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Mr H. Hoogervorst
Chairman
International Accounting Standards Board
30 Cannon Street
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UNITED KINGDOM

Dear Mr Hoogervorst

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

The Group of 100 (G100) is an organization of chief financial officers from Australia's largest business enterprises with the purpose of advancing Australia's financial competitiveness and is pleased to comment on the Discussion Paper.

Q1 Need for an accounting approach for dynamic risk management.
Do you think that there is a need for a specific accounting approach to represent dynamic risk management in entities' financial statements? Why or why not?
The G100 considers that this is a narrow and specialised topic which focuses on an activity of a class of entities which does not warrant a high priority in the work program.

While we support the issue of the DP we believe that further work and consultation is necessary to determine the implications of the proposed model for other hedging activities by financial institutions and dynamic hedging in other activities, such as commodity trading, electricity generation and certain agricultural activities. Responses to the DP can inform the nature of the research and consultation including the ways in which entities are currently accounting for these activities and whether the hedging requirements of IAS 39 are an impediment. Accordingly, we believe that if the portfolio revaluation approach is adopted by the IASB, its application by entities should be optional.

Our members have concerns that the portfolio revaluation approach as outlined in DP/2014/1 would create volatility in the profit or loss, would not fully reflect dynamic risk management activities and would not enhance the quality of the information to users of financial reports.

Q2 Current difficulties in representing dynamic risk management in entities' financial statements.
a. Do you think that this DP has correctly identified the main issues that entities currently face when applying the current hedge accounting requirements to dynamic risk management? Why or why not? If not, what additional issues would the IASB need to consider when developing an accounting approach for dynamic risk management?

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

The DP has identified the main issues associated with managing interest rate risk by financial institutions. However, it should be recognised that financial institutions, including banks are managing a broad range of risks including interest rate risk and that applying fair value to one component is unlikely to provide useful information to investors.

Q3 Dynamic risk management

Do you think that the description of dynamic risk management in paras 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 by financial institutions and its features is adequate.

Q4 Pipeline transactions, EMB and behaviouralisation

Pipeline transactions

a. Do you think that pipeline transactions should be included in the PRA if they are considered by an entity as part of its dynamic risk management? Why or why not? Please explain your reasons, taking into consideration operational feasibility, usefulness of the information provided in the financial statements and consistency with the Conceptual Framework for Financial Reporting (the Conceptual Framework).

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.

The G100 considers that if risk management instruments which are measured on a different basis than the hedged items are used, the inclusion of pipeline transactions, the equity model book and core deposits will contribute towards achieving an appropriate offset between the revaluation adjustment and changes in the value of the hedged items.

If cash flows are treated on a behaviouralised basis in an entity's dynamic risk management they should be included in the portfolio revaluation on the same basis. To do otherwise would reduce the usefulness of the approach.

We do not believe that the inclusion of these items would significantly increase the operational complexity beyond that which presently exists.

Q5 Prepayment risk

When risk management instruments with optionality are used to manage prepayment risk as part of dynamic risk management, how do you think the PRA should consider this dynamic risk management activity? Please explain your reasons.

On a portfolio basis the valuation of derivatives with optionality and the valuation of the underlying exposures for interest rate risk is likely to result in volatility in the profit or loss.

Q6 Recognition of changes in customer behaviour

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

The effect of changes in expected customer behaviour should be recognised in profit and loss when they are being hedged and included in the revaluation adjustment.

Q7 Bottom layers and proportions of managed exposures

If the 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.

Both approaches result in operational complexity which will require significant tracking to be undertaken. The G100 favours the bottom-layers approach as it is likely to be less complex to apply than the proportional approach and not be subject to the same degree of volatility in the profit or loss.

Q8 Risk limits

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

The G100 does not believe that standard-setters should impose risk limits on entities which already apply internal risk limits depending on the nature and environment of their activities.

Q9 Core demand deposits

a. *Do you think that core demand deposits should be included in the managed portfolio on a behaviouralised basis when applying the PRA if that is how an entity would consider them for dynamic risk management purposes? Why or why not?*

b. *Do you think that guidance would be necessary for entities to determine the behaviouralised profile of core demand deposits? Why or why not?*

The G100 believes that core demand deposits should be included in a managed portfolio on a behaviouralised basis consistent with how they are treated for dynamic risk management. However, although selection of such a portfolio would require the exercise of significant judgment we do not consider guidance is necessary.

Q10 Sub-benchmark rate managed risk instruments

a. *Do you think that sub-benchmark instruments should be included within the managed portfolio as benchmark instruments if it is consistent with an entity's dynamic risk management approach (ie Approach 3 in Section 3.10)?*

Why or why not? If not, do you think that the alternatives presented in the DP (ie Approaches 1 and 2 in Section 3.10) for calculating the revaluation adjustment for sub-benchmark instruments provide an appropriate reflection of the risk attached to sub-benchmark instruments? Why or why not?

b. *If sub-benchmark variable interest rate financial instruments have an embedded floor that is not included in dynamic risk management because it remains with the business unit, do you think that it is appropriate not to reflect the floor within the managed portfolio? Why or why not?*

The G100 prefers approach 3 to asset liability risk management. Where embedded floors are included in the net position being hedged they should also be included in the portfolio revaluation. We believe that cash flows should be treated consistently under the portfolio revaluation approach with the way in which they are managed for risk purposes.

Q11 Revaluation of the managed exposures

a. *Do you think that the revaluation calculations outlined in this section provide a faithful representation of dynamic risk management? Why or why not?*

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

The G100 considers that the revaluation adjustment under the PRA model should be effective as an offset to the changes in the value of the hedging instruments and as such contribute towards minimising the effects of any accounting mismatches.

Q12 Transfer pricing transactions

a. *Do you think that transfer pricing transactions would provide a good representation of the managed risk in the managed portfolio for the purposes of applying the PRA? To what extent do you think that the risk transferred to ALM via transfer pricing is representative of the risk that exists in the managed portfolio (see paras 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 para 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 paras 4.3.1-4.3.4 concerning ongoing linkage?*

On practical grounds limiting the use of PRA to hedged items is likely to result in concerns about identifying and treating other risk exposures that are outside the scope of dynamic risk management.

Q13 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?*

The G100 believes that directors and management are best placed to determine the funding index that best reflects the entity's circumstances and experience and, accordingly, the issue should not be addressed in a standard. If it is to be addressed, guidance on criteria for selecting suitable indices could be provided.

Q14 Pricing index

a. *Please provide one or more example(s) of dynamic risk management undertaken for portfolios with respect to a pricing index.*

b. *How is the pricing index determined for these portfolios? Do you think that this pricing index would be an appropriate basis for applying the PRA if used in dynamic risk management? Why or why not? If not, what criteria should be required? Please explain your reasons.*

c. *Do you think that the application of the PRA would provide useful information about these dynamic risk management activities when the pricing index is used in dynamic risk management? Why or why not?*

We consider that the application of the portfolio revaluation approach would provide useful information about dynamic risk management activities when the pricing index is used in dynamic risk management.

Q15 Scope

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

b. *Please provide comments on the usefulness of the information that would result from the application of the PRA under each scope alternative. Do you think that a combination of the PRA limited to risk mitigation and the hedge accounting requirements in IFRS 9 would provide a faithful representation of dynamic risk management? Why or why not?*

c. *Please provide comments on the operational feasibility of applying the PRA for each of the scope alternatives. In the case of a scope focused on risk mitigation, how could the need for frequent changes to the identified hedged sub-portfolio and/or proportion be accommodated?*

d. *Would the answers provided in questions (a-c) change when considering the risks other than interest rate risk (for example, commodity price risk, FX risk)? If yes, how would those answers changes and why? If not, why not?*

The G100 considers that PRA should be applied to those portfolios determined by directors and management consistent with the entity's policies. The DP is developed from the perspective of interest rate management by financial institutions and we do not presently know enough about other activities without further research to determine whether the PRA model is appropriate in these circumstances.

Q16 Mandatory or optional application of the PRA

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.*

The G100 believes that the scope of the application of the PRA should be optional and a matter for directors and management to determine.

Q17 Other eligibility criteria

a. *Do you think that if the scope of the application of the PRA were focused on dynamic risk management, then no additional criterion would be required to qualify for applying the PRA? Why or why not?*
   i) *Would your answer change depending on whether the application of the PRA was mandatory or not? Please explain your reasons.*
   ii) *If the application of the PRA were optional, but with a focus on dynamic risk management, what criteria regarding starting and stopping the application of the PRA would you propose? Please explain your reasons.*

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.*

The G100 considers that the application of macro hedge accounting should be optional.

Q18 Presentation alternatives

a. *Which presentation alternative would you prefer in the statement of financial position and why?*

b. *Which presentation alternative would you prefer in the statement of comprehensive income and why?*

c. *Please provide details of any alternative presentation in the statement of financial position and/or in the statement of comprehensive income that you think would result in a better representation of dynamic risk management activities. Please explain why you prefer this presentation taking into consideration the usefulness of the information and operational feasibility.*

Presentation of the PRA adjustment in a separate line on a net basis in the statement of financial position is the most appropriate presentation of the effect of these activities and the presentation of the actual net interest income in the profit or loss.

Q19 Presentation of internal derivatives

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

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

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

On practical grounds the grossing up of internal derivatives in the statement of comprehensive income is the preferred approach. However, we remain concerned about the lack of a conceptual basis for determining which items are included in this statement.

Q20 Disclosures

a. *Do you think that each of the four identified themes would provide useful information on dynamic risk management? For each theme, please explain the reasons for your views.*

b. *If you think that an identified theme would not provide useful information, please identify that theme and explain why.*

c. *What additional disclosures, if any, do you think would result in useful information about an entity's dynamic risk management? Please explain why you think these disclosures would be useful.*

The G100 is concerned about the level of detail of the proposed disclosures and believes that a short descriptive statement about the portfolio revaluation processes adopted and applied by the entity should be sufficient to enable users to understand and evaluate the entity's activities in respect of dynamic risk management. IFRS 7 already requires significant disclosures about the nature and extent of risks arising in respect of financial instruments.

Q21 Scope of disclosures

a. *Do you think that the scope of the disclosures should be the same as the scope of the application of the PRA? Why or why not?*

b. *If you do not think that the scope of the disclosures should be the same as the scope of the application of the PRA, what do you think would be an appropriate scope for the disclosures, and why?*

See above.

Q22 Date of inclusion of exposure 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.*

The requirements should be sufficiently robust and flexible to deal with the changing nature of the exposures and allow entities to include or remove exposures in open portfolios after their initial recognition or before derecognition, respectively.

Q23 Removal of exposure 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 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.*

As indicated above the requirements must be able to respond to the constantly changing nature of the exposure including removing exposures before they mature in order to reflect the dynamic nature of the activity. Where such changes occur the relevant portion of the PRA should be recognised in the profit and loss of that period.

Q24 Dynamic risk management of foreign currency instruments

a. *Do you think that it is possible to apply the PRA to the dynamic risk management of FX risk in conjunction with interest rate risk that is being dynamically managed?*

b. *Please provide an overview of such a dynamic risk management approach and how the PRA could be applied or the reasons why it could not.*

Conceptually it should be possible if the PRA model is robust and principles-based. However, given focus on interest rate management further information in relation to foreign currency implications is needed.

Q25 Application of the PRA to other risks

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

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

See above.

Q26 PRA through OCI

Do you think that an approach incorporating the use of OCI in the manner described in paras 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?

The G100 does not support this approach without there being a conceptual basis for identifying OCI items.

Yours sincerely
Group of 100 Inc

N Mitchell

Neville Mitchell
President