

We believe the managed risk should be a market funding index (such as IBOR index) in line with the hedging strategy.

In the situation where all derivatives are specifically identified on the trade date and designated as hedging derivatives from inception, we believe the value of such derivatives is a good proxy of the value of the Revaluation Adjustment.

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 purpose 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 believe 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?*

As the ANC does not support the Dynamic Risk Management Approach, our response is limited to comments regarding the Risk Mitigation Approach where the revaluation adjustment (Revaluation Adjustment) only applies to hedged positions (refer to Question 15).

As mentioned in our response to question 11, we believe the adequate funding rate to be designated as being hedged is a market index excluding any other transfer pricing spread. Selecting such transfer pricing could embed elements out of interest risk as administrative costs or internal margins: these elements could create volatility in the profit or loss which cannot be hedged on the market (change in internal spread, change in customer margin, etc...). Consequently, the use of a full transfer pricing rate is inconsistent with our support for the Risk Mitigation Approach where the Revaluation Adjustment is recognised as long as it is hedged on the market.

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 should those criteria be, and why?*

The purpose of ALM techniques is to measure and hedge the gap between different interest rate indices. Consequently, depending on the number of gaps between indices, there may be different types of hedging swaps and therefore different funding indices in the macro hedging relationships.

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 believe 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 risk management activities when the pricing index is used in dynamic risk management? Why or why not?*

We defer to risk managers to provide examples of dynamic risk management undertaken for portfolios with respect to a pricing index and to comment on the relevance of the application of the PRA.

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 (i.e. a scope focused on dynamic risk management) or should it be restricted to circumstances in which an entity has undertaken risk mitigation through hedging (i.e. 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?*
- (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?*
- (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?*
- (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?*

The ANC does not agree with the approach taken by the DP as regards the two following topics:

- The scope of the DP is significantly wider than the original macro hedging project since it includes all managed portfolios.
- The description of dynamic risk management relies on an independent valuation of balance sheet positions which is not aligned with risk management practices (Refer to Question 3).

More specifically, the ANC believes that the Dynamic Risk Management approach leads to a fair value accounting model of dynamically managed positions on risks (rate, counterparty, commodities ...). Consequently, we believe this approach:

- **would significantly increase assets and liabilities recognised at fair value (for the part of the hedged item, e.g. the interest rate risk in the DP), which the ANC cannot be supportive of as it fundamentally contradicts the business model of the banking book as defined in IFRS 9, ie recognised on an amortised cost basis, the performance of which is assessed through a net interest margin amortised over the remaining life of financial instruments ;**

- **would increase the accounting issues such as the accounting of the hedged item on core deposits, own funds, or pipeline transactions, compared to the RMA.**

The ANC could support a Risk Mitigation Approach where only financial risks that are subject to hedges are revalued for the hedged portion. Such an approach:

- complies with the general hedge model of IFRS 9 ;
- minimises all induced effects of valuation, which are aligned with the business model.

We therefore do not agree with a sub portfolio approach as detailed in 5.2.13-14 nor with a proportion approach as detailed in 5.2.15-16, which we understand could include revalued items without being hedged. Both approaches go beyond the purpose of a macro hedging project which is to represent only the effect of hedging activities.

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?*
- (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 the risk mitigation? Why or why not?*

As the ANC does not support the Dynamic Risk Management Approach, our response is limited to comments regarding the Risk Mitigation Approach where the revaluation adjustment (Revaluation Adjustment) only applies to hedged positions (refer to Question 15).

We note that fair value measurement of all derivatives imposes constraints on any model that is developed and leads to accounting mismatches when such derivatives are intended to hedge items at amortised cost, such as the net interest rate risk exposure . Therefore, unless the measurement of those derivatives is reconsidered and appropriate alignment with business models is effectuated, we consider that any model developed should be optional.

However, in accordance with IFRS 9 general hedging principles, the ANC considers that derivatives qualified as hedges should not be derecognised until the end of their remaining life, and should continue to be designated as hedges unless there is a change in the risk management strategy or business model.

Question 18 – Presentation alternatives

- (a) *Which presentation alternative would you prefer in the statement of financial position, and why?*
- (b) *Which presentation alternative would you prefer in the statement of comprehensive income, and why?*
- (c) *Please provide details of any alternative presentation in the statement of financial position and/or in the statement of comprehensive income that you believe 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.*

Statement of financial position

We believe the single net line approach is appropriate to record the value of the risk being hedged on all components of the balance sheet which are part of macro hedging. From a risk management perspective, all the components of the macro hedge are interdependent and managed globally : it is therefore more relevant to report the value of the risk being hedged globally rather than by splitting the amount by instrument or between assets and liabilities. In addition, a single net line is more easily identifiable and comparable between companies and over time.

Statement of comprehensive income

We support the actual net interest income approach. This approach is consistent with the amortised cost calculation according to IFRS 9 and separately presents the effect of the PRA.

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 believe that a gross presentation enhances the usefulness of information provided on an entity's dynamic risk management and trading activities? Why or why not?*
- (b) Do you think that the described treatment of internal derivatives enhances the operational feasibility of the PRA? Why or why not?*
- (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?*

The ANC as a principle believes that internal derivatives, because they are eliminated in the consolidation process, are not eligible to support accounting entries neither as hedging derivatives nor as a measure of the PRA according to the Risk Mitigation Approach.

However, risk management procedures often require all derivatives of the bank to be traded centrally by dedicated trading desks. In this context, risk management procedures require documentation that all internal derivatives with the central trading desk are fully reversed on the market through techniques such as sensitivity analysis before and after inclusion of internal derivatives.

Depending on the quality of the reversal mechanism and its documentation according to risk management procedures, the internal derivative may be a good proxy of the hedging instruments existing at the group level, if they are negotiated on a market basis (index established on the market). Hence, it can support accounting entries for both the hedging instrument and the measurement of the PRA according to the Risk Mitigation Approach.

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 an identified theme would not provide useful information, please identify that theme and explain why.*
- (c) What additional disclosures, if any, do you believe would result in useful information about an entity's dynamic risk management? Please explain why you believe these disclosures would be useful.*

The ANC is supportive of providing all relevant disclosures which provide a faithful and understandable presentation of interest rate risk management, whilst being very aware of disclosure overload.

We do however take the opportunity to highlight to the Board the difficulties in financial communication which would result from any accounting method or documentation required which would significantly deviate from operational practices: this would for example be the case when interest rate risk is managed based on notional positions whilst the accounting would be based on the valuation of the underlying risk components.

The ANC supports disclosures to be provided on the inclusion of core demand deposits in the interest rate risk exposure, and more specifically on their amortisation profile.

Question 22 – Date of inclusion of exposures in a managed portfolio

- (a) *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 the contract? Why or why not? If yes, under which circumstances do you believe it would be appropriate, and why?*
- (b) *How would you propose to account for any non-zero day 1 revaluations? Please explain your reasons and comment on any operational implications.*

Considering the Risk Mitigation Approach, the ANC considers that the date of inclusion of exposures in a managed portfolio should not lead to any P&L effect .

Question 23 – Removal of exposures from the 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?*
- (b) *Are there any circumstances, other than those considered in this DP, under which you think it would be appropriate to remove exposures from the managed portfolio? If yes, what would those circumstances be and why would it be appropriate to remove them from the managed portfolio?*
- (c) *If exposures are removed from the 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.*

As the ANC does not support the Dynamic Risk Management Approach, our response is limited to comments regarding the Risk Mitigation Approach where the revaluation adjustment (Revaluation Adjustment) only applies to hedged positions (refer to Question 15).

- a. Through the eyes of the business model, the managed exposure is constituted by the sensitivity of a net margin income which is mitigated by contracting derivatives. We therefore cannot support the criterion of “managed portfolio” as it is incompatible with an open portfolio mechanism.
- b. -
- c. The ANC supports any principle which requires a specific analysis to be performed in the case of a significant derecognition of elements previously part of the net exposure mitigated in interest rate risk, for example in the case of securitisation, or any circumstances in which the bottom layer is breached; in that case, after analysis, a part of the previous revaluation adjustment could be removed through P&L.

Question 24 – Risk management of foreign currency instruments

- (a) *Do you think that it is possible to apply the PRA to the dynamic risk management of foreign exchange risk in conjunction with interest rate risk that is being dynamically managed?*
- (b) *Please provide an overview of such a risk management approach and how the PRA could be applied or the reasons why it could not*

See question 25

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 believe 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.*

As the ANC does not support the Dynamic Risk Management Approach, our response is limited to comments regarding the Risk Mitigation Approach where the revaluation adjustment (Revaluation Adjustment) only applies to hedged positions (refer to Question 15).

In addition to working on resolving the issues for the banking industry, we consider that it would be appropriate for the IASB to also look at how such a model could cater for the needs of other industries or apply to other financial risks such as foreign exchange and liquidity risks.

Specific position of the ANC as regards insurance industry

The insurance industry, in particular, also manages risks related to open portfolios in a dynamic way in the context of their asset/liability management activities. We note however that :

- The DP was developed in an amortised cost environment whereas the macro hedging activities of insurers may include both insurance liabilities which should be measured at current value under the future standard for insurance contracts and their underlying assets which may be measured at amortised cost or at fair value through profit or loss or through OCI;
- Insurers manage other types of risk than the interest risk such as duration risks.

We understand that in the case of insurance activities, such analysis is, at this point in time, complicated by the fact that IFRS 4 is unfinished whilst IFRS 9 has been finalised and that much, including macro-hedging in the insurance industry, will depend on the interactions between those two standards.

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 portfolio revaluation approach, how could the conceptual and practical difficulties identified with this alternative approach be overcome?

The DP's approach is primarily driven by the accounting issues of ALM activities in the banking industry. The ANC believes the Board shall consider the concern of other constituents.

Amongst other constituents, insurance companies have also significant ALM activities with complex accounting implications. IFRS 4 Phase 2, which is not yet stabilised, is likely to impact the accounting of ALM activities as it will rebalance the measurement basis of risks being hedged between amortised cost and fair value. In order to address the accounting for ALM activities post implementation of IFRS 4 Phase 2, the ANC believes the Board should pursue its research project by also considering the relevance of an accounting model whereby the Revaluation Adjustment is recorded through OCI.