IASB
30 Cannon Street
London EC4M 6XH
UK

October 17, 2014

Dear Mr Hoogervorst,

Re: Accounting for Dynamic Risk Management: a portfolio revaluation approach to macro hedging

We are pleased to have the opportunity to respond to the Discussion Paper DP/2014/1 "Accounting for Dynamic Risk Management: a portfolio revaluation approach to macro hedging" (the DP).

We think that the Board has made significant progress in respect of the general hedging model. We are therefore very hopeful that the same effort will be made to solve concerns about "macro hedging" and the current inability of entities to reflect their economic hedging practices appropriately in financial statements. We therefore encourage the IASB to pursue its project by first achieving a thorough general understanding of all the mechanisms involved in macro hedging. It will then be able to ensure that it makes financial statements more reliable but without imposing undue complexity and burdensome administrative tasks which are necessary only for accounting purposes.

We are however concerned by the expanded scope that the DP proposes in considering an accounting model for the whole topic of dynamic risk management, whatever the group's decision about whether to hedge might be. We do not think that financial reporting, or at least primary financial statements, are the place to reflect all aspects of dynamic risk management and that the proposals will conflict with the recently developed IFRS 9. This is a proposal which goes beyond the current scope of financial statements and should not be dealt with in a project aimed at producing an accounting standard. We think that macro hedging is a sufficiently complex and urgent issue to deal with on its own to deserve the exclusive and immediate attention of the Board.

Finally, we believe that the macro hedging accounting model should remain an option, in the same way as the general model is, especially to the extent that it would apply on a mandatory basis to all entities, whatever their activities and the risks they hedge. In this regard, we find it difficult to comment at this stage on the possible application of the model to all entities and all risks hedged.

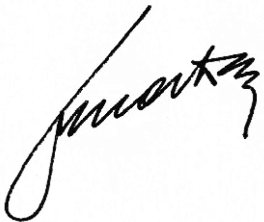
Before publishing an exposure draft, the Board should assess more deeply the issues faced by entities other than banks and other natures of risk.

If you have any questions or a need for further information, please do not hesitate to contact us.

Yours sincerely,

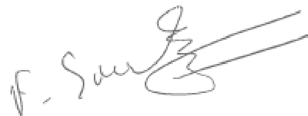
ACTEO

Patrice MARTEAU
Chairman



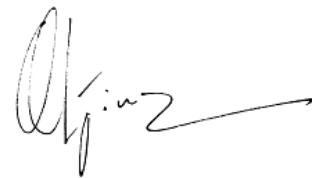
AFEP

François SOULMAGNON
Director General



MEDEF

Agnès LEPINAY
Director of economic
and financial affairs



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?

Because of the extended scope proposed for this project (the focus on Dynamic Risk Management), we find that the wording of this question is misleading.

We are of the opinion that there is a need for a model of hedge accounting that may capture the dynamic nature of risk management that some entities implement.

We believe that the current need is solely to complement the general hedging model that is not suitable for all hedging policies. In fact, the current limitations of IFRS 9 result in accounting that differs from the business model, with as a consequence many accounting mismatches that prevent entities from reflecting their hedging activity reliably in financial statements and performance. We believe that the discussion paper has appropriately identified the current weaknesses (paragraph 1.7 and following) and that the sole objective of this project should be to resolve them. We therefore support a macro-hedging model which will help reflect dynamic risk management.

However, we do not believe that there is currently a need for an accounting approach for general dynamic risk management in its broadest sense, nor is there a place for it in the current scope of financial statements.

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?

2a) Yes, as mentioned above, we believe that the Discussion paper has correctly identified the main issues regarding interest rate risk hedging for banks. We believe, however, that, before publishing an exposure draft, the Board should assess more deeply the issues faced by other entities and other natures of risk.

For instance, for the insurance business, the macro hedging solution will have to take account of insurance contract liabilities (measured under the IFRS4 Phase II yet to be finalised) and the measurement of backing assets. In order to be relevant to the insurance industry, it will also have to include wider risks beyond interest rate risk, such as longevity and liquidity.

2b) In our view, the best way to address the issues identified is to ensure that accounting will be closely aligned with risk management practice and not prevent some items from being designated as hedged elements provided that the management has included them in their risk management and hedging policies.

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 note that the proposed description encompasses two characteristics: the use of open portfolios but also the reaction to changes in the net position. While we agree that open portfolios are currently excluded from the general model and need to be dealt with, we have questions about the second characteristic. Actually, the general model provides provisions for the hedging of net positions and we wonder if there would be confusion as to which standard should be used.

For example, today for hedging a commodities risk on highly probable future net cash-flows, an entity may designate and document the position on a gross basis to obtain hedge accounting. Would such an entity be able to continue this practice or would it be forced to use the new model with a fair value re-evaluation of the overall net position. Such an approach is not available today, and indeed, the risks are managed on a nominal basis and not at fair value.

We do not think that it is appropriate that, as a result of an overly broad definition of dynamic risk management, some companies should be forced to adopt an overly complex model that uses fair value measurements that are not managed internally. We therefore ask the Board to re-examine this definition of DRM, particularly as it would become even more critical if the Board were to move toward a Dynamic Risk management approach and /or a mandatory accounting model.

Question 4 – Pipeline transactions, EMB and behaviouralisation

Pipeline transactions

(a) Do you think that pipeline transactions should be included in the PRA if they are considered by an entity as part of its dynamic risk management? Why or why not?

Please explain your reasons, taking into consideration operational feasibility, usefulness of the information provided in the financial statements and consistency with the Conceptual Framework for Financial Reporting (the Conceptual Framework).

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 account 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 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.

We believe that the only way to make the new hedging accounting model efficient is to permit entities to designate as hedged items all elements that contribute to the net position identified by them for risk management purposes and for which hedging instruments have been taken out.

We therefore support the inclusion of pipeline transactions, equity model books and cash-flows based on a behaviouralised rather than a contractual basis, as long as this is consistent with risk management. Having said that, we note that the term “pipeline transactions” is understood differently by different constituents, and think it would be helpful for this concept to be described in more detail.

We also believe that forecast transactions should be included in the position, especially if the model is to be extended to other industries and other risks.

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 believe 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 believe that a macro hedging accounting model should allow the use of the bottom layer technique when it is in line with risk management practices.

Question 8 – Risk limits

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

We believe that these risk limits are a matter of internal control and should not be reflected in an accounting model. Rather, such risk limits may usefully be described in notes to explain how the entity managed its risks.

Question 9 – Core demand deposits

(a) Do you believe 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 believe that guidance would be necessary for entities to determine the behaviouralised profile of core demand deposits? Why or why not?

Yes, we agree that behaviouralised exposures from core demand deposit portfolios should be eligible for inclusion in hedge accounting. We are not in favour of specific guidance developed by the standard setter since Banks normally have their own methodology for the inclusion of such behaviouralised exposures in their overall risk management approach.

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 the revaluation of managed exposures, limited to the risk mitigated, is one solution to offset effectively the change in the value of hedging instruments, and eliminate the accounting mismatch in net income.

However, since exposures are not always internally managed on a fair value basis (but often on a nominal basis), we encourage the Board to explore alternative models which may avoid burdensome measurement tasks.

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 (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 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?

As mentioned in our cover letter, we are opposed to applying a reevaluation approach to all dynamically managed portfolios. We believe that the Board should focus on developing a macro hedge accounting solution to reduce undue mismatches in net income. In contrast, applying a reevaluation model to all managed portfolios is likely to increase volatility and cancel all the benefit of applying IFRS 9 and its principles which are orientated toward the business model. Actually, revaluing all open net risk positions would not assist in understanding the performance of the entity and would introduce

irrelevant, and potentially significant, volatility in net income. This would not be decision-useful as it would negate the amortised cost measurement attribute which has been judged relevant in developing IFRS 9.

Question 16 – Mandatory or optional application of the PRA

(a) Do you think that the application of the PRA should be mandatory if the scope of application of the PRA were focused on dynamic risk management? Why or why not?

(b) Do you think that the application of the PRA should be mandatory if the scope of the application of the PRA were focused on the risk mitigation? Why or why not?

We support an optional model and not a mandatory model, even if the scope of the PRA were focused on dynamic risk mitigation. There is no justification for imposing an accounting model for macro hedging while the general model remains optional. Additionally we believe that preparers should be free to judge the balance between cost and benefits according to their specific situation and specific risk management policies.

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 believe 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.

Generally, we are not in favour of industry-specific standards. We therefore believe that the Board should further explore other natures of risk and other industries to confirm the robustness of its future proposals. We believe that the IASB has appropriately identified the additional challenges that it will face by expanding the scope of its current project. In any case, it will be important to maintain the optional nature of a model that might not be suitable for all risks and /or too complex to implement for other entities.