Hans Hoogervorst, Chairman
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

October 15, 2014

Re: Comment Letter on the Discussion Paper *Accounting for Dynamic Risk Management: a Portfolio Revaluation Approach to Macro hedging* ("the DP")

Dear Mr. Hoogervorst,

The International Energy Accounting Forum ("IEAF") welcomes the opportunity to comment on the DP.

The IEAF consists of the major European companies in the utility business (see the list of our members in appendix 2). The goal of the IEAF is to discuss and formulate best practices, to reduce areas of difference in accounting in the sector, to advocate the energy industry's point of view, and to make specialist energy industry knowledge available to the International Accounting Standards Board and other standard-setters.

This comment letter represents the view of the marked majority of the IEAF members. We nevertheless note that concerning the commodity risk, the EDF Group has reservations about PRA being a suitable approach to best represent commodity hedging. A model that would better represent macro-cash flow hedge risk management would be welcome, taking into account current issues such as written options not qualifying as hedging instruments or probable forecasts not qualifying as hedged items. The EDF Group will reply individually to the DP.

In the energy sector, the main sources of market risks derive from the "native positions" of the industrial/commercial activities, i.e. the risks embedded in the power plants and comparable drawing rights, the long-term fuel supply agreements and related transport and storage capacities, and the B2B

and B2C sales. The risk vectors that are managed are mainly related to the outright power, outright gas, clean spark spread[1], clean dark spread[2], gas-to-coal spread[3], gas-to-oil spread[4]...

Those risks can evolve significantly, not only in function of market prices, but also due to external elements: they have a physical nature and are subject to external risk factors (regulation, outage, blackout/imbalance, climate...).

While the hedge accounting is performed to avoid profit or loss mismatch and to appropriately reflect the economics of those transactions, it is often difficult to apply the general guidance to dynamic risk management strategies. Indeed both IAS 39 and now IFRS 9 are adequate for the management of rather "static" risks, but are not suitable for documenting the link between constantly evolving risks and the related hedging instruments and for implementing the recycling of OCI to profit or loss. For a dynamic risk management environment the hedge documentation requirements are burdensome or even impossible to implement in practice. We therefore strongly believe that there is a need for a macro hedge guidance.

However, in our opinion the IASB should be clearer on the aim of the DP and the PRA: is it to display risk management strategies within the financial statements (= accounting for dynamic risk management activities) or to reduce accounting mismatches that arise because of weaknesses of the current hedge accounting rules (IAS 39/IFRS 9) (= accounting for the macro hedge only when a risk mitigation action has been undertaken) ? We think that the latter should apply. Indeed, adequate disclosures should be made available on the way risks are being managed. This will encompass not only those information available on the risks mitigated through hedging transactions but also the way the native positions are being managed and why or why not (and how) a portion of risk is being transferred to the central netting factory. But disclosures and accounting treatment do not have the same scope:

- accounting for hedging transactions is to avoid unjustified profit or loss volatility. Here the scope includes only the hedging instruments and the portion of native risks for which risk mitigating actions have been taken;
- while disclosures should cover a broader scope to understand the dynamic risk management activities. Here the scope potentially includes all native risks (not only the portion for which risk mitigating actions have been taken) and all hedges.

[1] Margin of a gas-fired power plant, resulting from the sale of power and the purchase of the gas and CO2 emission rights that are needed to produce the power

[2] Margin of a coal-fired power plant, resulting from the sale of power and the purchase of the coal and CO2 emission rights that are needed to produce the power

[3] Gas indexed to coal price

[4] Gas indexed to oil price

In order for energy companies to be able to apply macro hedge accounting, the guidance should then deal with the following key issues:

1. Eligible hedged items should include FORECAST transactions: risks in energy companies encompass a.o. the forecast production of power plants and related fuel consumption, and calculation of risk exposures takes into account assumptions related to flexibilities in sales and purchase contracts...
2. DYNAMIC character of risks and hedging instruments: the risks that energy companies are facing evolve constantly, hence the hedges have to be constantly adapted. As a consequence, one-to-one hedge designation is not feasible, and the same goes for OCI recycling.
3. NET approach of risk mitigation: often risks are centralized in a netting factory, which then hedges the net exposures.
4. PROXY character of a significant part of the hedging instruments: mainly due to liquidity constraints of energy markets, risk mitigation often consists in concluding hedging instruments that are highly correlated but not identical to the initial risk exposures.
5. GRADUAL hedging strategies: not all risks are hedged at inception, most risks with a medium-term time horizon are gradually hedged (starting some years for maturity of the risk exposures, and reaching 100% at a given time before maturity). As a consequence, only the risks for which risk mitigating action are taken should be measured in fair value in view of being matched by the fair value of the hedging instruments.

Ideally, guidance would allow to measure in fair value (1) the risks centralized in the netting factory, and (2) the hedging instruments concluded by this netting factory. The sum of (1) and (2) would then adequately reflect the hedge ineffectiveness.

Applying a macro hedge model to the energy sector would consist in the following: as explained above, the external exposures that are included within the managed portfolio, stem mainly from forecasted use of economic "assets" and forecasted purchases and sales related to firm or deemed commitments. The lifetime of the assets and commitments often largely exceeds the liquid horizon of the markets where these forecast transactions can be hedged. Risk management focuses on gradually and progressively hedging these risks: generally starting once the exposures enter the liquid horizon, and reaching 100% hedge ratio at an often predefined moment before the hedged exposures come to maturity. Therefore, we think it is necessary to explicitly foresee in the new standard the possibility to allocate to the managed portfolio only those exposures for which risk mitigating actions have been taken.

In terms of documentation, it is essential to document risk strategies and their risk-reducing character. For many energy companies such documentation is already in place in the framework of the EMIR

regulation. When such documentation is available for EMIR, it should also be used for accounting purposes, so as to ensure both for EMIR and for the financial reporting a coherent documentation that is in line with the actual risk management.

We strongly believe that the question to whether the application should be mandatory should be considered as a whole together with the application of IFRS 9. As hedge accounting under IFRS 9 remains optional, there is no strong basis to consider that the macro hedge accounting would be mandatory. Optional application for IFRS 9 and for macro hedge accounting would leave the opportunity for entities to adopt the accounting guidance that best reflects the economics of their transactions. We therefore are concerned by the definition of a broad scope for "dynamic risk management" that would force entities to apply the accounting model set out in the DP although they are able to document their transaction using the current IFRS 9 guidance. We believe that this specific point should be clarified.

The detailed answers to the DP are set out in appendix 1.

In case you would like to obtain further explanations, please do not hesitate to contact us.

Best regards

On behalf of the IEAF,

Jonathan Susin
Tel: +32 2 518 65 87
Email: jonathan.susin@gdfsuez.com

Appendix 1: Answers to the DP

1. Introduction

The following answers mainly focus on the dynamic risk management of non-financial exposures (e.g. commodity exposures) as the energy sector is currently facing less accounting issues on interest rate and foreign currency exposures (i.e. it can apply IFRS 9 guidance to adequately reflect the economics of those transactions). Therefore we will not specifically answer question 25 since all information will be provided along the other questions & answers.

It should also be noted that some energy companies (with less complex activities) are well able to document their risk management strategies under IAS 39 / IFRS 9. The answers below are thus not deemed to provide an alternative model for those entities but should be viewed as relevant for energy companies that have more complex operations and for which IAS 39 / IFRS 9 do not offer an appropriate accounting framework. This robust framework would then be a cash flow macro hedge model (since, as it will be mentioned and explained below, the aim of the energy industry is to lock and optimise margins [= cash flows]).

2. Section 1 – Background and introduction to the portfolio revaluation approach PRA)

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

As a general remark, we would like to mention that in our opinion, the first approach as envisaged by the IASB would be more extensive.

As mentioned in DP 1.8 and 1.12, while the hedge accounting is performed to avoid profit or loss mismatch to appropriately reflect the economics of those transactions, it is often difficult to apply the general guidance to dynamic risk management strategies. Indeed, both IAS 39 and IFRS 9 are adequate for the management of rather "static" risks, but are not suitable for documenting the link between constantly evolving risks and related evolving hedging instruments and for implementing the recycling of OCI to profit or loss. For a dynamic risk management environment the hedge documentation

requirements are burdensome or even impossible to implement in practice. We therefore think that there is a need for an accounting approach for dynamic risk management.

However, in our opinion the IASB should be clearer on the aim of the discussion paper and the PRA: is it to display risk management strategies within the financial statements or to reduce accounting mismatches that arise because of weaknesses of the current hedge accounting rules (IAS 39/IFRS 9)? We think that the first approach would be much more extensive and probably include new ideas into accounting, whereas the latter problem could be resolved with amendments to the current standards (i.e. the macro-hedge guidance would be incorporated to IFRS 9 instead of being a separate standard). This would clarify the relationship/interaction between IFRS 9 as it is now and the macro-hedge guidance as it would be proposed by the IASB.

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?

While acknowledging in DP 1.54 and 1.55 that dynamic risk management activities are undertaken for risks other than interest rates, the DP mainly focuses on the way in which banks dynamically manage their interest rate risk. By doing so, the eligible "hedged items" in a PRA approach seem to be limited to (accounted for as such) financial instruments with some exceptions (deemed exposures, equity book model, pipeline transactions, behaviouralisation...) which also relate to some extent to financial instruments.

In the energy sector, the main sources of market risks in the "native positions" of the industrial/commercial activities are the following:

(i) Risks of industrial/commercial activities that are managed based on <u>forecasts</u>:
   a. power plants and comparable drawing rights: the risks concern power production and related fuel consumption and carbon emission rights. The risk management is based on forecasts that are frequently updated and that are function of technical and operational constraints and of market prices (power plants production forecasts are based on and

function of the profitability of the fuel/power spread, but also take into account operational and technical issues such as maintenance periods, outages observed,...);

b. long-term fuel supply agreements (and related transport and storage capacities): the risk management is based on forecasts of optimal off-take in function of needs (for power plants, customers,...) and market prices, while taking into account the contractual constraints and flexibilities;
c. the B2C sales are managed based on sales forecasts that are function of contractual framework and churn rates (i.e. the number of customers who cut ties with the company during a given time period).

(ii) Other risks, such as B2B sales contracts, are often hedged "at inception", i.e. when the exposure arises.

The risk vectors that are managed are mainly the following: outright power, outright gas, clean spark spread[5], clean dark spread[6], gas-to-coal spread[7], gas-to-oil spread[8] ,...

Therefore, the exposures do not arise from financial instruments but from "economic assets" of the portfolio (= could be referred to as deemed exposures, as mentioned in DP 1.18 and 1.19):

(i) Exposures arising from highly probable transactions embedded in power plants, liquefaction/regasification units, storage/transport capacities... which are accounted for under either IAS 16 *Property, Plant and Equipment* or IAS 17 *Leases* (when the Company is lessee) or IFRIC 12 *Service Concession Arrangement*;
(ii) Exposures arising from firm contracts (long-term contracts to purchase natural gas, LNG or coal, but also signed sales contracts, e.g. with B2B customers) –that often include flexibility clauses and that are accounted for as own use contracts, i.e. on an accrual basis
(iii) Exposures arising from forecasted sales to B2C customers (volume can be volatile,a.o. due to weather conditions)

[5] Margin of a gas-fired power plant, resulting from the sale of power and the purchase of the gas and CO2 emission rights that are needed to produce the power
[6] Margin of a coal-fired power plant, resulting from the sale of power and the purchase of the coal and CO2 emission rights that are needed to produce the power
[7] Gas indexed to coal price
[8] Gas indexed to oil price

We believe that taking into consideration and measuring these exposures would be conceptually correct since the exposure really arises and exists when the asset is recognised or the commitment has been entered into:

- an exposure to power / fuel / carbon emission rights exists once a gas-fired power plant is constructed and has been commissioned;
- an exposure to oil prices exists once an oil-indexed formula gas purchase contract has been entered into;
- an exposure to power prices exists in case a B2C contract at a fix price has been concluded;
- ...

It is to be noted that the industrial/commercial activities, and the resulting "native positions" have a physical nature and are subject to external risk factors:

(i) External risk factors include a.o.: regulation (authorization to operate), intrinsic risks of the facilities (construction defect, IT failure, blackout/imbalance,...), risks related to natural environment (seism, weather and climate phenomena that can impact client consumption as well as production levels, ...) and human risks (human failure, social conflict, terrorism,...)

(ii) Physical characteristics of native positions can differ significantly from hedge products available on the market, e.g.: power production peak/off peak, hourly profile of consumption and production forecasts,... versus base-load products for calendar years available on the market

Therefore forecasts can evolve significantly, not only in function of market prices, but also due to external elements.

While we understand the rationale of excluding the forecast transactions listed in Appendix A3, we strongly believe that the forecast transactions listed above are not of the same nature as they relate to / are embedded in native positions that are "economic assets" and firm and deemed commitments, that are strictly in accordance with the entity's expected production, sale and usage requirements, rather than merely "free standing" forecast transactions. Therefore, we do not see any rationale to exclude such forecast transactions while including pipelines transactions.

As a conclusion, we believe that the scope of the PRA should be clearer on the fact that it also includes the exposures listed above, i.e. the PRA should not be limited to financial instruments.

3. Section 2 – Overview

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 think that the current description is adequate, but may need to be further completed.
As explained above, for energy companies, the external exposures that are included in the managed portfolio, stem mainly from forecasted use of economic "assets" (power plants, gas pipelines, gas storages, LNG terminals,...) and forecasted purchases and sales related to firm or deemed commitments (long term supply agreements, B2B sales contracts, B2C sales contracts and related regulatory constraints,...). The lifetime of the assets and commitments often largely exceeds the liquid horizon of the markets where these forecasts can be hedged. **Risk management focuses on gradually and progressively hedging** these risks: generally starting once the exposures enter the liquid horizon, and reaching 100% hedge ratio at an often predefined moment before the hedged exposures come to maturity. Therefore, we think it is necessary to explicitly foresee in the new standard the possibility to **allocate to the managed portfolio only those exposures that are managed**, and thus allow to leave out exposures for which no risk mitigating actions are taken (e.g. longer-term exposures stemming from the same assets/commitments, or the non-hedged portion in case of gradual hedging).

It should be noted that currently, for many energy companies, the risks stem from own use contracts and from assets accounted for under IAS 16. The dynamic hedges, hard or impossible to document under IAS 39 / IFRS 9, are mostly accounted for at fair value through profit or loss. This leads to a mismatch: only the hedging instruments are at fair value through profit or loss, not the hedged items. It should be noted that most of the energy companies are using non-GAAP measures to clarify the financial communication and performance of the entity, i.e. by excluding or isolating such economically unjustified profit or loss volatility).

Under the new standard, it would be of utmost importance for energy companies, to apply a portfolio revaluation approach to those exposures for which (1) active risk management is ongoing and hedging has started and (2) that are deemed to be hedged.

To illustrate, let us take as an example gas exposures stemming from a 15-year gas procurement contract, for which the 5 nearest years are actively managed with hedging of the market price risks starting 5 years before maturity of the risks. Suppose that in year 5 before maturity, 10 % of the exposures are transferred for hedging to the hedging and netting factory. In this example, active risk

management is ongoing and hedging has started for those exposures of the LT contract that will come to maturity within 5 years. The deemed hedged exposures are 10 % of the total exposures of year + 5.

The PRA should take into account only these deemed hedged exposures, next to the hedging transactions. Fair valuing this coherent set of risks and hedging instruments would reflect the effectiveness of the hedging actions. The PRA should NOT take into account all exposures of the 5 coming years, as this would lead to having the non-hedged exposures at fair value, and thus the opposite mismatch of the current situation (only the hedging instruments at fair value). Moreover, if all exposures over the full lifetime of the long-term contract were to be considered into the PRA, we are concerned that the mismatch would be even worse.

4. Section 3 – The managed portfolio

Question 4 – Pipeline transactions, EMB and behaviouralisation
Pipeline transactions (a) Do you think that pipeline transactions should be included in the PRA if they are considered by an entity as part of its dynamic risk management? Why or why not? Please explain your reasons, taking into consideration operational feasibility, usefulness of the information provided in the financial statements and consistency with the Conceptual Framework for Financial Reporting (the Conceptual Framework). EMB (b) Do you think that EMB should be included in the PRA if it is considered by an entity as part of its dynamic risk management? Why or why not? Please explain your reasons, taking into consideration operational feasibility, usefulness of the information provided in the financial statements and consistency with the Conceptual Framework. Behaviouralisation (c) For the purposes of applying the PRA, should the cash flows be based on a behaviouralised rather than on a contractual basis (for example, after considering prepayment expectations), when the risk is managed on a behaviouralised basis? Please explain your reasons, taking into consideration operational feasibility, usefulness of the information provided in the financial statements and consistency with the Conceptual Framework.

(a) The energy sector may also face "pipeline transactions" issues in the sense of the DP (but see also question 2 on the inclusion of forecast transactions that are exposures embedded in the portfolio "assets"). This will be the case if a company offers to new customers the possibility to subscribe different types of standard contracts to purchase electricity or gas at predefined conditions. Nonetheless, majority of the energy companies will hedge the exposure (taking behaviouralisation into account ; see below) when the contract is signed.

(b) The EMB is not an issue for the energy sector.

(c) Behaviouralisation concept is not used in the sense of the concept explained in the DP. Nonetheless, behaviouralisation is part of the forecasting process of each energy company, i.e. it is the ability to reliably estimate cash flows based on the expected behaviour, i.e. taking into account the following:

- the flexibility of a B2B gas client: what will be the volume finally sold ?
- the (usually) full flexibility granted to B2C power clients: what will be the volume finally sold ? And what is the profile of the expected consumption (peak hours / off-peak hours...) ?
- the flexibility clauses of a gas purchase contract: what volume will a company have to purchase to face its commitments ?
- the contractual ability to renegotiate a long-term contract: will the company be able to renegotiate the purchase price and/or the indexation that determines the risk exposure (e.g. for a LT gas purchase contract that is partially indexed on oil: possible to renegotiate a switch to full gas indexation) ?
- ...

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.

The prepayment risk is not an issue for the energy industry.

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

We generally believe that if there is a change in the assumptions of customer behaviour, this change should be recognised in profit or loss through the application of the PRA when and to the extent the change occurs.

We however note that the question is more complex than what is exposed in the DP. We refer to comments in questions 11 and 12 as the issues are interrelated.

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.

As an introduction to this answer, it is important to highlight the usual key features of the dynamic risk management of an energy company:

- The risk management business model is mainly based on a transfer of the market risks (see risks identified above) that are located within the various entities of an energy group to a central netting factory (usually a distinct entity within the energy group ; if not, the use of distinct "books" will enable to clearly identify the position attributable to the central netting factory) that will be responsible to hedge a net exposure to the market;
- The risks are centralized by the energy's entities to the netting factoring through different types of hedging actions with the aim to gradually reduce price risk (= exposures) embodied in the Group's "economic assets" (power plants, long-term purchase contracts, sales contracts...);
- The risks, received by the netting factory are then brought to the market on a net and proxy basis[9]. The netting factory performs adequate risk management within clear limits that set boundaries for its fluctuating working portfolio (usually using a V@R limit).

[9] When a Belgian power plant is being hedged, the power exposure can be hedged using a forward contract on the German market (correlated instrument ; on a market which is more liquid). Another example would be the use of delta-neutral hedging as a proxy to hedge the native exposure.

As such, when a position/exposure is transferred to the central netting factory, the risk being managed (and that should be measured as such, see below) is assumed to be fully hedged and can be usually identified through a separate transaction between two entities of the energy group. The risks managed as well as the hedging instruments concluded are captured in the deal capture system of the central netting factory, which allows the identification and measurement of the macro portfolio (by aggregation of all deals captured).

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

The IEAF believes that risk limits should not be reflected in the application of the PRA. Indeed, a remeasurement of the managed exposures not equal to the fair value of the (external) hedging instrument would mean that the energy company is not perfectly hedged. This should be reflected in a net profit or loss impact.

We think that the application of the PRA should be based on the risk strategies and their implementation. Note that in some cases risk limits and risk strategies coincide, in as far as risk limits do not allow any unjustified deviation from a predefined hedging rhythm.

What may be useful to consider in the PRA, is that the risks that are brought into the macro portfolio for hedging, indeed require hedging, i.e. bringing these risks to the market is a risk-reducing action for the total existing risk position. For this purpose, risk strategies and the documentation of their risk-reducing character are essential, and risk limits and their monitoring contribute to this documentation). For many energy companies such documentation is already in place in the framework of the EMIR regulation. When such documentation is available for EMIR, it should also be used for accounting purposes, so as to ensure both for EMIR and for the financial reporting a coherent documentation that is in line with the actual 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?

(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 have identified similar exposure within the energy industry.

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 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?

As the IEAF has emphasized in its previous comment letters sent on the hedge accounting project in IFRS 9, the energy sector may face similar issue.

Examples:

1. The company sells LNG ex-ship that is delivered at the regasification terminal. The sales price is a "net back price" of the reference market price of the area (e.g. NBP or Henry Hub indexes). The sales price is usually designed as being "x% index +/- y".

   whereby:
   - "X" is constant and represents the "retainage percentage" of the terminal
   - "Y" may be a fixed amount, usually negative and representing the access costs to the market (such as pipe gas transport from the terminal to the market) and the margin. Or "Y" may also be a basis between the area of delivery and the market, then it is variable and may be either positive or negative.

2. The physical coal market has grown up over the last years, but it remains characterised by a lack of maturity and transparency that is difficult to manage because there are many different qualities of coal and that all the market participants do not have the same interest for one coal or for another one. Therefore, it is difficult for traders to see clearly in the coal's price and to create a market.

   In order to institute a market and to allow/facilitate trades to take place, indexes have been created, such as:

   - API#2 (API stands for "All Publications Index"). It shows the "CIF"(Cost, insurance and freight) delivered price in the region of ARA (Amsterdam, Rotterdam, Antwerp) which is Europe's main gateway for imported coal. It is the most followed European physical index.
   - API#4 shows the "FOB" (Free On Board) coal price for deliveries at Richards Bay (South Africa). It is the other important price index for coal.

   Adjacent to the physical market, there is a financial swap market on these indexes that offers more liquidity and allows "paper trades" to take place and hedging the price of physical coal contracts.

   For instance, it happens that some lower coal qualities (e.g. Indonesia) are traded at spreads of API#4 minus 10 to 15 USD/Ton, that will then be hedged at a later date using API#4 financial swaps, which could give rise to a situation where the cash flow related to the hedged component (in notional amount) is greater than the total cash flows related to the highly probable transaction (as a whole).

As the risk management objective regarding these contracts is to hedge the variability of the cash flows attributable to the sales price (and thus hedging only the variable indexes), the exposure being managed should be reflected only to that extent.

Therefore, we believe that approach 3 should be privileged.

5. Section 4 – Revaluing the managed portfolio

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?.

Question 12 – Transfer pricing transactions
(a) Do you think that transfer pricing transactions would provide a good representation of the managed risk in the managed portfolio for the purposes of applying the PRA? To what extent do you think that the risk transferred to ALM via transfer pricing is representative of the risk that exists in the managed portfolio (see paragraphs 4.2.23–4.2.24)? (b) If the managed risk is a funding rate and is represented via transfer pricing transactions, which of the approaches discussed in paragraph 4.2.21 do you think provides the most faithful representation of dynamic risk management? If you consider none of the approaches to be appropriate, what alternatives do you suggest? In your answer please consider both representational faithfulness and operational feasibility. (c) Do you think restrictions are required on the eligibility of the indexes and spreads that can be used in transfer pricing as a basis for applying the PRA? Why or why not? If not, what changes do you recommend, and why? (d) If transfer pricing were to be used as a practical expedient, how would you resolve the issues identified in paragraphs 4.3.1–4.3.4 concerning ongoing linkage?.

We believe that the issue to identify the exposure being hedged is less complex for the energy industry. Indeed, as we have said earlier in section 3, the risk that is transferred to the central netting factory (1) is the risk that is managed and (2) adequately represents the risk/exposure (i.e. same index) embedded in the native position and (3) is therefore the risk to be remeasured.

However and we have stated in question 6, the question of the change in behaviour has to be carefully analysed as this change cannot be considered without assessing the overall global position of the related

risk vector (i.e. the risk [gas, power, carbon emission rights, oil...]. To illustrate, let us consider the following example[10]:

- Entity A and entity B are fully owned and consolidated by Group XYZ;
- Entity A is running a nuclear power plant (i.e. at risk on the power price) of 1000 MW capacity installed ("plant A") while entity B is running a gas-fired power plant (i.e. at risk on the power, gas and carbon emission rights prices) of 1000 MW capacity installed ("plant B");
- At t0:
    - Entity A transfers the risk related to 40% of its production in year N (i.e. the exposure to variability in power price) ; it is therefore selling forward to the central netting factory power with maturity N ("X" MWh);
    - Entity B transfers the risk related to 40% of its production in year N (i.e. the exposure to variability in clean spark spread); it is therefore selling forward to the central netting factory power with maturity N ("X" MWh). It is also purchasing the equivalent volume of gas and carbon emission rights needed to produce "X" MWh of power;
    - To neutralise its position, the central netting factory will therefore sell on the market 2*X MWh of power and will also purchase the needed gas and carbon emission rights for plant B.

- At t1:
    - Assuming that plant A will be in outage in year N (i.e. the plant will no longer run), entity A has to purchase back its position that it has transferred at T0 ; it is therefore purchasing forward from the central netting factory power with maturity N ("X" MWh);
    - Entity B transfers another portion of its production in year N (40%) ; it is therefore selling forward to the central netting factory power with maturity N ("X" MWh). It is also purchasing the equivalent volume of gas and carbon emission rights needed to produce "X" MWh of power ;
    - As its exposure related to the power price has not changed, the central netting factory shall only further hedge the exposure related to the gas and carbon emission rights prices.

[10] This example is purely for illustrative purposes as it is not probable that the production forecasts are similar for a gas-fired and a nuclear power plant. Indeed, the order merit (= a way of ranking available sources of energy production based on ascending short-run marginal costs of production) or the duration of planned outage are not similar both power stations. We however take the benefits of a simplified example so to have a clear view on the considered issue.

Considering the above, we believe that the change in behaviour has to be assessed globally by risk vector. In the example above, the XYZ Group continues to be soundly hedged on the power price since the exposure is being considered at a macro level and net basis.

Question 13 – Selection of funding index
(a) Do you think that it is acceptable to identify a single funding index for all managed portfolios if funding is based on more than one funding index? Why or why not? If yes, please explain the circumstances under which this would be appropriate. (b) Do you think that criteria for selecting a suitable funding index or indexes are necessary? Why or why not? If yes, what would those criteria be, and why?

N/A.

Question 14 – Pricing index
(a) Please provide one or more example(s) of dynamic risk management undertaken for portfolios with respect to a pricing index. (b) How is the pricing index determined for these portfolios? Do you think that this pricing index would be an appropriate basis for applying the PRA if used in dynamic risk management? Why or why not? If not, what criteria should be required? Please explain your reasons. (c) Do you think that the application of the PRA would provide useful information about these dynamic risk management activities when the pricing index is used in dynamic risk management? Why or why not?

See questions 11 and 12.

6. Section 5 – Scope

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 scope should be limited to those transactions for which an entity has undertaken risk mitigation through hedging because it would better reflect the economics in the financial statement. This would benefit for a better representation compared to both IAS 39/IFRS 9 and

- under IAS 39/IFRS 9, entities had to suffer from P&L volatility in case risks were hedged (hedges in fair value, risks in 'own use');
- to the contrary, under the first approach of the DP (applying the PRA to all managed portfolios included in an entity's dynamic risk management), entities would have to suffer from P&L volatility even for positions on which no hedging action is undertaken (if **all** risks, even those for which hedging is planned only in the future, have to be taken into account in the portfolio that has to be measured in fair value).

The following issues would also arise in case approach 1 (view to account for dynamic risk management) is adopted:

- How to measure the full exposure arising from a coal-fired power plants having a 40-year useful life ?
- This measure would also have little virtue in a sense that the market horizon on which exposures can be managed/hedged is often limited to 3 to 4 years (no long-term liquidity). Disclosures in such context should provide rather qualitative than quantitative information.
- Therefore, the risk management shall never use approach 1 as a quantitative indicator for any of its activities.

As mentioned earlier, the "risks mitigation" approach can be easily identified in our business models because the exposure is expected to be hedged as soon as it enters into the scope of the central netting factory (i.e. as soon as is it is captured in a book for which the netting factory should ensure rapid hedging, either directly in the market or on a net or proxy basis). Therefore, we believe that the energy sector does not face the specific issues mentioned for "sub-portfolio approach" or "proportional approach".

Therefore, we strongly support that approach 1 would be better depicted through appropriate disclosures.

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 risk mitigation? Why or why not?

We strongly believe that the question to whether the application should be mandatory has to be considered as a whole together with the application of IFRS 9. As hedge accounting under IFRS 9 remains optional, there is no strong basis to consider that the macro hedge accounting would be mandatory. Optional application for IFRS 9 and for macro hedge accounting would leave the opportunity for entities to adopt the accounting guidance that best reflects the economics of their transactions.

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.

(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.

As we have said in question 8, when the risk mitigation approach is adopted, it should be clear that the transactions performed should be made on the basis that they are reducing the risks of the portfolio. Applying those principles to the business model explained above would result in a 2-steps monitoring:

1. does the transaction performed with the central netting factory adequately reflect the risks embedded in the native positions ?
2. have the risks been decreased following actions taken by the central netting factory ?

We note that similar requirements are to be provided in the framework of the EMIR regulation and any resulting documentation made should/could also serve for accounting purposes. In our view, once a documentation of such quality is available, IFRS should allow for using it for accounting purposes.

7. Section 6 – Presentation and disclosures

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 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.

As mentioned earlier, the measured exposures do not arise from financial instruments but from other "economic assets" (assets accounted for under IAS 16, IAS 17 or IFRIC 12 ; own use contracts). As a direct consequence, we believe that the first two proposals ("line-by-line gross-up" and "separate lines for aggregate adjustments to assets and liabilities") would not depict adequately the risks being measured and would be for some cases impracticable in case no "accounted for" asset can be identified (e.g. B2C sales).

Rather we believe that approach 3 would be in line with the risk management representation. An additional granularity of the exposure being hedged would be better reflected through adequate disclosures.

Applying to the energy sector, we believe that the result of the revaluation adjustment as well as the fair value measurement of the hedging instruments should be presented separately from the operating results (i.e. the result accounted for when electricity is delivered to the grid, or the gas consumed by the customers...) as it would only reflect the "basis risk" in future margins.

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?

(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?

We agree that the trading department plays an important role in the risk management strategy as it sometimes acts as a "window to the market", i.e. the central netting factory go the market via the trading department.

As far as the transaction is externalised, we agree that the internal derivatives should be grossed-up in the statement of comprehensive income as it will enable to reflect both risk management activities and any margin earned in the trading activities (to be understood as "window on the market").

We have conceptual concerns if this would also be applied in case the transaction is not externalised. Indeed, when the risk is being transferred to the central netting factory, the risk is assumed to be hedged. If a hedging transaction is performed by the central netting factory to the trading unit, the transaction should go to the market, either directly or through the trading unit using an externalization proof.

Doing this is a best practice as this would help in segregating the "proprietary trading" activities in a Group from those that are "portfolio management" activities. This segregation has always existed in the energy sector to keep a proper documentation, notably in respect of the own use documentation.

Finally, we are concerned with §A4.2.17 dealing with risk management strategies and risk limits. We strongly support a consistent approach in applying the PRA but we believe that having different risk limits may lead to different profit or loss outcome because the risk management strategies may differ from one entity to another. The accounting treatment should reflect the actual risk management activities ; the way risk limits are defined and applied should be clarified in the notes to the financial statements.

Question 20 – Disclosures
(a) Do you think that each of the four identified themes would provide useful information on dynamic risk management? For each theme, please explain the reasons for your views. (b) If you think that an identified theme would not provide useful information, please identify that theme and explain why. (c) What additional disclosures, if any, do you think would result in useful information about an entity's dynamic risk management? Please explain why you think these disclosures would be useful.

Subject to the confidential features of information provided (a.o. with respect to information that would be disclosed in accordance with §6.3.16), we globally believe that the information as identified in the DP would provide relevant information on dynamic risk management.

Question 21 – Scope of disclosures
(a) Do you think that the scope of the disclosures should be the same as the scope of the application of the PRA? Why or why not? (b) If you do not think that the scope of the disclosures should be the same as the scope of the application of the PRA, what do you think would be an appropriate scope for the disclosures, and why?

Adequate disclosures should be made available on the way risks are being managed. This will encompass not only those information available on the risks mitigated through hedging transactions but also the way the native positions are being managed and why or why not (and how) a portion of risk is being transferred to the central netting factory. Therefore, we believe disclosures and accounting treatment do not have the same scope:

- accounting for hedging transactions is to avoid unjustified profit or loss volatility;
- while disclosures should also have a broader scope to understand how the dynamic risk management activities are being undertaken.

We also note that cross-references should be allowed when this information is available at the same time in other parts of the financial communication (e.g. within a registration document that not only includes financial statements but also information on risks).

8. Section 7 – Other considerations

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

We are of the opinion that the question is a bit less relevant for the energy industry.

When the forecast power production of a power plant (accounted for in accordance with IAS 16 *Property, Plant and Equipment*) is progressively hedged over the time and is part of a dynamic risk management activity, the risks being transferred to the central netting factory through a transaction serve as a basis for remeasurement in a PRA approach. Those transactions have a different contract price since they are not concluded at the same moment. However, considering that those transactions have each a zero initial fair value and since they are considered as a risk being managed when they are captured within the central netting factory, we believe that this complies with the philosophy of the PRA approach.

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

No exposures can be prepaid or sold.

Question 24 – Dynamic risk management of foreign currency instruments
(a) Do you think that it is possible to apply the PRA to the dynamic risk management of FX risk in conjunction with interest rate risk that is being dynamically managed? (b) Please provide an overview of such a dynamic risk management approach and how the PRA could be applied or the reasons why it could not.

The energy companies are not experiencing any significant practical issue to apply hedge accounting to foreign exchange risk.

9. Section 8 – Application of the PRA to other risks

Question 25 – Application of the PRA to other risks
(a) Should the PRA be available for dynamic risk management other than banks' dynamic interest rate risk management? Why or why not? If yes, for which additional fact patterns do you think it would be appropriate? Please explain your fact patterns. (b) For each fact pattern in (a), please explain whether and how the PRA could be applied and whether it would provide useful information about dynamic risk management in entities' financial statements.

See the comments made in the introduction section.

10. Section 9 – Alternative approach: PRA through OCI

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?

As we said earlier, some entities may only need IFRS 9 to account for their strategies. If this is practicable and is in line with the way risks are managed, we believe those entities have to stick to that accounting treatment. For those other entities for which IFRS 9 does not represent the appropriate method (because of the dynamic features of their risk management activities), the alternative approach as explained in the DP would lead to significant practical difficulties:

- Considering that only the effective portion could be included in OCI, how to identify this portion when no clear link can be made between the hedged item(s) and the hedging instrument(s);
- considering the last comment, the recycling of OCI would be impracticable.

Appendix 2: Members of the International Energy Accounting Forum

Alpiq	www.Alpiq.de
Axpo	www.axpo.ch
BG Group	www.bg-group.com
EDF	www.edf.com **[As mentioned in the letter, EDF will issue its own comment letter]**
EnBW	www.enbw.com
EWE	www.ewe.de
Fortum	www.fortum.com
Gas Natural	www.gasnatural.com
Gazprom Marketing & Trading	www.gazprom-mt.com
GDF SUEZ	www.gdfsuez.com
Iberdrola	www.iberdrola.es
OMV	www.omv.com
RWE	www.rwe.com
Scottish Power	www.scottishpower.com
Unesa	www.unesa.es
Vattenfall	www.vattenfall.com
Verbund	www.verbund.com
Veolia	www.veolia.com