International Financial Reporting Standards

Feedback received in outreach activities—Seeking your advice

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

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The views expressed in this presentation are those of the presenter, not necessarily those of the IASB or the FRS Foundation

Objective

The following slides summarise the main feedback received during the outreach meetings on the Discussion Paper (DP) *Accounting for Dynamic Risk Management: a Portfolio Revaluation Approach to Macro Hedging*.

As of the date these slides were submitted we have received 117 comment letters.

Slides 3–10 provide a high level summary of the overall feedback received.

Slides 11–14 ask for your feedback and advice on the main aspects that have been identified for development of the accounting approach.

High level feedback summary

- The DP is perceived as a good document which addresses dynamic risk management issues in a comprehensive manner.

- We have classified the feedback received in the following main areas:

  (a) scope;
  (b) feedback from users;
  (c) the Portfolio Revaluation Approach (PRA);
  (d) behaviouralisation, core demand deposits, pipeline transactions and Equity Model Book (EMB);
  (e) disclosures;
  (f) applying the PRA to other risks; and
  (g) PRA through OCI.

High level feedback summary

Scope

- It is not clear what the **primary objective** of the DP is (ie to solve an accounting mismatch or to reflect dynamic risk management (DRM)?).
- There is a **clear preference for the scope focused on risk mitigation**, which was shared in particular by banks. Some have highlighted that banks need a solution to their current problems when dealing with open portfolios in IAS 39/IFRS 9 instead of an approach to fully reflect DRM in their financial statements.
- How could the approach be modified so that it is an extended form of hedge accounting? Would proxy hedging still be allowed? **Operational difficulties** are also perceived with this alternative (eg transactions between different sub-portfolios, proportionate approach will involve tracking, etc). However, because this is the preferred approach, the perception is that these difficulties could be overcome.
- A few concerns were raised in relation to the risk that the combination of IAS 39/IFRS 9 with this scope alternative could result in a more enriched ‘toolkit’ that entities could use to reduce volatility in profit or loss.
- **Focus on DRM**—concerns about having to revalue the managed exposures that an entity has decided to leave unhedged.

High level feedback summary

Feedback from users

Generally users see the DP represents real progress in relation to the usefulness of the information.

They particularly value the information provided by:

- the net interest from DRM line in the actual net interest income (NII) presentation will allow users to understand the effect of DRM activities on an entity's NII;
- the scope with a focus on DRM allows users to have a holistic picture of an entity's DRM activities (ie the effect of hedging and leaving positions unhedged); and
- the stable net interest income presentation would allow users to understand the performance of the business unit and the performance of ALM.

High level feedback summary

Feedback from users—continued

- However there is divergence in views relating to whether the revaluation effect from dynamic risk management (ie the clean revaluation changes from the managed portfolios and the changes in the clean fair value of the derivatives) should be recognised in the current statement of comprehensive income (ie PL or OCI) or only through disclosures. The main reasons for and against are:
  - as it is important information it must be accurate and robust. Consequently, the preference is recognition in the income statement and for it to be subject to audit;
  - this line will depend too much on an entity’s judgement. Incorporating the effect of future mismatches in the current income statement would lead to also including the uncertainty arising from the measurement of those future mismatches and this would not be appropriate.

High level feedback summary

Portfolio Revaluation Approach

- One of the key messages received is that the Portfolio Revaluation Approach (PRA) **may not be the appropriate model in all circumstances and all risks**. The DP assumes that the risk of an entity is more accurately portrayed if that risk is measured at current value. The **cash flow perspective is not captured** by this approach. Current value is incidental because banks manage future net interest margin (NIM), rather than current values, for banking book-type products.
- Could we be **overriding the classification & measurement requirements in IFRS 9**?
- It might be more appropriate to look at the designation process/strategy to move away from 1-1 designations, accept a dynamic designation strategy and then derive the effects on the balance sheet from these derivatives (ie the **change in the fair value of the derivatives is a proxy for the change in the hedged risk**).
- An alternative may be a more limited scope approach that would focus on fixing the problems with the macro fair value hedge accounting model in IAS 39.
- Unsure as to whether or not the PRA would lower operational complexity (eg termination of risk management instruments may require some tracking, etc)?

High level summary of feedback received—*continued*

Behaviouralisation, core demand deposits, pipeline transactions and EMB

- The **consideration of behavioural aspects** in the approach has generally been welcomed.
- There is generally more **support for core demand deposits** than for Equity Model Book (EMB) and pipeline transactions. The relevance of pipeline transactions and EMB varies among jurisdictions.
- Some constituents are happy to include pipeline transactions and EMB if they are considered by an entity as part of its DRM. Some constituents think that the inclusion of these exposures should depend on an entity's business model. Other preparers have stated that any model excluding pipeline transactions and EMB would depart from risk management activities and the current proxy hedge accounting approach will need to be retained.
- Concerns were raised relating to the interaction of these issues with the **Conceptual Framework**. However, some other constituents think that if the goal is to reflect DRM, then the approach needs to consider risk management comprehensively.
- Concerns have also been raised about the **comparability** between banks and whether some degree of discipline would be needed in this area. Some users have also expressed concerns about the opportunity for **earnings manipulation** that behaviouralisation may provide, which would impair the relevance of the information provided.

High level summary of feedback received—*continued*

Behaviouralisation, core demand deposits, pipeline transactions and EMB—continued

- Relevance of **providing guidance** on this area has been found to be important by regulators. Preparers do not necessarily agree with the IASB providing this guidance.
- Relevance of **disclosures relating to behaviouralisation** has been highlighted as being key. Some preparers have also expressed their concerns that disclosures in this area may require providing commercially sensitive information, depending on the product.

Disclosures

- Preparers would generally prefer to provide **disclosures regarding their future interest rate risk exposure mismatches** rather than having them recognised in the income statement.
- Some think that **IFRS 7 should be overhauled** to enable banks to provide more meaningful disclosures of the risk management of the banking book, including key metrics such as sensitivity of future net interest margin (NIM) to changing rates.

High level summary of feedback received—*continued*

Applying the PRA to other risks

- Certain sections of the **utility industry** had similar concerns to the ones raised by financial services preparers regarding the scope with a focus on dynamic risk management. In addition the PRA would only be feasible for them if it allowed the inclusion of highly probable forecast transactions.
- In case of the insurance industry the majority of the meetings held were educational in nature. On the basis of our discussions it is the alternative approach (PRA through OCI) that has been the primary focus of their interest in the DP.

PRA through OCI

- Views differ amongst jurisdictions. Asia is more inclined towards this approach while Europe has not shown much interest. One of the concerns is the impact on equity and the interaction with regulatory capital.

Seeking your advice

Scope of application

Question 1

The key objectives of the DP were to develop an accounting model to better reflect DRM activities in entities' financial statements and decrease operational complexities.

Considering the marked preference for a scope focused on risk mitigation can we still achieve the stated objectives?

(a) Can the approach still provide useful information?
(b) Can the approach result in a decrease in operational complexity?

Seeking your advice

Is revaluation the only way?

Question 2

According to the feedback received, some think that the DP illustrates only one approach used by banks to manage interest rate risk (ie a current value approach).

An alternative approach is to consider the stabilisation of the net interest income through the management of the cash flows by taking a cash flow perspective.

(a) Do you think the PRA as explored in the DP should also consider a cash-flow perspective? If yes, how?

Seeking your advice—*continued*

Behaviouralisation, core demand deposits, pipeline transactions and EMB

Question 3

Considering the feedback received in this area:

(a) How much guidance on behaviouralisation should the IASB provide?

(b) How can we minimise lack of comparability and the risk of earnings management?

(c) Inclusion of core demand deposits, pipeline transactions, EMB would decrease the need for proxy hedging and would contribute to reflecting DRM activities better. However, the inclusion of these exposures also raises critical conceptual issues.

How can we reconcile this tension?

Seeking your advice—*continued*

Disclosures

Question 4

Considering the feedback received in this area:

(a) Should the scope of disclosures be different from the scope of the approach (ie should the impact of unhedged positions in future net interest income only be reflected through disclosures)?

(b) Should the project try and explore solutions based on disclosures rather than purely recognition and measurement?

Questions or comments?—Thank you