The Association of
Accountants and
Financial Professionals
in Business

October 8, 2014

International Accounting Standards Board
30 Cannon Street
London
EC4M 6XH
United Kingdom

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

Dear IASB Board Members:

The Financial Reporting Committee (FRC) of the Institute of Management Accountants (IMA) is writing to share its views on the International Accounting Standards Board (IASB) Discussion Paper, *Accounting for Dynamic Risk Management: a Portfolio Approach to Macro Hedging* (the Discussion Paper).

The IMA is a global association representing more than 70,000 accountants and finance team professionals. Our members work inside organizations of various sizes, industries and types, including manufacturing and services, public and private enterprises, not-for-profit organizations, academic institutions, government entities and multinational corporations. The FRC is the financial reporting technical committee of the IMA. The committee includes preparers of financial statements for some of the largest companies in the world, representatives from the world's largest accounting firms, valuation experts, accounting consultants, academics and analysts. The FRC reviews and responds to research studies, statements, pronouncements, pending legislation, proposals and other documents issued by domestic and international agencies and organizations. Additional information on the FRC can be found at www.imanet.org under the Advocacy section.

We appreciate the effort expended by the IASB in seeking to develop a new model of accounting for dynamic risk management. While we are supportive of providing users with more useful information as to how an entity's risk management activities are applied, we have concerns as to whether a new accounting model to measure an entity's risk management activities is the best avenue to provide users with information for these types of activities. We are specifically concerned that the measurement approaches presented in the Discussion Paper will result in volatility that will be difficult for entities to manage and users to interpret.

Overall, we do not support the Portfolio Revaluation Approach (PRA) outlined in the Discussion Paper for the following primary reasons.

- We believe there is volatility that could arise from application of the PRA accounting model that has the potential to be significant. Such volatility would be difficult for entities to manage and explain from both an earnings and capital perspective. Of most concern is the dynamic risk management approach that would require entities to measure risk positions that are part of a risk management activity. The examples used to describe the measurement approaches are simplified by assuming the interest rate exposures arise in the same maturity time bands (see paragraph 1.13, footnote 3, and paragraph 1.37 examples). This simplification is rare in practice as exposures may be managed for both short-term and long-term interest rate risk exposures, which may result in a portion of the risk not being hedged due to entity-perceived risk levels or interest rate expectations. While financial institutions generally distribute interest-sensitive assets, liabilities and derivative transactions into 'time bands' according to maturity (if fixed interest rates) or time remaining to next repricing (if variable interest rates), the application of this theory is more difficult and often requires a time portion of certain assets and liabilities to be managed within certain bands while the non-managed portions are monitored and possibly managed as markets and positions change. However, it appears that these open positions, which are generally longer-term assets and liabilities, will be subject to remeasurements and have the potential to be quite volatile. We are concerned that the volatility associated with these remeasurements, for certain assets and liabilities, would be similar to volatility that would occur if the items were subject to fair value measurements which will be difficult and expensive for companies to manage and, if not managed, difficult for investors and other users of the financial statements to understand. As a consequence, the PRA accounting may cause an entity to change its operations or strategies to manage this volatility, instead of being representative of an entity's business strategies.

- We believe the PRA, especially a required use of the dynamic risk management approach, would be too much of a deviation from the amortised cost measurement basis that is well understood and preferred by users, in addition to being consistent with business strategies. While an entity may have a hold-to-collect business strategy for a financial asset, the application of the PRA could change the current reporting of these instruments as, at points in time, there could be inherent interest rate risk exposures associated with the instrument. For example, if an entity was holding a long-term fixed rate asset and that entity was unsure of longer-term future interest rate levels, they may choose to manage the short-term interest rate risk and not manage the longer term interest rate risk of the asset until they had better indications and information to form their own expectations of the longer-term interest rate levels. The application of the PRA would remeasure the financial asset for the entire expected life of the instrument which would effectively eliminate the amortized cost basis from the financial statements that investors have previously indicated they find very decision useful. While the IASB could choose to make the PRA optional, we do not believe that a large number of entities would choose to adopt the models for the reasons discussed above.

- The changes to the general hedge accounting requirements that have been incorporated within IFRS 9, *Financial Instruments* (IFRS 9) address many of the inconsistencies and weaknesses in the hedge accounting model in IAS 39 that made hedge accounting difficult to apply regardless of whether positions were managed under a dynamic risk management approach. By better aligning hedge accounting with risk management, IFRS 9 should resolve many of the practice issues related to the existing requirements. Although we recognise that some of the current hedge accounting limitations will persist when applying IFRS 9 to open portfolios of assets and liabilities that are risk managed on a dynamic basis, we believe companies should be given time to implement IFRS 9 to assess its limitations when applied to portfolios subject to dynamic risk management before further developing such a significant new model as proposed in the Discussion Paper. This will provide the IASB and its constituents time to assess whether macro hedging can be more easily accommodated by amending the general hedging requirements in IFRS 9 rather than developing an entirely new model. For example, incorporating some of the features included in the PRA that are important for dynamic risk management but are not currently permitted under the general hedging accounting model (e.g., designating core deposits as hedged items, hedging of 'sub-benchmark' instruments, use of a bottom layer approach, more use of expected cash flows, etc.) could accommodate dynamic risk management activities without creating an entirely new accounting model.

- We believe implementing the proposals in the Discussion Paper under either scope alternative will create significant operational complexities that will outweigh the potential benefits the PRA will provide to users of financial statements. In our opinion, the PRA essentially represents a completely new classification and measurement model for a sub-set of financial instruments, i.e., those subject to dynamic risk management, which could be a very significant part of the assets and liabilities of an entity. This will require significant systems development, costs, time and other operational changes to implement procedures to capture and collate the necessary information to report the exposures concerned. Once implemented, we believe that measuring mismatches between hedged items and hedging instruments under this new classification and measurement model, which only revalues hedged items for the hedged risk, and changing the portfolios from both an exposure and duration perspective as assets and liabilities are added to or removed from the open portfolios, will be particularly challenging for preparers from an operational perspective and should not be underestimated.

Overall, given the complexities of the PRA, we do not believe that investors or other users would necessarily find the volatility the PRA is likely to create in both earnings and capital useful. Moreover, the costs of implementing the PRA would be quite high and not aligned with the information that we believe investors or other users of the financial statements want regarding how an entity manages its dynamic risk management activities. We encourage the IASB to undertake further outreach to the investor community to determine their appetite for such a significant change to financial reporting as the PRA would entail.

Thus, we believe the IASB should not proceed with further developing the PRA at the present time, but should allow time for preparers to implement the new general hedging accounting requirements in IFRS 9 and users to react to the results. A review of the application of those new requirements should be undertaken in due course to assess whether any changes need to be made to better accommodate open portfolios subject to dynamic risk management rather than continuing to develop an entirely new model to account for dynamic risk management activities.

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We appreciate the opportunity to express our views in this letter.

Sincerely,

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