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Mr Hans Hoogervorst, Chairman
International Accounting Standards Board (IASB)
30 Cannon Street
London EC4M 6XH
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1 September 2014

Dear Mr Hoogervorst,

On behalf of the Austrian Financial Reporting and Auditing Committee (AFRAC), the privately organised standard-setting body for financial reporting and auditing standards in Austria, we appreciate the opportunity to comment on the Discussion Paper *Accounting for Dynamic Risk Management: a Portfolio Revaluation Approach to Macro Hedging* (DP/2014/1).

Principal authors of this comment letter were Peter Bitzyk, Thomas Gaber, Michael Hammer, Heiner Klein, Philip Kudrna, Roland Nessmann, Caroline Pranzl, Julia Stipek, and Raoul Vogel. In order to provide a balanced Austrian view on the DP, the professional background of these authors is diverse (five auditing/regulatory organisations and four preparers).

General remarks

We strongly support the IASB's determination to resolve the issue of dynamic hedging and to publish a Standard. From our point of view, this new Standard will narrow the remaining gap between risk management and accounting and result in a more realistic view of an entity's business.

In responding to the Discussion Paper, we have referred in places to the Draft Comment Letter of the European Financial Reporting Advisory Group ("EFRAGs view"), "Re: DP Accounting for Dynamic Risk Management: a Portfolio Revaluation Approach to Macro Hedging" of 1 July 2014.

Responses to individual questions

Q 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?

Financial accounting ought always to give a correct picture of economic decisions made by management, so that users of financial statements can assess the performance of the reporting entity and make comparisons with competitors. However, financial accounting should never be allowed to affect the economic usefulness of decisions made by management. Especially in hedge accounting for open portfolios, this was not the case under the existing IFRS framework. Nonetheless, we do not share the IASB view that dynamic risk management per se requires a new accounting approach. We follow the arguments of EFRAG: we believe that macro hedge accounting rather than dynamic risk management is the issue to be addressed. The focus of a future macro hedge accounting standard should therefore be limited to risk mitigation.

Q 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 agree that the main issues and challenges of hedging dynamic portfolios have been addressed. However, the issues mentioned by EFRAG (tenor basis spreads, OIS discounting for collateralised derivative positions, currency basis spreads and own credit risk effects) also need to be taken into consideration.

Q 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 general description of dynamic risk management appears to be complete. We would emphasise, however, that we see no need for this definition, as we are convinced that the scope of the new Standard should be restricted to optional application in situations with a hedging intent.

Q 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).

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.

General remarks

Any new approach to accounting for dynamic risk management should as far as practical aim to limit accounting mismatches. To achieve the maximum offset between the revaluation adjustment and the changes in value of hedging instruments in the PRA (applied to risk mitigation only), the new hedge accounting model should incorporate all items that contribute to the identification of the managed risk. Therefore, pipeline transactions, the equity model book (as well as the other model book – see our answer below) and core deposits should all be included.

a. We agree with EFRAG's position that pipeline transactions should be eligible in the PRA.

b. If equity model book exposures were excluded from risk management, spurious volatility would be depicted in net interest income. Such volatility would result from defining a net risk position based on assets alone without including any funding used to finance those assets.

The same issue arises with other non-interest bearing positions, such as long-term provisions (e.g., social capital), tangible assets or goodwill. Economically, these positions carry interest rate risk and are therefore modelled and hedged based on their corresponding time bucket (based on expected maturity).

Currently, many banks do not hedge these items with derivatives, as the EMB and other items are not eligible for hedge accounting under IAS 39. Instead, they hedge them with other interest-bearing financial instruments. Using hedge accounting for these hedging relationships would correspond to the economic viewpoint of financial institutions that include these items in their dynamic risk management.

c. We agree that the use of behavioural assumptions in estimating the cash flows should be included in the PRA, because this increases operational feasibility and brings accounting in line with risk management practice. In fact, we consider this to be one of the most important aspects of the proposed new model. We share EFRAG's view that estimations as to when and to what extent cash flows will occur are consistent with the Conceptual Framework. We also share EFRAG's view that variations in practice mean that guidance would not be helpful, as it would restrict application. Instead, adequate disclosures would in our view be more helpful to users wishing to understand the assumptions being used.

As explained above, both pipeline transactions and behaviouralisation should be included in the PRA if they are part of an entity's dynamic risk management and serve risk mitigation purposes. If both are allowed, there is no need for the PRA to distinguish between the two types of transactions, if not, there is a need for an Implementation Guidance to give additional guidance as to which kind of transactions are allowed and which are not. In all events, principles of validation, and the relevant disclosure requirements would appear to be useful topics for inclusion in an Implementation Guidance.

Q 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

Since lending in the Austrian Market is largely at variable rates, the hedging of the prepayment risk is not as relevant in Austria as in other regions (e.g., Germany). The use of options for hedging prepayment risk in a fixed rate portfolio is operationally complex and therefore currently not common. We believe that this issue can be dealt with via the behaviouralisation assumptions. However, we still believe that the PRA should consider this hedging practice.

Q 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? 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 share EFRAG's view that the use of a bottom layer approach would avoid any tracking and amortisation issues, unless the prepayments became so significant that the bottom layer was breached. Such a breach should be recognised in profit and loss as it represents ineffectiveness resulting from overhedging.

We also assume that in practice any model replicating customer behaviour would incorporate a buffer for a model risk, so that frequent adaptations would not be necessary.

Regarding changes in customer behaviour, it is important to distinguish between:

- Changes in replication assumptions: these should be derived from risk management. In our opinion, the effects should be amortised over the original residual term, as this is comparable to ending an old hedging relationship and starting a new one. This treatment is also consistent with the IAS 8 logic of a change in accounting estimates.

- Changes in volume: these should be accounted for through P&L, as these represent changes to the existing hedged item.

This differentiation should be operationally possible for financial institutions. Although accounting for effects of changes in replication assumptions on an accrual basis is operationally challenging, it is – in our view – the appropriate accounting method. We believe that adaptations should only be require infrequently, which would limit the tracking effort.

The entity should disclose whether the change should be a "day 1" gain or loss taken directly to P&L or whether the effect would spread over the average maturity of the portfolio.

Q 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.

In economic terms, banks generally hedge the complete sight deposits position, but take into account a bottom layer of deposits treated as long-term funding.

In our opinion therefore, banks should be allowed to apply the PRA to sub-portfolios (e.g., of sight deposits) as this is essential when a bottom-layer approach is used. Without the bottom

layer approach, banks would be obliged to include the total sight deposits position in hedge accounting, which would mean ongoing amortisation adjustments not related to risk management.

We share EFRAG's view that a bottom layer approach would be less burdensome and restrict the need for tracking to situations where the bottom layer is affected. We oppose the idea of a proportional approach, because the tracking problem makes the model unduly complex.

Q 8 RISK LIMITS

DO YOU THINK THAT RISK LIMITS SHOULD BE REFLECTED IN THE APPLICATION OF THE PRA? WHY OR WHY NOT?

We share EFRAG's view that the standard should not impose additional external risk limits, and that instead qualitative disclosures should be used to provide transparency on the use of internal risk limits imposed by the banks themselves. This would, however, be subject to certain limits, in order to avoid the disclosure of internal pricing strategies and other factors that reveal a bank's legitimate business secrets.

Q 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?

a. We share EFRAG's view that behaviouralised exposures from core demand deposit portfolios should be eligible for inclusion in hedge accounting. We consider this to be one of the most important aspects of the new model (see answer to Question 4).

b. In line with EFRAG, we oppose the idea of additional extensive guidance, as this would very much reduce flexibility and usability of the model in practice. Instead we believe that – if necessary – additional disclosures could help the user understand the behavioural assumptions and the underlying model. However, we do not agree with detailed disclosure on pricing policies, as this would reveal the bank's business model (see answer to Question 4).

Q 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?

a. We support EFRAG's view that approach 3 would be preferable, as it is consistent with the approach based on risk mitigation, so that the hedged cash flows are the same as those managed and hedged in ALM, and it does not cause day one revaluation gains and losses. Embedded floors are currently not hedged in the risk management approaches of most Austrian banks.

b. We also agree that embedded floors should only be included in the net position hedged if they are also included in ALM.

Q 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 share EFRAG's view that a macro hedge accounting solution should reflect the effects of risk mitigation faithfully. If customer margins are not being hedged, they should not be included in the hedged position. If the managed risk is the funding index, any changes in counterparty credit risk and the differential between the pricing and the funding index are not relevant to the risk management and should not be reflected in the revaluation adjustment. Most Austrian banks currently hedge their portfolios based on a funding index (excluding any liquidity costs).

Q 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?

a. We share EFRAG's view that the use of internal transactions as proxies for risk exposures in portfolios being managed and hedged by ALM is a common practice. We also see that preserving the audit trail back to the original transactions will be a challenge. We also see the potential danger of bias in the measurement, so appropriate guidelines and safeguards for calculating transfer prices are needed.

b. For several financial institutions, the transfer price represents the hedged risk, which is the risk-free interest rate (corresponding to the residual term). Incentives are not included in the risk-free interest rate but in a liquidity premium, which would not be taken into account for revaluation. For these banks, therefore, we do not see a risk of bias. However, we believe that restrictions to eliminate bias will be necessary and that the transfer pricing should be capable of being objectively – or indeed externally – validated. The hedged risk should be free of any liquidity premiums, incentives or other kinds of bias. We see this topic linked to the topic of internal derivatives.

c. We share EFRAG's view that any restrictions should only aim at eliminating bias. Too many restrictions could force entities to change their funds transfer pricing systems in order to be able to implement the new macro hedge accounting approach.

d. For the reasons given, we feel that an ongoing linkage to the external customer transaction (via regular back testing or externalisation testing, or similar) would be needed. In a bottom layer approach scenario, this could be simplified, as the revaluation of the bottom layer portfolio would simply be the mirror of the internal derivatives, with which the risk is transferred to the trading desk.

Q 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?

a. We share EFRAG's opinion that entities should be free to choose the funding index or indices that best reflect their risk mitigation approach. Mandatory criteria for selecting suitable funding indices could force entities to change their hedging approach, and should therefore be avoided.

b. See above: we believe that the choice of a funding index depends on the strategic internal risk management decision (short-term/long-term funding mixes, liabilities/equity mixes) and should therefore not be limited by externally imposed criteria. However, most Austrian banks have said that they would not expect liquidity price mark-up to be included in the basis for a hedged risk – it would never form part of suitable funding index. Austrian banks usually define their funding index as the risk-free rate excluding any own credit spread or liquidity premiums.

Q 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 aware of any Austrian banks using a pricing index as reference for risk management of their portfolios. If an entity wished to use such an approach, we believe it should be permissible, since we believe that accounting practice should as far as possible be consistent with – and in fact reflect – the entity's risk management practice.

Q 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?

a. We agree with EFRAG's position – the PRA should not be applied to all managed portfolios, as this would increase balance sheet and P&L volatility and would in our eyes not result in improved information for the users. Instead, the application should be limited to portfolios where risk mitigation is intended, in order to avoid accounting mismatches. In addition, application should be voluntary.

b. We agree with the EFRAG position, that if the scope were widened to include dynamic risk management (as defined in the DP), this would not provide useful information, as it would effectively eliminate the amortised cost basis of accounting.

c. Some banks have said that they would try to keep the hedged sub-portfolio stable and only evolving. They believe that this would reduce or entirely eliminate the problem of tracking prematurely terminated parts of the portfolio. Still, operational challenges will remain.

We believe that the answers (a)-(c) would not change if other risks (for us, particularly FX risks) were considered. This DP addresses banks' needs for dynamic risk management of interest rate risk. We understand that banks have very robust risk management systems in place to monitor and mitigate those risks. Furthermore, banks are closely supervised by the competent national authorities and are accustomed to very tight standards for documentation, validation and back testing. This may not always be so in other industries. We therefore see the need for more eligibility criteria and for guidance on those criteria, in order to ensure a level playing field for entities using PRA, and consistent application in different industry sectors. Those criteria might consist of minimum requirements for the risk management systems and models used (e.g., a need for back testing the results and the validation and calibration of the system, stress-testing scenarios, models widely used in the markets). Hence, the risk management system should be robust and well tested in practice.

Q 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?

We share EFRAG's view that the scope should be based on risk mitigation and consequently the application should remain optional. Any other approach would not achieve the elimination of accounting mismatches, and would introduce additional volatility into the balance sheet and the P&L. We believe that this would work against the decision usefulness of the information conveyed in such financial statements.

Q 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.

a. We believe that application should be optional, and that the main criterion should be that the position is being dynamically managed and hedged. We believe that a specific quantitative effectiveness test (according to rules and regulations laid down in the Standard) should not be considered as application criterion (in line with the new IFRS 9, where such quantitative criteria have been abandoned), as this would bring greater complexity back into the model. However, we also believe that **some** kind of effectiveness test should be taken into account or introduced as criterion, as

otherwise the approach would be too permissive. This effectiveness test should be on an individual basis, depending on the entity's risk management systems and approach. The Standard should specify only the minimum requirements of such a test.

b. The DP assumes that all entities have a centrally organised asset and liability management function. However, not all entities are organised in this way. In some groups, ALM can be performed at the individual entity level, as well as at subgroup or group level. We believe that application should be allowed at subsidiary level (as a limited portfolio) or at a sub-consolidated or consolidated level. In both options, the entity must demonstrate how intercompany (IC) issues can be treated. In the stricter version, it should be permitted for a portfolio at subsidiary level that contains no IC instruments being used for the hedge. Otherwise, a clear externalisation (via an audit trail) must be demonstrated. If a portfolio at consolidated level is hedged, IC hedged items and IC derivatives could be excluded. It is, however, very tricky for entities to simultaneously fulfil hedge accounting requirements in their individual financial statements (e.g., for local regulators) and at the consolidated or sub-consolidated level, if IC instruments have to be netted out. Following the arguments of the "gross-booking" of internal derivatives, we feel there is room for similar gross disclosure at the consolidated level of IC derivatives at least. The resulting consequences would however have to be explored in more detail first.

Furthermore, we do not see why the general hedge accounting model and the macro hedge accounting model should not be allowed to be applied side by side. We think that micro-hedges could run through the portfolio and that any related ineffectiveness would in any case be recognised in the P&L in accordance with IFRS 9 regulations. Excluding micro-hedges from the PRA would increase operational complexity and require single item tracking, not only of the derivatives, for which this would operationally be feasible in a bank´s treasury systems, but also for the hedged items (loans, deposits), for which single item tracking appears almost impossible.

Q 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.

a. We share EFRAG's view that the presentation of the revaluation adjustment in an

individual net line item in the balance sheet would be most appropriate, because it is the net position that is being hedged. Any breakdown between individual assets and liabilities or single line items would make tracking necessary, which is operationally cumbersome and sometimes even conceptually self-contradictory (e.g., if a bottom layer approach is used).

b. We share EFRAG's view that the actual net interest income approach is to be preferred because the net interest income accrued over time in the reporting period is kept separate from mismatches in anticipated future net interest income, thus clearly separating the effect of hedge accounting from actual interest income.

c. We do not see the need for any other presentation alternative. Especially, we would not support a breakdown of the revaluation in the Notes, as we feel that this contradicts the portfolio concept.

Q 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?

a. We support the idea of gross presentation of internal derivatives in the statement of comprehensive income as a practical expedient. However, the presentation should be optional and limited to cases where internal derivatives are in fact used to manage and hedge net exposures and are used between portfolios in different business models (e.g., trading book versus banking book). This would bring accounting more in line with the risk management view and could therefore enhance the information available to users. We share EFRAG's observation that some "noise" could remain in the trading desk if internal derivatives do not mirror the conditions of the external ones (e.g., due to OIS discounting and other effects). We believe that the internal derivatives could serve as an audit trail, and that the risk transferred from ALM by internal derivatives could be an appropriate proxy for the mitigated risk.

b. We believe that this alternative would enhance operational feasibility, as internal derivatives are in fact used to transfer risks from one internal book to another.

c. We support the idea that externalisation of internal derivatives could be deemed to have happened as long as predefined limits of the trading book are not breached.

Q 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:

a. We share EFRAG's view that an excess of disclosures is not only operationally burdensome, but also confusing to the user: disclosures should be limited to what is necessary in order to understand the financial statements. We agree that similar and duplicate disclosures should be avoided. We also believe that a description of the risk exposure being mitigated (and how it is mitigated) and the information needed to understand the effects of hedge accounting are the prime disclosure requirements.

b. We oppose a breakdown by class of financial instrument, as this would require tracking of the hedged instruments, which would remove much of the attractiveness of the model and would in some cases contradict the concept (e.g., in case of a bottom layer approach).

c. We agree with EFRAG's suggestions that particular qualitative disclosures on behavioural assumptions (especially in connection with the hedge of core demand deposits) as well as disclosures on the use of transfer prices and internal derivatives and risk limits would be desirable for the user and would help understand the applied hedge accounting model. However, we fear that any kind of quantitative disclosures could result in the publication of a bank's pricing strategy and thus of a bank's business secrets.

Q 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 support EFRAG's position that the scope for the disclosures should be aligned with the scope of the PRA and that this scope should be limited to risk mitigation situations.

Q 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. We believe that the model should be as flexible as possible. This requires allowing the inclusion of exposures after day one. The appropriateness should be dependent on the risk management/mitigation approach. Many banks feel that any day one gain from a late inclusion of a portfolio in the PRA should result in an amortisation similar to a pull-to-par-effect.

b. We recognise that any non-zero day 1 revaluations will require special accounting treatment. In our intended approach, such late inclusions of positions (similar to early terminations in case of a bottom layer breach) should remain exceptions. In the particular case of post day 1 inclusions, we believe that the difference should not be taken to the P&L immediately, but should be spread over the lifetime of the instrument. Even though this would require tracking and may be operationally complex, we believe it to be a feasible approach – provided such changes remain the exception. Late inclusion may typically occur when a total portfolio of existing loans is purchased from another bank and which would then need to be brought under the PRA (or into a new PRA portfolio). The day 1 gain/loss is similar to the pull-to-par effect that entities currently face when starting micro hedge accounting some time after initial recognition. This pull-to-par effect should be excluded from the revaluation recognised under the PRA. For a portfolio, the pull-to-par effect may be estimated by calculating the present value of the portfolio at the beginning and at the end of the period using the same discount curve (i.e., not taking into account any changes in interest rates that have occurred in the period). It is also worth pointing out that if valuation gains/losses from post day 1 inclusions were not deferred, management could misuse post day 1 inclusions for earnings management.

Q 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.

a. We believe that, in actively managed portfolios, there may be situations where premature exclusion of an existing exposure from the portfolio becomes necessary, so that it should be allowed in principle. In our view, however, this should be the exception to the rule (e.g., in case of a breach of a bottom layer assumption). As this would effectively constitute an overhedging situation, we agree with EFRAG's conclusion that the corresponding portion of the revaluation adjustment should be recognised in profit or loss immediately. We would add that, in practice, rather than reducing the exposure, additional (but opposite) derivatives would usually be entered into in order to avoid overhedging. So we believe this problem to be largely a theoretical one, if the risk management system works properly. Nonetheless, the accounting treatment of such situations must be defined. Some banks feel that on removal of a portfolio, the portfolio should be removed with its PRA fair value (partial fair value) as of the removal date and that this should be the new basis for subsequent amortised cost treatment.

b. Nothing to add.

c. See above.

Q 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.

a. Some banks have said that they are applying Scenario C, i.e., lending and raising funds in different foreign currencies and managing any short or long positions with the use of cross currency swaps (CCSs). It is therefore essential that FX risk should be able to be included in dynamic interest rate risk management, as this is what is happening in practice.

b. Under IAS 21, foreign currency exposures must be remeasured via P&L. We believe

that this treatment should be retained, as these effects would be hard to identify and eliminate. In any case, they come together with the FX remeasurement of the CCSs in P&L. Nonetheless, we believe that the interest rate risk also covered by fixed-for-floating CCSs (or even floating-for-floating CCSs) should be eligible for the PRA. (It has become common practice to hedge the basis spread between currencies using floating-to-floating CCSs). In addition, in the leasing industry, especially in CEE countries, it has become common to hedge the FX exposure on EUR leasing contracts (in non-EUR countries) by remeasuring the firm commitment in the contracts. This is tricky, but feasible under IAS 39, and would be a perfect candidate for the PRA. In the new IFRS 9 there is a new idea that the effects of currency basis spreads should be disclosed in OCI (IFRS 9.6.5.16). Any new regulation of macro hedge accounting should not be in contradiction of other standards. Under a PRA, the currency basis spread effect should also be disclosed under OCI.

Q 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 the PRA should be available for all measurable dynamic risk mitigation situations.

Q 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 agree with EFRAG's position that the scope of the PRA should be limited to risk mitigation situations and that the use of OCI would not make a wider scope acceptable. This is particularly the case for banks, for which IFRS equity is increasingly becoming important for regulatory purposes. If the scope of the PRA were limited to risk mitigation situations, then an approach incorporating OCI could only be considered for cases in which a cash flow hedge based macro model were applied (e.g., if basis IRS were used to transfer tenors or if floating-tp-floating CCSs were used to hedge basis risks between currencies).

We refer to our answer to 24b where we outlined a potential conflict between the new

IFRS 9, which will allow the recognition of a currency basis spread effect in OCI. Any PRA dealing with FX risks should allow a similar treatment at least for this effect.

Kind regards,

Romuald Bertl

Chairman