Dear Sir/Madam

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

Norsk RegnskapsStiftelse (the Norwegian Accounting Standards Board) welcomes the opportunity to submit its views on the discussion paper Accounting for Dynamic Risk Management: a Portfolio Revaluation Approach to Macro Hedging.

We do not support the development of an ED based upon the proposed solutions in the discussion paper. We believe that a number of issues should be solved before the project is developed into an ED.

We believe that further analysis should be made regarding the relevance of the resulting measurements after applying the portfolio revaluation approach. What is the relevance of a partial fair value measurement and what does it faithfully represent?

We do not support a number of the suggestions in the discussion paper relating to the definition of the hedge exposures as we find them to be in conflict with our current understanding of the requirements in the conceptual framework. We advise the Board to be careful in developing standards that are incompatible with current understanding of the conceptual framework.

We urge the Board to further consider the operational feasibility of the proposed solutions and at the same time confirm that the proposed solutions can be subject to independent external audit and enforcement.

Our comments to the detailed questions are laid out in the appendix to this letter. Please do not hesitate to contact us if you would like to discuss any specific issues addressed in our response, or related issues, further.

Yours faithfully,

Erlend Kvaal
Chairman of the Technical Committee on IFRS of Norsk RegnskapsStiftelse
Appendix

Accounting for Dynamic Risk Management: a Portfolio Revaluation Approach to Macro Hedging

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?

Although there may be some general common understanding of the basic concepts of dynamic risk management, dynamic risk management is not a well-defined term. We believe there are both a danger and a challenge to develop a separate accounting approach to represent a behaviour that is not well defined.

In general the Board should be cautious before deciding to develop special accounting regulation that deviates from general accounting regulations to reflect specific intentions and actions of entities.

Based on our experience the multitude of actions and policies that can be conducted within the label of dynamic risk management may be very large and disperse. We are concerned that a policy to override normal accounting regulation to reflect the entity’s own version of dynamic risk management will significantly impair the comparability of financial statements between entities.

In our view risk management is a continuous process of identifying gross and net exposures to defined risks, measuring these exposures, taking actions to mitigate the measured exposures to become within limits set by management, reporting on net exposures after having conducted risk mitigating actions and reporting on the effects of changes in defined risks on measured exposures over a reporting period.

"Proper" risk management should not exclude any known measurable exposures from those that are measured, managed and reported upon. Failure to include all known and measurable exposures will provide reports that are neither relevant nor representationally faithful at an entity level.

"Proper" risk management develops over time as what are known and measurable risks evolve over time, as do measurement techniques and system capabilities. As "proper" risk management develops it should not be described by static procedures or approaches.

Risk management of separate exposures is more often than not a complex task. Cost considerations most often lead to actual processes that deviate from the theoretically best solutions. Variable entity, market and risk characteristics make it impossible to determine procedures that will fit all entities and all risks.

"Proper" risk management is a concept to strive for rather than a given state. The evolving nature of what is currently "proper" risk management implies that any regulation that is based upon risk management concepts should be principle based.

It is our opinion that if IASB is to develop an accounting standard that has risk management concept as a premise for its conclusions, it would not be appropriate to include rule based concessions motivated by operational practicability. Deviations from the regulations of a principle based standard should be made at an entity level on a materiality basis.
Risk management is, as stated, more often than not a complex task involving multiple and evolving procedures. If accounting regulation is to be based upon risk management concepts that regulation should not be marketed as easy to achieve or as a method of reducing operational complexity.

It is our position that a standard based on risk management concepts would be defined by two sets of constraints. First, it must have the objective that the accounting solutions should be consistent with appropriate risk management concepts. Secondly, it must be developed within the borders of the qualitative characteristics and limitations set by the reporting possibilities within the financial statements and additional disclosures.

We find the discussion and proposed solutions in the discussion paper (DP) to be too heavily focused upon interest risk management within the financial sector (banking industry). We generally support the IASB in focusing upon developing generic standards that are not industry specific. Before proceeding to an ED phase of this project, we recommend the Board to further develop the concept so that it is clearly applicable to risks other than interest rate risks.

**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?

We believe that application of the proposed portfolio Revaluation Approach (PRA) will be challenging and will require extensive system development and system support by all entities that intend to apply it. To run smoothly, an approach as described in the DP would have to be operated, as a minimum, on a daily basis. We fear that we might ultimately see PRA be applied such that hedged exposures, rather than representing true net exposures, may be defined to fit to actual derivative positions so that zero ineffectiveness will be shown at any time.

A main issue that has not been focused upon in the DP, is the issue of how to derecognise effects of PRA when exposures are removed from a managed portfolio (derecognised) prior to maturity.

We generally believe that the DP has gone a long way in identifying issues relevant when applying PRA to interest rate risk within the banking industry. Given the limited coverage of issues related to FX and commodities we are less sure that the DP has correctly identified main issues, including presentation, which might come up when applying the PRA to risks other than interest rate risks.

As stated in our answer to question 1 we do not believe that IASB should develop the proposed model further unless it is proved applicable to the risk management of risks other than interest rate risks.

**Question 3 – Dynamic risk management**

Do you think that the description of dynamic risk management in paragraphs 2.1.1–2.1.2 is accurate and complete? Why or why not? If not, what changes do you suggest, and why?

We do not believe that paragraphs 2.1.1-2.1.2 do a sufficient job in defining what is, and thus what is not, dynamic risk management. We see this as a critical issue. Unless what is and
what is not dynamic risk management is clearly defined, IASB should not develop separate
rules for the accounting when dynamic risk management is claimed to be applied.

2.1 does not define what is meant by a "dynamic basis" and by "timely basis". For a five year
exposure, what is required for the management of the exposure to be dynamic? Is it
sufficient that the exposure is revisited on a yearly, quarterly, monthly or weekly basis or
does it have to be managed on a daily, hourly or continuous basis?

2.1.1 says that dynamic risk management "usually" has a set of characteristics. Does this
imply that dynamic risk management always is the case when all of the presented
characteristics are present? How much deviation is allowed before the management activity
is no longer that of dynamic risk management?

According to 2.1.1 (b) "risk management is [to be] updated on a timely basis". Should this be
read as a requirement to update the derivative positions entered into as part of the risk
management on a timely basis? Or is this intended to assess whether the risk is within
intended limits at any time?

2.1.2 states some additional characteristics that dynamic risk management may exhibit. We
do not find the descriptions of these characteristics to be very helpful when it is stated that
dynamic risk management may exhibit some of these characteristics. What is the
consequences if some of the described characteristics are not present or are opposite of
what is described?

Based upon the current description in the DP it is to us not intuitively clear what constitutes
and what does not constitute dynamic risk management. Because of this we cannot offer
advice for a clearer definition. However in our reply we have as a premise that dynamic risk
management is the hedging of defined risks existing for the reporting entity related to a
defined dynamic object (the hedged position) over a period covering multiple
remeasurements of the change in cash flow or fair value caused by variations in the defined
risk to the defined object.

We do not believe that a claim of application of dynamic risk management should be the key
to overrule all of what is currently known as IFRS regulations. Accordingly we do not believe
that a statement consisting of "this is in accordance with our [the entity's] dynamic risk
management approach" should be a sufficient condition to allow an entity, in accordance with
IFRS, to apply special recognition, measurement or presentation procedures.

We strongly recommend that the term is clearly defined before IASB proceed with a project
which has as a premise, the presents of dynamic risk 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

**EMB**

(b) Do you think that EMB should be included in the PRA if it is considered by an entity as part of its dynamic risk
management? Why or why not? Please explain your reasons, taking into consideration operational feasibility,
usefulness of the information provided in the financial statements and consistency with the Conceptual
Framework.
Behaviouralisation

(c) For the purposes of applying the PRA, should the cash flows be based on a behaviouralised rather than on a contractual basis (for example, after considering prepayment expectations), when the risk is managed on a behaviouralised basis? Please explain your reasons, taking into consideration operational feasibility, usefulness of the information provided in the financial statements and consistency with the Conceptual Framework.

Pipeline transactions

We believe that the core characteristics of what is described as a pipeline transaction is a possible future transaction that comes as a consequence of honouring a non-binding generic fixed price offer that has been made in form of a published (fixed price) pricelist. We do not support an action where the definition of a pipeline transaction is limited to a fixed price credit transaction and that "special" concessions are given to pipeline transactions.

We agree with the conceptual challenges that are presented in A2.2. However we do not see the conceptual merit in distinguishing between pipeline transactions that today qualify for hedge accounting, because they are considered highly probable, and pipeline transactions that fail to qualify for hedge accounting because they are considered just short of being highly probable.

Equity model book (EMB)

We consider the interest rate risk exposure that is deemed to arise from own equity capital to be a fictitious risk exposure that is non-verifiable and should not be accepted as part of a hedged position / hedged risk. The list of risks or exposures that may be deemed to be implicit in the equity is entirely subjective. We do not believe that financial statements that include hedging of such exposure will provide information that is relevant or faithfully representational. We echo the concerns expressed in A1.12.

However as a counter argument we see that the effect of including EMB could be replicated by entities by excluding opposite positions from the scope of the PRA.

Behaviouralisation

The issue of behaviouralisation becomes relevant when a customer voluntarily may continue on a path of seemingly uneconomic behaviour (core deposit issue) or has the option to terminate a contract without paying the fair value of the contract at time of termination (prepayment issue).

We see the greater issue related to behaviouralisation to be that of documentation of an unobservable and potentially continuously changing expected future customer behaviour. Expected exposures are determined upon expected future customer behaviour while actual exposures are given by future actual behaviour. It is extremely challenging (if not impossible) to decide whether deviations between previously expected future behaviour and current observed actual behaviour is caused by imperfect previous expectations or change in actual behaviour that has taken place after the time of making the estimate about future behaviour. It is further complicated to determine whether observed behaviour is the realisation of previously expected behaviour or element of new behaviour with future consequences.

As the true exposure is given by the actual behaviour to be realised in the future we believe that it may be appropriate to reflect behaviouralisation in the financial statements. The issue is really how to treat the un-documentable true up of the difference between previous expected behaviour and actual realised behaviour. Are effects to be recognised immediately in profit or loss or can they be deferred or presented in OCI? Our initial preference is to recognise them as they are being identified in the profit or loss section of the statement of comprehensive income.
When considering behaviour it is often a complicating factor that the level of the risk being measured affects the exposure that is being exposed to behaviouralisation. The large number of unobservable factors influencing behaviour for which the effects of each unknown factor can be time and level dependent makes it very challenging to embed behaviourism in accounting. The audit and enforcement challenges that would arise if unconstrained behaviour where to be allowed embedded in accounting would be extensive and must be considered before opening the doors to behaviourism in accounting.

If ex post the deviation between expected and actual behaviour is small, then reflection of behaviouralisation can be argued to have provided information that has been both relevant and faithfully representational. However if this deviation was not small then clearly the qualitative characteristics of faithful representation has suffered if expected behaviours has been reflected in the financial statements.

We cannot provide a recommendation to this trade off that will be applicable to all situations involving what might be described as dynamic risk management.

**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.

We consider the relevant questions to be whether behaviouralisation should be allowed to be reflected in a PRA and whether a one-sided risk should be allowed to be designated in a PRA. These are separate issues that should be discussed separately.

In regard to behaviouralisation we refer to our discussion above.

In regard to allowing one-sided risks to be designated in a PRA we have the same concerns as those relating to hedging of one-sided risks in IFRS 9. As hedging of one-sided risk is accommodated in IFRS 9 we believe that it should also be accommodated in a PRA. However, as stated in our cover letter we have concerns related to the conceptual merits of the resulting accounting figures.

**Question 6 – Recognition of changes in customer behaviour**

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

We believe 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. We see no conceptual argument for another treatment.

**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.

We do not support permitting a bottom layer approach within PRA. We do not support it for two reasons.

First we find it conceptually hard to envision and follow what is a bottom layer of a net exposure consisting of both assets and liabilities (net of gross long and short positions) that is dynamic. To us this is a construct that is only possibly to retrospectively define after having identified the gross assets and gross liabilities that constitutes the hedged portfolio.
Second we find the concept of a bottom layer to violate "proper" risk management when it exclude known measurable exposures from the exposure that is measured, managed and reported upon.

As we do not support permitting a bottom layer approach we are also concerned about a proportion approach.

While with a proportion approach all exposures are identified, we believe that they are misrepresented by the ignored proportion and thus not living up to what we consider "proper" risk management. We recognise the challenges identified in paragraph 3.5.9, but as we are advocating the optional use of the PRA we do not consider the implications of changes in the hedged proportion to be dismissing of the proportion approach.

On balance we would support a conclusion where a proportion approach where not allowed within the PRA.

**Question 8 – Risk limits**

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

We strongly disagree with the concept of allowing risk limits to be reflected in the application of the PRA. Risk limits are, after management considerations, but with a continuously full range of freedom, set by the entity and would be expected to be dynamic within what is assumed to be dynamic risk management. We cannot foresee how inclusion of risk limits possibly can provide information that is anything less than subjective and at the entity's discretion.

**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 understand the concerns raised in paragraph 3.9.16. We believe that it will be very hard to document the determination of the behaviouralised profile of core demand deposits. We believe that the inherent uncertainty in this estimate is such that the weighting of relevance against expected faithful representation (see our answer to behaviouralisation in question 4) is most often expected to be in favour of not including core demand deposits in the managed portfolio on a behaviouralised basis when applying the PRA.

**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?*

(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 hold the opinion that sub-benchmark instruments might be included within the hedged position as a benchmark exposure. If the sub-benchmark instrument is containing a floor then the inclusion of that instrument within a portfolio of other instruments not containing a
similar floor will create ineffectiveness. We hold the position that changes in the defined (assumed or measured) exposure between periods of measurement, of the effect of changes caused by the hedged risk, will cause ineffectiveness that is to be reflected in profit or loss in that period. However it is our position that the standard should not prescribe one specific approach for the calculation of this ineffectiveness.

In the case where the sub-benchmark instrument do include a floor we do not believe that it is appropriate to exclude the effect of changes in the hedged risk on the fair value or cash flow of that floor component. That would violate the basic premise that “proper” risk management should not exclude any known measurable exposures from the exposures that is measured, managed and reported upon (in this case the exposure related to the hedged risk caused by the floor embedded in the sub-benchmark instrument).

**Question 11 – Revaluation of the managed exposures**

(a) Do you think that the revaluation calculations outlined in this Section provide a faithful representation of dynamic risk management? Why or why not?

(b) When the dynamic risk management objective is to manage net interest income with respect to the funding curve of a bank, do you think that it is appropriate for the managed risk to be the funding rate? Why or why not? If not, what changes do you suggest, and why?

We believe that to apply a PRA the hedged risk should be an external observable risk. The subset of dynamic risk management that is conducted based upon risk exposures that are not external observable should not qualify for separate risk management based accounting regulation.

We generally do not believe that an internally defined risk such as the pricing index described in section 4.1 is a risk exposure to the entity.

We believe that the funding curve of a bank is often an external observable risk and thus should be a risk that would often qualify for a PRA.

**Question 12 – Transfer pricing transactions**

(a) Do you think that transfer pricing transactions would provide a good representation of the managed risk in the managed portfolio for the purposes of applying the PRA? To what extent do you think that the risk transferred to ALM via transfer pricing is representative of the risk that exists in the managed portfolio (see paragraphs 4.2.23–4.2.24)?

(b) If the managed risk is a funding rate and is represented via transfer pricing transactions, which of the approaches discussed in paragraph 4.2.21 do you think provides the most faithful representation of dynamic risk management? If you consider none of the approaches to be appropriate, what alternatives do you suggest? In your answer please consider both representational faithfulness and operational feasibility.

(c) Do you think restrictions are required on the eligibility of the indexes and spreads that can be used in transfer pricing as a basis for applying the PRA? Why or why not? If not, what changes do you recommend, and why?

(d) If transfer pricing were to be used as a practical expedient, how would you resolve the issues identified in paragraphs 4.3.1–4.3.4 concerning ongoing linkage?

We do not agree with the assumption that it is a good idea to regulate the use of internal transfer prices as an operational expedient. We do not support a standard that take as a premise that internal transfer pricing mechanisms reflects external observable risks. Nor do we support a standard that takes as a premise that, since behaviouralisation is assumed to be reflected in internal transactions, that reflection is sufficient to substantiate that application of the behaviouralisation will provide accounting information that is reliable and faithful representations of the actual exposure of the entity. However, we are of the view that, in many cases, internal transfer prices may be carried out at such approximation to an
externally observable risk and an observable level of behaviouralisation, that they appropriately represent practical expedients that can be used by those entities where it is relevant.

We do not believe that a standard should include a general expedient to allow hedged risk and hedged position to be determined by internal transactions. In regard to the approaches described in paragraph 4.2.21 we do not support any of the approaches. In the examples we could see a case for using 4.0 % in determining the cash flows in the numerator and 3.8 % as initial discount rate. 3.8 % is the level of the LIBOR which is an observable risk thus eligible for hedging. Using 4.0 % in determining the cash flows in the numerator provides the actual funding cash flow. Thus all LIBOR risks in the funding cash flow are captured by using 4.0 %.

We generally believe that the hedged risks should be limited to externally observable risks. Any transfer pricing that is not actual close approximations to an externally observable risk should not be an eligible basis for applying the PRA.

We do not believe that a standard should include a general expedient to allow hedged position to be determined by internal transactions. In the case described in paragraph 4.3.2 the alternative in (c) is the most descriptive of the actual situation.

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

(b) Do you think that criteria for selecting a suitable funding index or indexes are necessary? Why or why not? If yes, what would those criteria be, and why?

We do not 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 where the hedged risks in the different funding indexes are not the same or perfectly correlated. Doing so would not faithfully represent the actual risk position of the entity.

As we have stated before the selected funding indexes should reflect externally observable risks. Different risks should not be suppressed to one risk unless perfectly correlated in which case they are in fact one risk.

**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 do not have sufficient information to answer this question.

**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?

If applied, we believe that the PRA should be applied to all managed portfolios included in an entity's dynamic risk management. That is, we believe that the scope should be focused on dynamic risk management. We believe that this is the better solution for several reasons. When the scope is focused on dynamic risk management compared to risk mitigation this will marginally increase comparability. We believe the usefulness of the resulting accounting figures will be better, and the volume of risk mitigation is changing over time and might not be present at a balance sheet date. Risk effect should though be reported in profit or loss when the PRA is applied, it would be inconsistent to apply PRA dependent upon whether a risk position through risk reducing activities has been slightly reduced or not.

We are concerned about what information content can be derived from the financial statements if a PRA is applied only if, and to the extent that, an entity in a period has undertaken risk mitigation through hedging. We believe that the information content of the resulting figures will be better if PRA is applied to all exposures included in an entity's dynamic risk management.

We believe that the operational challenges will be significant for close to all applications of a PRA. However, once the system is set up we do not believe that the operational challenges for the entities will significantly increase with increased scope.

As we do not believe that PRA should be applicable unless it is applicable to all externally observable managed risk, we have tried to have all risks in mind when providing our comments above.

**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 application of the PRA were focused on risk mitigation? Why or why not?

We believe that the application of the PRA should be optional. We think this should be the case both if the PRA where focused on dynamic risk management and if the PRA were focused on risk mitigation. We generally believe that hedge accounting is an exception that should be voluntary.

In addition we find that it is not clearly defined what is a risk and what makes a specific risk separate from another risk. The implication of this is that is it not clear when one risk may be exposed to dynamic risk management without this having implications for another "similar", but not identical risk. Due to this we believe that application of the PRA must be optional.

**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 were focused on dynamic risk management, we currently foresee no need to add further criteria for the use of the PRA. While we recommend that the use of the PRA, if applicable, should be optional, we do not see need for different application criteria. However as mentioned in our answer to question 16 above it is challenging to define what is a risk and what constitutes the border of one risk in relation to another risk. Is it acceptable for one entity to apply the PRA to a floating 6 month LIBOR risk while at the same time not applying the PRA to a 12 month floating LIBOR risk?

If PRA is made optional there would have to be developed some criteria related to starting and stopping the application of PRA. We have not yet developed a view on what these criteria should be.

We do not foresee a need for further eligibility criteria in addition to what we have proposed above if the application of the PRA were to be focused on risk mitigation.

**Question 18 – Presentation alternatives**
(a) Which presentation alternative would you prefer in the statement of financial position, and why?
(b) Which presentation alternative would you prefer in the statement of comprehensive income, and why?
(c) Please provide details of any alternative presentation in the statement of financial position and/or in the statement of comprehensive income that you think would result in a better representation of dynamic risk management activities. Please explain why you prefer this presentation taking into consideration the usefulness of the information and operational feasibility.

The measurement that results from the PRA is at best challenging to interpret and will require extensive disclosures.

If the PRA is to be applied we believe that a line-by-line gross up in the statement of financial position will be the least bad solution. We do not see the conceptual merit in splitting the measurement of an asset or a liability over multiple line items in the statement of financial position. However we see as potential counter argument that application of line-by-line gross up will increase the difficulty of presenting line items that consists only of "clean" measurement attributes and that it would hide from the front of the statement of financial position the fact that the PRA has been applied.

When choosing between actual and stable net interest income presentation, we would prefer the former. However, we are generally not supporters of presenting realised cash flow and changes in valuation as separate line items in the statement of profit or loss, as this will lead to recycling between line items in the statement of profit or loss. Further as the PRA should be applicable to different risks we would not in detail specify the presentation in the statement of profit or loss as part of the regulation of the PRA.
We do not have any suggestion for a better presentation alternative, but we do not believe that a presentation that involves OCI could in any case be a preferable alternative.

**Question 19 – Presentation of internal derivatives**

(a) If an entity uses internal derivatives as part of its dynamic risk management, the DP considers whether they should be eligible for inclusion in the application of the PRA. This would lead to a gross presentation of internal derivatives in the statement of comprehensive income. Do you think that a gross presentation enhances the usefulness of information provided on an entity’s dynamic risk management and trading activities? Why or why not?

(b) Do you think that the described treatment of internal derivatives enhances the operational feasibility of the PRA? Why or why not?

(c) Do you think that additional conditions should be required in order for internal derivatives to be included in the application of the PRA? If yes, which ones, and why?

We do not support an approach whereby the effect of internal derivatives is presented in the statement of comprehensive income. Allowing such a presentation would potentially unlock a can of worms. Reporting of internal derivatives is a concept applicable to the segment reporting, but not for the reporting in the consolidated financial statements. The argument that gross presentation enhances the usefulness should not be used to impute information related to eliminated transactions into the statement of profit or loss.

The reporting of risk management activities based on one side only of internal derivatives is in our view in conflict with "proper" risk management as (by including only one side of the internal derivative) it excludes known exposures at the entity level.

We find the question whether the use of internal derivatives enhances the operational feasibility to be a leading question. We clearly see that improved flexibility in regard to the hedging instruments will enhance operational feasibility, but we do not want to open the door to use of internal derivatives. In addition to the conceptual problems that is caused by the use of internal derivatives we fear that allowing the use of internal derivatives will lead to the dynamic structuring of perfect derivatives to secure 100% effective hedges.

We do not see how additional conditions could be imputed to ring fence "good" internal derivatives from "bad" internal derivatives.

**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.

Except stating the obvious that the PRA will require extensive disclosures, we do not have comments relating to content of disclosures at this stage.

**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 believe that the scope of disclosures should be the same as the scope of the application of the PRA. We see a further extension of the scope of disclosures to be potentially very costly compared with expected benefits.

As we recommend that the PRA if implemented should be optional, an extension of the scope of disclosures would not increase comparability.

**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.

Except at inception of the PRA we do not believe that the PRA should allow for inclusion of exposures in the managed portfolios after an entity first becomes party to a contract. We believe that exclusions of exposures would violate our principles of "proper" risk management as described in our answer to question 1. However if contract conditions are altered after contract inception such alterations must be reflected and lead to updated exposures even though the alteration may not lead to contract derecognition.

In our view the PRA is all about changes in fair values caused by risks on the exposure after inception. Issues of non-zero day 1 valuations are thus limited to separating day 1 valuation changes from day 1 "inception non-zero valuation" and potential "measurement errors" caused by not identifying the rewinding of non-zero day 1 valuations (that is "inception non-zero valuations"). We do not expect these effects to be material to any specific period.

**Question 23 – Removal of exposures from a managed portfolio**

(a) Do you agree with the criterion that once exposures are included within a managed portfolio they should remain there until derecognition? Why or why not?

(b) Are there any circumstances, other than those considered in this DP, under which you think it would be appropriate to remove exposures from a managed portfolio? If yes, what would those circumstances be and why would it be appropriate to remove them from the managed portfolio?

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

We do agree with the criterion that once exposures are included within a managed portfolio, at inception of the exposures or implementation of the PRA, they should remain there until derecognition. We believe that treatment and only that treatment would be in accordance with our principles for "proper" risk management.

Unless errors in recognition or measurement have been made, we do not see any circumstance other than those considered in this DP, under which it would be appropriate to remove exposures from a managed portfolio.

If exposures are removed from a managed portfolio prior to maturity a cumulative catch up should be recognised. The requirement of being able to identify the cumulative catch up may be operationally challenging to comply with. However, what constitutes a reasonable approximation for this cumulative catch up will be entity and case specific and should not be regulated in detail in a standard.

**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.

We believe that it is, and should be, possible to apply the PRA to the dynamic risk management of FX risk in conjunction with interest rate risk and other risk that is being dynamically hedged. If it is documented that this will not be the case, it is our position that the IASB should amend the PRA or terminate this project.

We generally believe that, as an approach, the PRA should be applicable to a wide range of risks subject to dynamic risk management. However, we do not believe that the PRA should be applicable to all risks subject to dynamic risk management. To fulfil the qualitative characteristics of relevance and faithful representation, we believe that the PRA should only be applicable to the extent that the risks being subject to dynamic risk management are externally observable risks.

**Question 25 – Application of the PRA to other risks**

(a) Should the PRA be available for dynamic risk management other than banks’ dynamic interest rate risk management? Why or why not? If yes, for which additional fact patterns do you think it would be appropriate? Please explain your fact patterns.

(b) For each fact pattern in (a), please explain whether and how the PRA could be applied and whether it would provide useful information about dynamic risk management in entities’ financial statements.

We believe that the PRA should only be described such that it is applicable to all externally observable financial risks and not only in the context of interest rate risks. Commodity and FX risks should be risks for which the application of PRA should be tested and found workable before introducing the concept of the PRA into IFRS.

**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 incorporating the use of OCI in the manner described in paragraphs 9.1–9.8 should be considered further. We believe that risk management is a core part of the business activities of all entities that applies it to an extent that makes the application of the PRA a conceivable option. For such entities, it would not be correct to exclude the effects of such a core part of its business activities from the profit or loss section of the statement of comprehensive income.