19 December 2014

Mr Hans Hoogervorst
Chairman
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
UNITED KINGDOM

Dear Hans

AOSSG comments on IASB Discussion Paper DP/2014/1 *Accounting for Dynamic Risk Management: a Portfolio Revaluation Approach to Macro Hedging*

The Asian-Oceanian Standard-Setters Group (AOSSG) is pleased to provide comments on the IASB Discussion Paper DP/2014/1 *Accounting for Dynamic Risk Management: a Portfolio Revaluation Approach to Macro Hedging*. In providing this feedback, the AOSSG sought input from its constituents within each jurisdiction.

The AOSSG currently has 26 member standard-setters from the Asia-Oceania region: Australia, Brunei, Cambodia, China, Dubai, Hong Kong, India, Indonesia, Iraq, Japan, Kazakhstan, Korea, Macao, Malaysia, Mongolia, Nepal, New Zealand, Pakistan, Philippines, Saudi Arabia, Singapore, Sri Lanka, Syria, Thailand, Uzbekistan, and Vietnam.

To the extent feasible, this submission to the IASB reflects in broad terms the collective experiences of AOSSG members. Each member standard-setter may also choose to make a separate submission that is consistent or otherwise with aspects of this submission. The intention of the AOSSG is to enhance the input to the IASB from the Asia-Oceania region and not to prevent the IASB from receiving the variety of inputs that individual member standard-setters may wish to submit. This submission has been circulated to all AOSSG members for their feedback after having initially been developed through the AOSSG Financial Instruments Working Group.

Overall, AOSSG members supported the IASB's efforts in exploring a new approach in accounting for dynamic risk management. However, AOSSG members expressed the following views:

- some members do not support application of the portfolio revaluation approach (PRA) with a dynamic risk management focus as this is not in line with the original needs of the project ie. to address problems of existing hedge accounting requirements.

- however, some members do support exploring the PRA in the context of a risk mitigation scope.

- some members do acknowledge that the PRA has the potential to address operational challenges in applying existing hedge accounting to dynamic risk management activities, for example, if it would remove the need for frequent re-designation and tracking. However it is also acknowledged that practical application of the PRA is also likely to have operational challenges.

- one member thinks that a non-mandatory PRA scope focused on risk mitigation is more promising than a scope focused on DRM, if the IASB could overcome the various operational issues that are explained in more detail in the Appendix.

- some members do not support the PRA as it is significantly different from the recognition and measurement criteria in IFRS 9 *Financial Instruments*.

- some members suggest exploring alternative approaches to the PRA, including considering amendments to IAS 39 *Financial Instruments: Recognition and Measurement* or IFRS 9.

- some members are of the view that reflecting behavioralisation in the context of the PRA may improve faithful representation of underlying transactions and activities, however those members consider that sufficient guidance would need to be developed to ensure that an appropriate level of verifiability can be achieved, given the potential for estimation uncertainty.

- some members are concerned about recognising items on a behaviouralised basis, because they may not meet the definition of assets or liabilities in the *Conceptual Framework.*

- members' views are mixed on whether the IASB should explore an approach using other comprehensive income (OCI).

- some members suggest exploring application of the PRA, on a risk mitigation approach, to risk other than interest rate risk, such as foreign currency risk and commodity price risk.

Inputs from the AOSSG members to specific questions in the Discussion Paper (DP) are explained in more detail in the Appendix. If you have any questions regarding any matters in this submission, please contact either one of us.

Yours sincerely,

Clement Chan
AOSSG Chair

Kris Peach
AOSSG Financial Instruments Working Group Leader

APPENDIX – Detailed comments from the AOSSG on Specific Questions in the DP

Q1 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?

1 Members acknowledge that the hedge accounting limitations in IAS 39 are highly restrictive and do not allow entities, in all cases, to easily reflect the underlying economic interactions between particular transactions. Some members are concerned about the prevalence of 'proxy hedge accounting'.

2 However, some members are of the view that the IASB has increased the original scope of the project from the operational difficulties of hedge accounting for open portfolios by financial institutions, to accounting for dynamic risk management. Most members would prefer that the IASB prioritises the original hedge accounting objective. Some members think that information on risk management activities should be provided by disclosure rather than through an accounting model.

3 Some members do not consider that there is a need for a specific accounting approach for dynamic risk management and do not support the PRA with a dynamic risk management scope. However, some members support exploring the PRA in the context of a non-mandatory risk mitigation scope.

4 Some members think that the PRA may be of interest to other sectors such as the insurance industry and commodities industry.

5 However, some members recommend that the IASB undertake further research on accounting for risk management in general and that this could be carried out as part of the work on revising the *Conceptual Framework*.

6 Members have concerns about application of the PRA for the following reasons:

(i) the PRA accounting may be inconsistent with IFRS 9 recognition and measurement;

(ii) the PRA scope based on dynamic risk management may be inconsistent with the existing *Conceptual Framework*;

(iii) increasing the use of 'behavioralisation' may increase estimation uncertainty, need for judgement and could increase the risk of earnings manipulation;

(iv) voluntary application of the PRA would provide yet another optional accounting treatment and may reduce comparability of financial statements;

(v) the PRA may actually increase operational complexity, for example, in determining the boundaries of the PRA and in tracking which items are included or excluded from its scope;

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(vi) a revaluation approach may not work well for cash flow hedges of floating rate instruments since cash flow variability does not create a corresponding fair value exposure; and

(vii) the PRA may combine remeasurement of components of managed risk which are based on different levels of inputs (ie. 'level 1', 'level 2' or 'level 3' inputs under IFRS 13 *Fair Value Measurement*) and this may reduce transparency.

7 Some members would like the IASB to consider requiring additional information about dynamic risk management through disclosures, rather than recognition and measurement. Disclosures might include, for example, information about duration mismatch or repricing mismatch. One member recommends that the IASB consider the existing reporting for regulatory monitoring in different jurisdictions and whether disclosure of such information is necessary for financial reporting purposes, or whether disclosure to regulatory bodies is sufficient.

8 One member encourages the IASB to also consider its work on its Principles of Disclosure project in deliberating on what modifications to existing disclosure requirements would improve information for users, subject to appropriate cost/benefit considerations.

9 Some members recommend that the IASB should break the project into two distinct parts being (a) a project to improve existing hedge accounting and (b) a long term project on the implications of accounting dynamic risk management, in the context of the work on the *Conceptual Framework*. Those members consider that the hedge accounting project should be prioritised.

10 In one member's view, it is appropriate for the IASB to continue to consider the sub-portfolio approach assuming the scope is focused on risk mitigation. This is because in the sub-portfolio approach an entity would designate a specific sub-portfolio to which the PRA is applied and thereby could address the difficulties in defining an entity's risk mitigation activities. That member does not support the proportional approach because, although the approach might be possible in theory, there are not necessarily many cases that an entity establishes a policy to hedge a specific proportion of the entire portfolio that are dynamically managed if the size of the portfolio is relatively large. Accordingly, the member thinks that it would be normally difficult to faithfully represent hedging activities for an open portfolio by applying the proportional approach.

Q2 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?

11 Some members agree that the DP has correctly identified the main issues. However, members do not think that the PRA would address the issues identified.

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12 One member notes that some entities manage their interest rate risk profiles on a cash flow basis rather than a revaluation basis. In their view it is debatable whether the PRA would faithfully represent their dynamic risk management. This is particularly the case where an entity has floating rate exposures.

13 One member encourages the IASB to clarify the principle behind application of hedge accounting based on behaviouralised cash flows rather than contractual flows.

14 One member notes that the IASB has introduced fair value hedge accounting for a portfolio of interest rate risk in IAS 39 and has introduced new requirements in IFRS 9 for eligibility of group hedge accounting to accommodate risk management practices on a net basis. That member does not think that the DP sufficiently explained the reasons for the need for a further significant change.

15 Another member suggested that the IASB take time to fully explain the objective and frame of the DP for Asian territories before publishing an exposure draft related to macro hedge accounting because some Asian banks or other corporate bodies would benefit considerably from applying the portfolio revaluation approach for dynamic risk management. In their jurisdiction, no corporate body or financial institution is currently applying the fair value hedge accounting for a portfolio hedge of interest rate risk in IAS 39, and thus not many constituents would be interested in the concept of the DP which is similar to the portfolio hedge accounting in IAS 39. Another reason may be that most preparers feel that it is difficult to understand general hedge accounting and the time and effort needed in understanding the details of the DP may be even burdensome for them.

16 Another member notes that the issues the DP seeks to address predominantly arise due to:

(a) the use of a mixed measurement model (including the requirement to account for derivatives at fair value through profit or loss);

(b) identification of the unit of account in accounting for open portfolios; and

(c) the requirement to account for financial instruments based on their contractual terms, rather than their expected behaviour.

17 That member considers that a significant amount of research would be necessary, ideally in the context of the *Conceptual Framework*, before it could be determined that remeasurement of components by managed risk is the optimal basis for an accounting model, given the pervasive nature of the above issues in accounting for open portfolio of financial instruments.

Q3 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?

18 Some members consider that the DP describes many of the high-level characteristics of dynamic interest rate risk management of banks. However, some of the characteristics do not reflect dynamic risk strategies in all banks at a more detailed level or other sectors or other risks, for example insurance companies have exposure to interest rate, equity price and inflation risks. Open portfolios are also prevalent in insurance companies and the PRA may well be of interest to them.

19 One member also notes that 'preserving the economic value of equity of an entity' could be included to enhance the description of the objective of risk management.

20 One member notes that if the PRA is applied on a risk mitigation basis as they prefer, the description of dynamic risk management does not necessarily need to be accurate and complete.

21 One member encourages the IASB to more fully explore the rationale for basing accounting on dynamic risk management, taking into account the objective of financial reporting and its work on the *Conceptual Framework*.

22 Some members think that a robust definition of dynamic risk management is needed if this would be a pre-requisite for application of the PRA to portfolios that are dynamically managed.

23 One member thinks that a robust description of risk mitigation would also be important, particularly if the IASB pursues a PRA scope focused on risk mitigation.

24 This member further believes that the PRA should be confined strictly to the hedging of the managed risk using risk management instruments.

Q4 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*).

Equity Model Book

(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*

25 Some members support including pipeline transactions if they are included in dynamic risk management practices, to more faithfully reflect how risk is mitigated through hedging activities. Some note that this would be as an exception to the *Conceptual Framework*.

26 Some members consider that it would be particularly important for the IASB to clarify the scope and criteria for permitting inclusion of pipeline transactions, for example, regarding

the relationship of the pipeline transactions to risk management and how.obligations arising from pipeline transactions would meet the definition of liabilities under the *Conceptual Framework*.

27 However, other members do not support recognition of items that do not meet the definition of assets or liabilities according to the *Conceptual Framework*. Pipeline transactions as described in the DP do not appear to meet the definition of assets or liabilities; therefore, alternative means of providing information about these economic phenomena, such as disclosure, would be preferable.

28 Most members do not support requiring or permitting the recognition of amounts relating to the EMB as doing so would be inconsistent with the *Conceptual Framework* definitions of assets and liabilities and there is insufficient justification to override these concepts.

29 One member would support the IASB in considering how to improve accounting for items whose behaviour may differ from their contractual terms if this were part of a broader exercise to consider current value measurement of liabilities, ideally as part of the work on the *Conceptual Framework*.

30 Another member supports reflecting behaviouralisation in the financial statements, but prefers that it be limited to when sufficient guidance can be provide to ensure verifiability.

Q5 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.

31 Members have mixed views as to whether the managed portfolio or sub-portfolio is remeasured for the managed risk both up and down. One member notes that this reflects the actual change in value due to the risk, independent of the nature of the instruments used for risk mitigation, however if the objective is to align to risk mitigation activities only one-sided remeasurement should be made accordingly.

32 Some members note that whilst IFRS 9 permits options to be designated in hedge accounting relationships of one-sided risks this is operationally achievable in a micro hedging relationship. In an open portfolio, it would likely introduce a high degree of complexity and be practically difficult to identify a portion in which only one-sided risks are hedged in a managed portfolio.

Q6 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?

33 Some members agree 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.

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34 Some members note that this is because the change in estimate is a current period change that should be reflected immediately. This is consistent with paragraph 36 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

35 Some members would limit the recognition in the statement of comprehensive income to the extent that such changes are hedged ie. that they affect the layer or proportion designated in accordance with the risk management strategy and objectives.

36 A member also noted that this would increase the complexity of the approach as it would be necessary to determine when and to what extent these changes occur.

Q7 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.

37 Members' views include the following:

(i) a bottom layer or proportional approach should not be permitted as managed portfolios generally do not consist of homogenous items therefore allowing this approach raises the issue of tracking the hedged transactions through the whole period in which the risk is dynamically managed;

(ii) a bottom layer or proportional approach should be permitted if that is consistent with the entity's risk management strategy and objectives. Although this would introduce a need for tracking mechanisms this is a common approach used by banks therefore it would more closely reflect risk management;

(iii) one member thinks that, if permitted, additional guidance would need to be provided to help ensure that bottom layer accounting was consistent between portfolios and entities; and

(iv) another member recommends that further analysis should be carried out to consider the use of practical expedients.

Q8 Risk limits

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

38 Members do not support the use of risk limits in accounting. The reasons given include that risk limits are entity specific, they are subjectively set and therefore could reduce comparability between entities.

39 One member is of the view that the tolerance or appetite of an entity for risk does not appear to be relevant in determining the appropriate representation of the underlying economic transactions in a given period.

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Q9	**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?

40 Members' views include the following:

(i) some members think that core demand deposits should be included in the managed portfolio as this would reflect more faithfully the economic reality of an entity's exposure to interest rate risk and provide more relevant information for users of financial statements.

(ii) one member supports including core demand deposits only if this is consistent with how management considers them for risk management purposes.

(iii) some members consider that there should be specific measurement guidelines;

(iv) one member thinks that inclusion of core demand deposits should be limited to the case where sufficient guidance could be developed in order to ensure verifiability;

(v) one member suggests that illustrative examples could be useful. Disclosures including estimation and assumptions and methodologies would be also be useful

(vi) one member would only support consideration of accounting for core demand deposits on a fully behaviouralised basis if it were part of a wider exercise to consider current value measurement of liabilities, including consideration of overriding paragraph 47 of IFRS 13 *Fair Value Measurement* which requires the fair value of a financial liabilities with a demand feature (e.g. a demand deposit) to be no less than the amount payable on demand, discounted from the first date that the amount could be required to be paid. However, that member considers that permitting the designation of the interest rate risk component of core demand deposits as an eligible hedged risk could be considered in the context of IFRS 9 hedge accounting, and should be subject to the same restrictions applicable to other hedged components including the requirement in paragraph 6.3.7 of IFRS 9 that the risk component is separately identifiable and reliably measurable.

(vii) that member also has the view that if hedge accounting of core demand deposits were permitted, some guidance may be useful for entities that do not already have systems and processes in place to measure the component, however as practice already exists any guidance should consider the merits of existing methodologies which achieve the IASB's aim.

Q10	**Sub-benchmark rate managed risk instruments**
(a)	Do you think that sub-benchmark instruments should be included within the managed portfolio as benchmark instruments if it is consistent with an entity's dynamic risk management approach (ie Approach 3 in Section 3.10)? Why or why not? If not, do you think that the alternatives presented in the DP (ie Approaches 1 and 2 in Section 3.10) for calculating the revaluation adjustment for sub-benchmark instruments provide an

appropriate reflection of the risk attached to sub-benchmark instruments? Why or why not?

(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?

41 Members' views concerning sub-benchmark rates include the following:

(i) some members think that sub-benchmark instruments should be included if that designation is consistent with the entity's risk management strategy;

(ii) one member would also require that such a rate is contractually specified; and

(iii) one member thinks that sub-benchmark instruments should be included within the managed portfolio as benchmark instruments if that is consistent with an entity's risk management approach.

42 Members' views concerning embedded floors include the following:

(i) some members think that embedded floors should be included in the managed portfolio as generally embedded floors included within sub-benchmark instruments are not separately transferred to ALM, even though those embedded floors may have an impact on the actual cash flows;

(ii) some members think that embedded floors should not be included as the financial statements should faithfully reflect the risk management activities of the entity rather than the ALM;

(iii) some members think that embedded floors should be included only if the risk is being managed or hedged by the entity; and

(iv) one member considers that further research is necessary before it could be established whether, and to what extent, it would be desirable for accounting to be based on risk management activities.

Q11 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?

43 Members generally agree that the revaluation calculations in the DP are consistent with revaluation of the managed risk only.

44 One member thinks the IASB should consider how to define managed risk.

45 Some members are concerned that revaluation calculations may not provide faithful representation of dynamic risk management for entities that manage their interest rate risk

profiles on a cash flow basis rather than on a revaluation basis. Furthermore, one member considers that the 'cost of hedging' approach from IFRS 9 should be included in the PRA.

46 Members' views are mixed as to whether it is appropriate for the managed risk to be the funding rate.

(i) some members think that it is appropriate to include the funding rate in the PRA if the risk management objective is to manage net interest income with respect to the funding curve.

(ii) one member considers that the funding rate is appropriate to the extent that it is being used to estimate future cash flows which are being hedged.

(iii) however, another member notes that, although use of a funding rate will result in a model which is closely aligned to an entity's risk management, the funding rate is entity specific so comparability would be difficult to achieve.

Q12 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?

47 Members' views include the following:

(i) some members do not support the use of transfer pricing (TP) as it is entity specific and may include additional effects eg profit margins charged on business units. It may therefore not be a faithful representation of the managed interest rate risk;

(ii) another member supports using internal TP as proxies as a matter of practical expediency, although sound internal control would be necessary. A further consideration would be how to determine whether the transfer rate was 'close enough' to the managed risk to be acceptable;

(iii) one member thinks that the first approach (market funding rate index) must faithfully represent dynamic risk management, because the impact from the TP strategy has been excluded such that the revaluation adjustment is consistent with the circumstances under which there is no transfer pricing;

(iv) one member's view, based on the feedback from constituents, is that using an internal transfer price to identify a managed risk might have merit as a starting point. However, although internal TP may be based on a core risk free curve, it may then be adjusted (for example for long term funding, incentives or disincentives) and the adjustments may not be consistent between banks. To remove the effect of entity specific adjustment to TP, restrictions would likely be necessary in order to adequately represent the managed risk. Without restrictions there is potential for inadvertent distortion of results as well as manipulation of earnings;

(v) another member agrees with using the TP transactions as a practical expedient but thinks that there should be specific restrictions and requirements for related disclosures because of concerns about arbitrary revaluation; and

(vi) one member believes that fundamentally, for the purposes of applying the PRA, the managed risk should be represented by well-established benchmarks for which risk mitigation could be undertaken and that the PRA should capture actual risk exposures and any hedge ineffectiveness that arises.

(vii) This member has reservations about whether the use of TP would be effective as a practical expedient, having regard to:

a) the different DRM strategies that exist in practice;

b) the fact that the TP rate may include elements unrelated to actual risk exposures, resulting in TP not being representative of actual risk exposures; and

c) the fact that TP is commonly used as a tool to encourage particular behaviours in business units, which has little relevance to the managed risk and would be adjusted over time in response to changes in market conditions and business strategies.

48 Feedback from some members is that outside of banking, the use of internal pricing is not common. Therefore alternative approaches may need to be developed to identify managed risks for other scenarios.

Q13 Selection of the 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?

Q14 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?

49 Members' views include the following:

(i) some members support the use of more than one benchmark or funding index if they represent the interest rate risk to which an entity is exposed in the managed portfolio. The chosen index should represent the actual interest rate risk that exists in the managed portfolio;

(ii) one member suggests that using a blended rate might be appropriate (and if so, guidance may be necessary on how to determine the rate);

(iii) some members support that the funding index should be determined by an entity's risk management policy. There should be freedom to choose as long as the chosen index or indexes are within the internal risk management controls and policies;

(iv) one member thinks that the funding index or pricing index used should be consistent with risk management which the member thinks in many cases would be a benchmark rate. However the member envisages that it may not be appropriate to identify a single funding index as the managed risk for all managed portfolios if funding is based on more than one funding index. The member thinks that to ensure comparability and consistency of approach between entities additional criteria and guidance would be necessary;

(v) one member had no information from constituents about net positions which are identified and hedged based on a pricing index, however the member does not support the use of pricing index since the interest rate risk is only one component of a pricing index so they do not believe pricing indexes would provide a faithful representation of the managed interest rate risk;

(vi) one member thinks a pricing index should be allowed to be used if they are included in risk management activities; and

(vii) one member recommended that disclosure of the applicable rate should be considered.

Q15 Scope

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

(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?

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(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?

50 Refer to the answer to question 1.

Q16	**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?

51 Members' views include the following:

(i) the PRA should be on a voluntary basis – similar to existing hedge accounting;

(ii) the PRA should be limited to a risk management scope;

(iii) if the scope of the PRA is dynamic risk management the PRA should be mandatory, however significant further research would be necessary to determine whether a risk management focus is appropriate for financial reporting purposes;

(iv) a mandatory approach could create problems for entities who combine PRA and the general hedge accounting in IFRS 9;

(v) to be mandatory there would need to be a very clear definition of what constitutes 'dynamic risk management'. This may be difficult to define; and

(vi) the cost of mandatory application could be in excess of the benefits for some entities.

52 Some members identified a concern that mandatory application of the PRA would be extremely difficult from an operational standpoint unless sophisticated risk management processes are established within the entity.

Q17	**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.

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(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.

53 Some members consider that if the IASB proceeds with the PRA additional criteria should be included for items to qualify for the PRA, whether mandatory or not.

54 Some members think that the additional criteria might include, for example, formal documentation about the method of risk mitigation, including identification of items and risk management objectives of items included in the portfolio or sub-portfolio and a clear definition of the portfolio or sub-portfolio which is consistent with risk management objectives.

55 One member thinks that effectiveness testing should be required however others think this may introduce significant complexity.

56 Other members do not think that additional eligibility criteria would be needed since the approach would be based an entity's risk management strategy and objectives and the existence of an economic relationship.

57 Other members do not think that additional eligibility criteria would be needed for a mandatory approach as the revaluation would capture any ineffectiveness in profit of loss. However if the approach is based on risk mitigation other criteria might be considered such as effectiveness testing.

Q18 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.

58 Members' views include the following for the Statement of Financial Position:

(i) one member supports line-by-line gross up as this is more consistent with existing hedge accounting requirements and would result in more faithful representation in each line item; and

(ii) other members support a separate single net line item as this is consistent with dynamic risk management activities and allocation to different assets and liabilities would be arbitrary.

59 Some members are of the view that for the Statement of Financial Performance, the actual net interest income presentation (with the revaluation effect from dynamic risk management activities presented in a separate line item) would provide the most useful information.

60 One member's view is that further research into the PRA is necessary before secondary questions such as presentation and disclosure can be fully considered.

Q19 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?

61 Members' views include the following:

(i) internal derivatives should not be presented gross as doing so would conflict with the consolidation principles. Internal transactions which eliminate on consolidation would not, in concept, give rise to revenues and expenses of the entity;

(ii) gross presentation of internal derivatives could provide information about whether derivatives are for risk management or trading, but they should not be included in the PRA;

(iii) gross presentation may enhance the usefulness of information about dynamic risk management and trading activities – however different entities may have different internal models and methodology resulting in non-comparable information;

(iv) grossed up presentation seems likely to confuse users and detract from the presentation in financial reporting of the entity as a whole;

(v) when it is necessary to provide information about the risk mitigation in the ALM department, it is possible to provide related information by disclosing it in the notes to the financial statements;

(vi) the issue about gross presentation of internal derivatives cannot be considered in isolation from the issue regarding the need for externalisation of internal derivatives for the purposes of applying the PRA. In particular, the PRA as outlined in the DP would not require an entity to demonstrate the externalisation of managed risk that is transferred via internal derivatives. Similar to the presentation of internal derivatives, this would conflict with the principle of not reflecting internal transactions in the financial statements. More importantly, this conflict would be more pronounced as compared to the gross presentation of internal derivatives, since it would lead to the grossing up of both the statement of financial position and the statement of comprehensive income, unlike the latter which would only result in the grossing up of gains or losses within profit or loss, without any net impact on profit or loss; and

(vii) if gross presentation of internal derivatives were prohibited, it is questionable whether reflecting only the revaluation adjustment on the managed portfolio without the corresponding fair value changes of the internal derivative used for risk mitigation would result in faithful portrayal of the effects of risk mitigation.

Q20 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.

62 Members' views include the following:

(i) it is premature to determine the appropriate disclosures before determining the relevant recognition and measurement approach;

(ii) the IASB should avoid potential overlaps with the disclosures in IFRS 7 *Financial Instruments: Disclosures*, especially the sensitivity analysis;

(iii) information about risk mitigation in the ALM department relating to internal derivatives should be disclosed in the notes to the financial statements;

(iv) if the PRA were to be applied as described in the DP the four themes appear reasonable;

(v) disclosure should be made when the changes in the main assumptions and judgements from the previous period have a material effect on the financial statements;

(vi) the requirements seem onerous and some of the information can be commercially sensitive. There is a risk of duplication of the already extensive disclosure requirements (both from financial and regulatory reporting); and

(vii) the IASB should focus on disclosure of the key risks and how these risks are measured and managed.

Q21 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?

63 Members' views include the following:

- (i) the scope of disclosures should be based on the risk mitigation approach;
- (ii) the IASB should develop accounting principles for disclosures rather than detailed disclosure requirements (also considering the IASB's work in its Principles of Disclosure project when developing new disclosure requirements);
- (iii) if the aim is to enable users to better understand entities' dynamic risk management activities the disclosure requirements should consider the key risks arising from those activities and how the risks are monitored, measured and managed;
- (iv) the scope of the disclosures should be the same as the scope of the PRA to avoid a disconnect in the information presented; and
- (v) at a minimum, the scope of the disclosures should be the scope of the PRA, but the IASB should give consideration to requiring information about the entity's risks as a whole, not just activities subject to dynamic risk management.

64 As noted in the response to question 1, some members would like the IASB to consider requiring additional information about dynamic risk management through disclosures, rather than recognition and measurement. Disclosures might include, for example, information about duration mismatch or repricing mismatch. One member recommends that the IASB considers the existing reporting for regulatory monitoring in different jurisdictions and whether disclosure of such information is necessary for financial reporting purposes, or whether disclosure to regulatory bodies is sufficient.

Q22 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.

Q23 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.

65 Members have the following views regarding inclusion/exclusion of exposures:

(i) some members think that as the objective of the approach is to reflect risk management then inclusion and/or exclusion of items would be expected to follow the risk management activities;

(ii) some members think that that exposures should generally be included in the PRA when an entity first becomes a party to a contract and as a general principle, should remain in the PRA until derecognition. However in some cases application of the PRA could be applied at a later time, for example if there are significant changes in risk management objectives or strategies, or in how portfolios are defined;

(iii) some members suggest that consideration could be given to either prohibiting removal, similar to the fair value option, or restricting removal of exposures in a similar manner to discontinuing hedge accounting in paragraph B6.5.23 (a) of IFRS 9 [if the exposure still meets the risk management objective on the basis of which it qualified for hedge accounting (ie the entity still pursues that risk management objective)]; and

(iv) one member thinks that inclusions of exposures after initial recognition would necessitate tracking if amortisation of day one revaluations were required, which would be operationally challenging in light of the dynamic nature of open portfolio hedges. More importantly, this member thinks that this approach lacks conceptual basis because the deferred amount arguably would not meet the definition of assets or liabilities under the *Conceptual Framework* and should not affect profit or loss in future periods. As such, this member thinks that the alternative of immediate recognition to profit or loss could be given some consideration, despite it being not reflective of the outcome of DRM activities.

66 Some members think that revaluations should be prospective only; therefore, day-one revaluations should not arise. Others think the day-one revaluation should be taken to profit or loss immediately. Other members think this question should be considered at a later stage in the project.

67 Members have mixed views on accounting after removal of exposures from the PRA, for example:

(i) one member thinks that if exposures are removed from the PRA, the revaluation adjustment could be amortised over the instrument's remaining term (although there is likely to be significant tracking needed if instruments are permitted to be removed);

(ii) another member thinks that the revaluation value at the time when the exposures are removed should be carried forward as the new carrying amount of those exposures and they should continue to be measured based on the business model. This is because they think that it is appropriate to account for the items in analogy with the treatments for changing business models in classification and measurement requirements of IFRS 9;

(iii) another member's view is that revaluation effects of the items being removed from the PRA should be reversed through profit or loss; and

(iv) one member thinks that one approach is to require amortisation to profit or loss of the revaluation adjustment recognised prior to removal of exposures, but acknowledges that this would involve operationally challenging tracking. For interest rate risk exposures, this approach might provide a better representation of the effects arising from past decisions to undertake DRM and risk mitigation on these exposures, by altering the future profit or loss profile to broadly reflect the effects of DRM undertaken up to the point of removal. However, for other risk exposures, it is unclear what the amortisation would represent. Due to these considerations, this member thinks that the alternative of immediate recognition to profit or loss could be given some consideration, despite it being not reflective of the outcome of DRM activities.

Q24 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.

Q25 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.

68 Members consider that other risks could be considered (such as commodity price risk, foreign currency risk, inflation risk), however some members think that bank's risk management of interest rate risk should be prioritised to deal with the most pressing needs of constituents.

69 Some members note that the implications of basing accounting on risk management activities are yet to be fully researched. Some members think that research of this nature would be more appropriately tackled at the *Conceptual Framework* level because a number of issues that may surface are pervasive to financial reporting, such as the objective of financial reporting, unit of account and selection of measurement bases.

70 Some members note that existing accounting for foreign currency is somewhat similar to the PRA therefore application of the PRA may not result in significant benefit even if foreign currency exchange risks are dynamically managed. However, one member was of the view that where an entity manages both recognised and unrecognised items on a net basis for foreign currency risk, the PRA could be used to present those items faithfully in the financial statements.

71 Another member notes that where foreign currency items are in a subsidiary or foreign operation the exposure is to the net investment which might not be compatible with operation of the PRA.

Q26 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?

72 Members have mixed views concerning whether an approach incorporating OCI should be considered.

73 Some members support considering an OCI approach for the following reasons:

(i) in relation to the Insurance Contracts project, an OCI approach could be used to address accounting mismatch between assets and insurance contract liabilities;

(ii) an OCI approach has similarities with cash flow hedge accounting and separates the future impact (in OCI) from the current period impact (in profit or loss); and

(iii) a cash flow hedge approach could be aligned with how risk is mitigated in practice, and so use of OCI would be appropriate.

74 However some members have concerns about using an OCI approach for the following reasons:

(i) an OCI approach could increase volatility in net equity;

(ii) judgement would need to be applied in determining when /if to recycle amounts from OCI to profit loss and whether to recognise ineffectiveness;

(iii) there is no conceptual reason for reflecting revaluations in OCI;

(iv) the objective of the DP was to address the operational challenges of fair value macro hedge accounting, not to consider macro cash flow hedge accounting;

(v) there might be implications for regulatory reporting;

(vi) some have concerns about speculative trading positions achieving hedge accounting using the OCI approach; and

(vii) rather than adopting a binary classification of economic ('comprehensive') income, the IASB should develop principles for a multi-faceted disaggregation of economic income that facilitates classifying items of economic income (supported by disclosures) according to their different implications for predicting the amount, timing, uncertainty and velocity of future cash flows. The distinction between profit or loss and OCI, if made at all, should be a matter of sub-classification of items recognised once (and only once) in the statement of comprehensive income.

75 Some members recommend that the IASB considers providing education material for macro cash flow hedge accounting, noting that the implementation guidance and illustrative examples to IAS 39 have not been incorporated into guidance to accompany IFRS 9. Some members also support the IASB in exploring opportunities to improve the existing macro cash flow hedge accounting model in IFRS 9.