RAAD VOOR DE JAARVERSLAGGEVING

Secretariaat:
Antonio Vivaldistraat 2-8, 1083 GR Amsterdam
Postbus 7984, 1008 AD Amsterdam

T +31(0)20 301 02 35
F +31(0)20 301 03 02
rj@rjnet.nl
www.rjnet.nl

International
Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Our ref :RJ-IASB 452
Direct dial : (+31) 20 301 0391
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Re :**Comment on 'Accounting for Dynamic Risk Management: a Portfolio Revaluation Approach to Macro Hedging'**

Dear members of the International Accounting Standards Board,

The Dutch Accounting Standards Board (DASB) appreciates the opportunity to comment on your Discussion Paper DP/2014/1 – *Accounting for Dynamic Risk Management: a Portfolio Revaluation Approach to Macro Hedging* (the 'DP').

The DASB appreciates the IASB's efforts to develop an accounting approach that better reflects the dynamic risk management activities of banks regarding interest rate risk and other risks. We also welcome the intention of the IASB to reduce complexity of hedge accounting and to remove the so called EU carve out.

General comment

We compliment the IASB on its depiction and understanding of the risk management activities of banks in the DP. The objective of risk management is to preserve (future) interest margins in a hold and collect business model, as is described in IFRS 9. The challenges are dynamically managing open risk portfolios and modelling exposures. Achieving hedge accounting for open portfolios is difficult under the current hedge accounting requirements of IAS 39 and the general hedge accounting guidance of IFRS 9. This means that not all exposures that are part of the dynamic risk management activities of banks are eligible for hedge accounting. The DASB notices that it is a leap forward that the DP addresses this issue by considering the following eligible hedged items:

- Prepayable mortgages (including bottom layer principles)
- Core demand deposits
- Sub-benchmark rate exposures
- Pipeline trades/loan commitments
- Equity model book

Accounting mismatch and the full PRA

The objective of a future macro hedge accounting standard should be limited to eliminating accounting mismatches between the measurement of financial instruments which are classified based on the underlying business purpose and the derivatives which need – by default – to be measured at fair value through profit and loss. The DASB noticed that the DP proposes a completely new model, the Portfolio Revaluation Approach ('PRA'), introducing a full fair value model for interest rate risk instead of addressing the issues banks face under the current hedge accounting requirements of IAS 39 in a new macro hedge accounting solution.

We believe that the full PRA will not give a faithful representation of the economic result in the banking book based on a business model to hold and collect cash flows. According to the classification and measurement criteria under IFRS 9, the banking book is measured at amortised cost. As a result, an unhedged exposure would result in a changed interest margin in future reporting periods. However, under the PRA a change in fair value of the total future interest margin or a change in risk strategy would be reported forward in the income statement of the current reporting period. We are of the opinion that this is inconsistent with the business model of many banks.

Scope: dynamic risk management vs. dynamic risk mitigation

The IASB has expanded the scope of the project by considering the accounting for dynamic risk management, through revaluation of all portfolios that are dynamically managed, rather than focusing on finding a hedge accounting solution for open portfolios. We disagree with a scope that focuses on dynamic risk management.

The DP discusses two scoping alternatives: one with a focus on dynamic risk management and the other with a focus on risk mitigation. As described above, the problem with the focus on dynamic risk management is that it assumes that the objective of risk management is to manage exposures to changes in fair values. However, to record income volatility from intentionally unhedged positions is inconsistent with how banks would describe their objective of dynamic risk management. Accordingly, a focus on risk mitigation would probably be more appropriate, as a possible compromise between financial reporting principles on the one hand and the objectives of actual risk management on the other. We recognise that this is likely to lead to another approach that may require tracking and amortisation of items. Although this will not result in the operational simplicity that was one of the IASB's objectives, we understand that banks generally would support a more complex approach if it better reflects their risk management objectives and activities.

If further information is required regarding the susceptibility of an entity to risks associated with future market movements then we believe that such extension can be dealt with through expanded disclosures, not by selection of a measurement basis which is not aligned with the underlying business model.

Alternative approaches

As described above, the DASB is of the opinion that the full PRA would not give a faithful representation of the economic results in the banking book based on a business model to collect and hold cash flows. The PRA is an approach that has been elaborated in the DP while alternative approaches are not discussed in great detail. We believe that the DP should outline alternatives to accounting for dynamic risk management activities. By expanding more on alternative approaches one can reach a better view which risk mitigated approach might be suitable. Since we believe that the full PRA is not the best alternative, we are reluctant to comment on each individual question.

Scope: banks vs. other entities and interest rate risk vs. other risks

The outcome of this project would replace the current 'fair value hedge accounting for a portfolio hedge of interest rate risk' in IAS 39. As described above, the DASB compliments the IASB on its depiction and understanding of the risk management activities of banks. Dynamic risk management of interest rate risk, particularly as managed by banks, is used throughout this DP for illustrative purposes. However, it is the IASB's intention to develop an accounting model for dynamic risk management activities that would accommodate different types of risks, e.g. commodity price risk, foreign currency exchange risk, etc., that may be managed dynamically on the basis of an open portfolio. In addition to applying the model to different types of risk that are dynamically managed, the IASB intends to apply the model to industries other than the banking industry, e.g. energy and utility industry, retail industry, manufacturing industry, insurance industry, etc., provided the entities apply dynamic risk management.

We believe that the accounting of dynamic risk management activities by non-banks is neglected and should be expanded in order to understand IASB's view how the accounting for these types of industry and types of risks (other than interest rate) will turn out.

Behaviourlisation, Equity model book, Pipeline transactions and Prepayment risk

It is clear for us that, notwithstanding our concerns about the full PRA, accounting of the dynamic risk management activities of banks needs to include exposures that are calculated on a 'behaviouralised' basis rather than on a contractual basis. The DASB believes that the new macro hedge accounting model should include all such items in order to achieve meaningful information. This means all the items as listed in the DP such as core demand deposits, equity model book, pipeline transactions and prepayment risk, but also forecast transaction as currently covered in the cash flow hedge accounting model under IAS 39 should be considered. If the actual risk management should be reflected in the accounting then all such relevant exposures should be eligible for inclusion in the macro hedge accounting model.

Disclosures

The DASB supports the IASB's intention to enhance the transparency of an entity's dynamic risk management activities. Although we do not support the full PRA, we support the IASB's view that the added value of disclosures is enhanced if these are descriptive and specific to the entity. We believe that the disclosure requirements arising from this project should fit with the current IFRS disclosure requirements rather than simply be additive.

Mandatory application
The DASB does not support mandatory application of macro hedge accounting, including any form of PRA. There will be a diversity in practice about the definition and scope of dynamic risk management as well as macro hedge accounting models could be quite complex (also considering the proposals in the DP), including the items that should be in the scope of a mandatory macro hedge accounting model.

Final comments
We support the IASB's initiative for developing a macro hedge accounting model. We do not support the full PRA model and we believe that the DP does not reflect alternative approaches that might be worthwhile to expose. It would be favourable if the IASB considers these aspects when determining the appropriate next steps in the project before the IASB will issue an exposure draft. For these reasons, we do not respond to the individual questions in this stage of the project.

We will be pleased to give you any further information that you may require.

Yours sincerely,

Hans de Munnik
Chairman Dutch Accounting Standards Board