MALAYSIAN ACCOUNTING STANDARDS BOARD
LEMBAGA PIAWAIAN PERAKAUNAN MALAYSIA

17 October 2014

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Chairman
International Accounting Standards Board
30 Cannon Street
London ED 4M 6 XH
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Dear Mr. Hoogervorst

IASB Discussion Paper DP/2014/1 Accounting for Dynamic Risk Management : A Portfolio Revaluation Approach to Macro Hedging

The Malaysian Accounting Standards Board (MASB) welcomes the opportunity to provide comments on the above IASB discussion paper.

The MASB commends IASB's efforts to simplify and improve the usefulness of financial statements by developing accounting requirements for hedging within the context of open portfolios that are more closely aligned with a company's risk management activities. Consistent with the general hedging model in IFRS 9, the IASB is attempting to align accounting more closely with risk management in this Discussion Paper with the objective of reflecting the underlying economics of an entity's dynamic risk management activities.

We note that the macro hedge accounting model proposed in this Discussion Paper is not simply a modification to hedge accounting but rather it represents a fundamental change in how the role of risk management judgment is considered for the purposes of financial reporting. The increased focus on risk management means that entities now are increasingly relying on their risk management information previously used only for internal purposes to support financial reporting requirements.

The proposed portfolio revaluation approach to macro hedging introduces items and concepts for instance, pipeline transactions, equity model book and behaviouralisation of core deposits. Whilst the proposed inclusion of these items closer align hedge accounting with risk management, the trade-off is the inconsistency with conventional accounting concepts.

Besides inconsistency, we believe the trade-off between information comparability and operational feasibility of the proposed approach also needs to be carefully considered. Given that risk management objectives, strategies and practices vary, it would be operationally very challenging for preparers to change their risk management policies and systems to accommodate financial reporting if the final requirement is prescriptive and significantly different from what is currently practised or available.

We also note that the IASB has acknowledged the importance of considering the application of the proposed model to other risks and other industries, for example commodity and foreign exchange risks. We urge the IASB to undertake further outreach with other industries before finalising the exposure draft. Besides financial institutions, we have not heard from any of our constituents that manage risks dynamically on a portfolio basis.

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Our detailed responses are enclosed in the Appendix of this letter. If you need further clarification or have any queries regarding this letter, please contact Ms Christine Lau at +603 2240 9200 or by email at christine@masb.org.my.

Yours sincerely

Dato' Mohammad Faiz Azmi
Chairman

Appendix

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?

Generally our respondents have mixed views.

(i) Preparers, particularly the financial institutions are generally supportive of an accounting approach which will better reflect the economics of their risk management activities. The current IAS 39 hedge accounting rules are operationally onerous because the hedging relationships need to be tracked and adjusted to match the dynamic nature of the open portfolios.

(ii) There is another view which urges IASB to focus on addressing the macro hedge accounting issues instead of developing a new approach which reflect the dynamic risk management activities of an entity. The IASB is urged to continue to explore an alternative macro hedging model that will ultimately replace the macro fair value model in IAS 39 and have wider applicability to other risks. Improvements could be made to the general hedge accounting model to accommodate macro hedge accounting and if information about dynamic risk management strategy is considered useful, it could be reflected in the disclosures.

(iii) There is yet another view which supports the measurement of financial instruments included within dynamic risk management at fair value through profit or loss (i.e reflecting the full fair value instead of only re-measuring the items for the risks being managed). The measurement of such financial instruments at fair value will provide more useful information about the economic value of the assets or liabilities being managed.

Question 2—Current difficulties in representing dynamic risk management in entities' financial statements

(a) Do you think that this DP has correctly identified the main issues that entities currently face when applying the current hedge accounting requirements to dynamic risk management? Why or why not? If not, what additional issues would the IASB need to consider when developing an accounting approach for dynamic risk management?

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

The DP has correctly identified and discussed many of the main issues. However we would like to suggest that in addition to discussing interest rate risk management, the DP also needs to consider discussing other types of risks, both in isolation and in a collective manner. For instance, the DP should discuss the use of cross currency interest rate swaps (CCS) to manage the risks associated with a foreign currency loan. Another example could be one where interest rate swaps (IRS) and credit default swaps (CDS) are used to hedge the risks associated with a corporate bond. Hence we would urge IASB to consider these risks and also to assess how such risks are being considered and managed by non-financial institutions.

Appendix

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?

The description of dynamic risk management is comprehensive particularly in the context of financial institutions. However the description can be enhanced to include characteristics of other risks, for example foreign exchange, commodity, liquidity and credit risks. The objective can also be enhanced to include "preserving the economic value of equity (EVE) of an entity" in addition to net interest income management.

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).

Pipeline transactions are currently considered by some financial institutions. There are 2 views as to whether such pipeline transactions should be included in the PRA.

(i) Those who are of the view that it is not necessary to include such transactions in the managed portfolio for the purposes of applying the PRA highlight that risk managers manage risks within given limits and it is therefore not unusual to find that portfolios are often under/over hedged. Pipeline transactions may not significantly impact the overall risk for the entity. Hence the inclusion of such transactions adds another layer of complexity to the accounting process as arriving at a pipeline amount requires significant judgment.

(ii) Another view supports the inclusion of pipeline transactions in the managed portfolio for the purposes of applying the PRA if the entity recognizes the pipeline transaction as one of the measured risks and such inclusion is representative of how risks are being managed by the entity.

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

Generally respondents do not agree with the proposal to include EMB in the PRA.

Notwithstanding the intent to secure a fixed rate of return for the shareholders, this objective is not consistent with the overall objective of risk management which is to protect the net interest income or net assets of the entity. Compare with pipeline transactions, EMB has a weaker case for inclusion as such transaction is between the entity and its shareholders. The return

Appendix

on equity is decided by management annually as part of an internal budgetary process and there is no contractual obligation to compensate the shareholders for providing funding and there is no accounting cost or expense reflected in the financial statements. It would be considered as poor risk management if risk amounts are changed purely to accommodate an internal budget adjustment.

There is one respondent who supports the inclusion of EMB in the PRA if the EMB is a component of the entity's risk management activity.

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.

When risks are being managed on a behavioralised basis, respondents agree that cash flows be based on behavioralised rather than contractual for the purpose of applying the PRA.

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 common view is that when risk management instruments with optionality are used to manage prepayment risk, the PRA should consider such dynamic risk management activity.

Our respondents also share the following practices:-

(i) Even though optionality/prepayment risk is considered, the use of risk management instruments with options is not common. In the situation where the cost of the inherent optionality of a loan or deposit is not priced into the product, the optionality risk is managed based on behavioral expectations and there is no separate strategy for the management of such interest rate re-pricing risk or prepayment risk. In this scenario the PRA has already considered such risks when cash flows for the purposes of applying the PRA is based on a behaviouralised basis.

(ii) In the second scenario, the prepayment risk in a loan is managed through pricing, be it embedded into the actual loan price or through a break fund/penalty clause. In the case of liabilities with elements of embedded prepayment or optionality, the use of risk management instruments with options are usually required to hedge off this risk. Based on this scenario, the PRA should consider options under dynamic risk management subject to the availability of a robust prepayment risk measurement matrix. One sided risk management should be translated into a common risk measurement matrix which is used

Appendix

by the entity and any second order risks should not be considered.

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 recognized in profit or loss through the application of the PRA when and to the extent they occur? Why or why not?

There are 2 views.

(i) The changes in past assumptions of customer behavior should not be recognized immediately in profit and loss account. Even though changes in customers' behavior are considered, the change is usually not that significant where it requires a corresponding revision to the hedging instrument. As the portfolio is dynamic, changes in behavior invariably do have some offsetting effect and hedging instruments are usually allowed to run off. In such instances it is not necessary to reflect the impact of the changes in assumptions of customer behavior when they occur. The proposal in the DP to recognise the impact of changes from past assumptions through profit or loss when and to the extent that they occur would add an additional layer of complexity to the process and it would be operationally not feasible to track and measure such behavioral changes.

(ii) Another view supports the proposal that changes in expected customer behaviour should be included in the revaluation adjustment as long as these changes are hedged within the risk management activities. As such, the impact of these changes should be recognised in profit or loss.

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.

There are 2 main views.

One group of respondents does not support the inclusion of the bottom layer or a proportion approach. The prepayment risk is already being considered for the purposes of risk management and robust risk models would have taken into account the prepayment, which may or may not utilize the bottom layer approach. Hence introducing a bottom layer does not add any value to the process and it introduces unnecessary complexity in having to track what constitutes the bottom layer.

Another view supports the use of the bottom layer approach if the scope of the PRA is to focus on risk mitigation. Under a risk mitigation strategy, only the bottom layer of the portfolio is considered and subsequent amortization is avoided unless the bottom layer is breached.

Appendix

Question 8—Risk limits **Do you think that risk limits should be reflected in the application of the PRA? Why or why not?**
Respondents agree with IASB not to incorporate a risk limit approach into the PRA. The setting of risk limits is integral to risk management. We however do not agree with Paragraph 3.8.3 of the DP which states that "in accounting terms, the concept of risk limits could imply that there should be no volatility in profit and loss as long as the net open risk position is within the risk limits set by management". The risk limit is an internally set trigger and is an indication of the risk appetite and the maximum amount of potential downside that the entity is willing to undertake. Risk limits and changes in risk limits should not be required to be disclosed in the financial statement as this could impact the competitiveness of the players in the industry.

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 support the proposal to include core demand deposits in the managed portfolio on a behaviouralised basis if that is how a financial institution would consider them for dynamic risk management purposes. Such an approach captures and represents the interest rate risk profile that is being embedded in such core demand deposits. We agree with the IASB that the selection of an appropriate term and volume of the core demand deposits is dependent on a number of factors, some of which involve significant judgment. Each institution will have its own criteria to assess the behavior of the portfolio and will also make use of various core deposit models. Financial institutions are already required to comply with Basel requirements which prescribe or provide guidance on the determination and treatment of core deposits. As such we do not think further application guidance is necessary. The IASB may however consider providing illustrative examples. There is a suggestion to include disclosures on how the financial institutions view and identify core demand deposits, including the estimation, assumptions and methodologies used.

Question 10—Sub-benchmark rate managed risk instruments **(a) Do you think that sub-benchmark instruments should be included within the managed portfolio as benchmark instruments if it is consistent with an entity's dynamic risk management approach (ie Approach 3 in Section 3.10)? Why or why not? If not, do you think that the alternatives presented in the DP (ie Approaches 1 and 2 in Section 3.10) for calculating the revaluation adjustment for sub-benchmark instruments provide an appropriate reflection of the risk attached to sub-benchmark instruments? Why or why not?**
We agree that sub-benchmark instruments should be included in the managed portfolio as

long as it is consistent with the entity's dynamic risk management approach.

It is noted in the DP that Approach 3 revalues the benchmark cash flows with respect to changes in benchmark index whilst in Approaches 1 and 2, the cash flows included in the revaluation would be based on contractual cash flows. The revaluation adjustments from Approaches 1 and 2 will include the effect of changes in the discounting effect of the benchmark cash flows and on the negative margin.

In terms of approaches, some respondents would like all 3 approaches be given as options. Others support Approach 3 as they believe it is most reflective and consistent with their actual risk management process.

(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?

We think the embedded floor should be included in the managed portfolio as long as this risk is being managed or hedged by the entity in such a manner. If the entity does not transfer the cost of the embedded floor risk via its funds transfer pricing mechanism, an alternative method needs to be in place to capture the floor risk in the PRA.

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?

The DP proposes the use of present value techniques to arrive at the revaluation calculation. The revaluation adjustment represents the measurement of one particular risk and hence is not identical to fair value which includes all risk.

We agree that the revaluation adjustment is suited to overcome the accounting mismatch between hedged items at amortised cost and fair value of the hedging derivatives. The revaluation adjustment provides a faithful representation of the actual risk being considered.

(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?

There are 2 views:-

(i) The objective of dynamic interest rate risk management of financial institutions is to secure the expected level of net interest income. It is therefore appropriate for the managed risk to be revalued at the funding rate in the PRA. The use of a funding rate will result in a model which is closely aligned to the entity's risk management. However, it is worth noting that the funding rate is entity-specific and hence comparability will be difficult to achieve.

(ii) The managed risk should be revalued using the benchmark interest rate as the funding

rate includes an element of the financial institutions' own credit risk.

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)?

The use of internal transfer pricing transactions as proxies for risk exposures in portfolios that are managed and hedged by ALM should be acceptable as a matter of practical expediency. The funds transfer pricing (FTP) process itself should be robust and supported by policies and strong internal control framework.

Another point to note is that the FTP is not the complete representation of the risks in the managed portfolio. Besides interest rate risk, other types of risk could be present but not transfer-priced to ALM. A possible limitation in using FTP is that it only caters for "business as usual" transactions and not abnormal ones. For instance, in a stressed market, the abnormal movement of market rates will have an impact on the business strategy as well as the product pricing.

(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.

Respondents have mixed views.

(i) Market funding index (approach 1) – This approach is supported because the use of a market funding index eliminates any other transfer pricing spreads which could introduce bias in the measurement of a hedged position. It is further noted that when applying the PRA, transfer pricing transactions should only be permitted as proxies for the risk of the managed exposures if those transfer pricing transactions provide a "close enough" representation of the actual risk. The criteria of what is considered as "close enough" needs to be determined but it should not take the form of "bright lines".

(ii) Cash flows based on full transfer pricing rate, discount rate restricted to current market funding index plus static other transfer pricing spreads (approach 3) - Respondents who support this approach are of the view that this approach provides the most faithful representation of dynamic risk management. This approach is deemed fair given it reflects the actual pricing of the product and it is operationally feasible.

(iii) Some respondents are neutral as each approach has its own merit in terms of operational efficiency.

Appendix

(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?
Our respondents have mixed views. (i) Some believe that there should be restrictions on the eligibility of indexes. The index to be used will need to be based on general market indices which are widely accepted across the industry. If there is more than one market index, the entities will need to decide on one most appropriate index. With regards to external and internal funding spreads, more flexibility should be given in order not to restrict business decision making. However, justifications will need to be given for the choice of spreads. Consistency with the internal FTP framework and historical practices should be taken into account when allowing or deciding the spreads to be applied for PRA purposes. (ii) Another group of respondents is not in favour of introducing restrictions. There are many existing transfer pricing methodologies in the market, for example single pool method, multiple pool method and matched rate method, to name a few. Entities may also add various spreads to arrive at the FTP rate for example bid/ask spread, reserve ratio spread, liquidity margins and ALCO spreads. Given this, respondents do not think restrictions should be put in place as this may result in making a particular entity's existing FTP model not suitable for the purpose of applying PRA.

(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?
The key criterion to use transfer pricing as a practical expedient is the extent in which it adequately identifies the hedged exposures. If transfer pricing is allowed as a practical expedient, the entities should be allowed to use their FTP model as it is given this is how risks are represented and managed in the entity. Until such time the FTP model no longer adequately identifies the dynamically managed and hedged exposures then transfer pricing should not be used as a proxy. An effective internal control framework would play a critical role in providing trails on the status of the hedged risk exposures and providing linkages between the hedged risk exposures with the actual transactions. For example, if a customer prepays early, the business unit should not have the option not to hand over the prepayment to ALM; the reduction in the exposure should be reflected immediately as part of the FTP process.

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.**
In practice currently multiple indices are used for different portfolios. The key criterion for

Appendix

determining whether a single funding index for all managed portfolios is appropriate or not, depends on whether that single index reflects the entity's risk management activity.

It is the internal risk management policy that decides to use one or more than one funding index. Entities should be able to choose one suitable funding index or multiple indexes as they see fit.

(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?

As mentioned in part (a) above, choosing a suitable funding index or indexes should be determined by the entity's risk management policy. Entities should be given the freedom to choose a suitable funding index or indexes as long as the chosen index or indexes are within the internal risk management controls and policies. In the selection of the index, a criterion which could be considered is that the index will need to be based on general market indices and one which is widely accepted by the industry.

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?

We are not able to comment on this question as currently pricing index is generally not used for risk management activities here.

Question 15—Scope

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

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?**
Respondents who support a scope that is focused on **risk mitigation** thinks that the overall outcome arising from a risk management approach will bring an overlay of current value on all managed portfolios and this may be contradictory to the conclusion reached in IFRS 9 which states amortised cost is the best measurement of simple debt instruments. The consideration of all net open risk positions under dynamic risk management approach would not address the key issue which is eliminating the accounting mismatch between fair value measurement of the hedging instruments and the amortized cost measurement of the hedged items. The revaluation of all open net risk positions would not bring about a better understanding of the business performance of the entity especially when such revaluation gives rise to volatile net income which is not even related to business performance. In other words, a scope which is focused on dynamic risk management will introduce unnecessary volatility in the profit or loss – a decision not to hedge an open position should not lead to volatility in the profit or loss. Respondents who support a **dynamic risk management approach** are of the view that this approach provides a complete picture of the net open position and the related risk management instruments. This approach is also perceived to be operationally less onerous. The PRA proposed in this DP would have operational challenges notwithstanding which scope is chosen. For example, the behaviouralised cash flows under dynamic risk management would need some tracking in order to provide information of changes in customer behavior. Another example is the tracking of valuation adjustments related to risk exposures that have expired or disposed of. A scope focuses on risk mitigation would equally require tracking of revaluation adjustments related to extinguished exposures that were hedged. Regardless of the scope, we believe a a robust FTP engine and FTP process need to be in place in order to implement the PRA. The. above comments are equally valid for other managed risks. Therefore, we would like to urge the IASB to develop the model that would be applicable to other risks and other industries before finalizing the DP and developing an ED.

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?**
Regardless of the scope, we think that the application of the PRA should be optional. Hedge accounting has always been voluntary and if entities wish to apply hedge accounting, they should have a choice between the PRA and the general hedge accounting model in IFRS 9.

Appendix

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.**
If the scope of the application of the PRA is focused on risk management, we do not think further eligibility criteria are required. If the scope is focused on risk mitigation and application is optional, other eligible criteria that could be considered include clear policies on when to apply the general hedge accounting requirements in IFRS 9 and when to apply the PRA.

Question 18—Presentation alternatives **(a) Which presentation alternative would you prefer in the statement of financial position, and why?**
The alternative where the net revaluation adjustment for the whole managed portfolio is reported in a single line is preferred because this presentation is consistent with dynamic risk management which focuses on managing risks on a net basis.

(b) Which presentation alternative would you prefer in the statement of comprehensive income, and why?
The actual net interest income presentation approach is preferred whereby actual interest revenue and interest expense would be presented along with an additional interest line to present net interest income from dynamic risk management instruments. The revaluation effect from dynamic risk management activities, is also presented in a separate line item, would provide information on mismatches in anticipated future net interest income. This presentation is easier to understand and the users of financial statements will be able to see the impact of risk management activity on profit or loss.

(c) Please provide details of any alternative presentation in the statement of financial

position and/or in the statement of comprehensive income that you think would result in a better representation of dynamic risk management activities. Please explain why you prefer this presentation taking into consideration the usefulness of the information and operational feasibility
We have no further comments.

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?**
The respondents have 2 views, one of which supports the gross presentation of internal derivatives. The grossing up of the offsetting internal derivatives in the statement of comprehensive income would provide useful information as it allows users to differentiate between risk management and trading activities. There is another group who is of the view that the presentation of internal derivatives does not provide useful information as each institution has its own internal models and methodology and hence the gross presentation of internal derivatives will result in non-comparable information.

(b) Do you think that the described treatment of internal derivatives enhances the operational feasibility of the PRA? Why or why not?
Generally, respondents do not think operational feasibility will be enhanced with this treatment.

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.**
In general the proposed disclosures do provide information which will give a user a better understanding of the entity's risk management activities. However the requirements are onerous particularly the requirement to disclose information about an entity's net open position. The financial institutions disagree with this disclosure requirement as the nature of the information is too commercially sensitive.

Appendix

Financial institutions in particular are already subject to extensive disclosure requirements (both financial and regulatory reporting) and there is a risk of duplication. The IASB is urged to consider these areas of overlap and only require the disclosure of key risks that arise from the dynamic risk management activities and how these risks are measured and managed.

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?

We think the scope of the disclosures should be the same and consistent with the scope chosen for the application of the PRA. Otherwise, there will be a disconnect in the information presented. For example if the scope of the PRA is that of dynamic risk mitigation and scope of disclosure is risk management, the information provided may not be particularly useful.

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.

(a) The PRA should allow for the inclusion of exposures in the managed portfolio after an entity first becomes party to a contract. By the very nature of an open portfolio, the associated exposure is expected to change constantly. Due to the dynamic nature of current market environment in which the entity is operating, the risk level of financial items in the open portfolio is changing constantly, for example, initial risk may deem insignificant and hence not included in the dynamic risk management but subsequently the risk could turn for the worst and be transferred from business unit to risk management where the item is hedged dynamically. The ever changing nature the risk profile warrants such risk exposures to be included in the PRA to reflect the dynamic risk management decisions that are made after the contract is concluded.

(b) We acknowledge the dilemma of these two positions, that is, Day 1 revaluation adjustments recognised in profit or loss reflecting the changes to benchmark indexes during a period when the exposure was not dynamically managed. This would result in a profit or loss impact that does not reflect dynamic management activity. On the other hand, amortisation of Day 1 revaluation would significantly increase operational complexity and may reduce the usefulness of reported profit or loss.

Some respondents believe the amortisation of Day 1 revaluation faithfully reflects the dynamic risk management activities whilst other respondents prefer the former option given it is less burdensome operationally.

Appendix

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?**
There are 2 views. One respondent agrees with the criterion that once exposures are included within a managed portfolio, they should remain there until derecognition. Another group of respondent is of the view that the removal of risk exposures from the hedge portfolio before maturity or earlier de-recognition should be permitted so as to reflect the managed risk and related risk management activities in the portfolio.

(b) Are there any circumstances, other than those considered in this DP, under which you think it would be appropriate to remove exposures from a managed portfolio? If yes, what would those circumstances be and why would it be appropriate to remove them from the managed portfolio?
Other circumstances which may warrant a removal of exposures from a managed portfolio include changes in economic environment and changes in an entity's risk management strategy.

(c) If exposures are removed from a managed portfolio prior to maturity, how would you propose to account for the recognized revaluation adjustment, and why? Please explain your reasons, including commenting on the usefulness of information provided to users of financial statements.
Respondents have two views. The first view is that if exposures are removed from the managed portfolio prior to maturity from the mitigated portfolio, the revaluation effects of the asset or liability related to that risk exposure being removed should be reversed and charged/credited to profit or loss. Charging/crediting to profit or loss reflects the removal of risk exposures being excluded from the managed portfolio. Other respondents prefer the amortisation of the revaluation effects of removed exposures over remaining life of the underlying items as long as those items are still with the entity.

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.**
Some respondents agree, an example given is the hedging of FX and interest rate risk via cross currency swap.

Appendix

A respondent pointed out a situation when funding and lending in a foreign currency are undertaken via a subsidiary or a foreign operation with the same functional currency as the foreign currency. The foreign currency exposure is an exposure to the net investment in a foreign operation, which might not be compatible with the PRA.

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

We do not believe it is the intention of the IASB to apply PRA only for portfolio interest rate hedging by banks. The concepts discussed should be applied to any entity that hedges on a dynamic portfolio basis for any risks. As such, entities which engage in active commodity price risk and/or foreign currency risk management of their exposures may wish to explore the application of this PRA. Insurance companies undertaking interest rate risks, equity risks and inflation risks may equally need to consider the PRA application as it would potentially provide a faithful representation of their risk management activities.

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?

We do not think that an approach that recognizes the net effect of the revaluations of a managed portfolio in OCI should be considered. The revaluation adjustment of the hedged position with changes in value of the hedging instruments shows ineffectiveness in the way the instruments being hedged. There is no conceptual reason to reflect this adjustment in OCI.