



MORTGAGE BANKERS ASSOCIATION

September 29, 2014

IFRS Foundation
30 Cannon Street
London EC4M 6XH
United Kingdom

Re: DP/2014/1

To Whom It May Concern:

The Mortgage Bankers Association (MBA)¹ thanks the International Accounting Standards Board (IASB) for the opportunity to comment on *Accounting for Dynamic Risk Management: a Portfolio Revaluation Approach to Macro Hedging* (Exposure Draft). Following please find a project background section, a background section on dynamic hedges used in mortgage banking in the United States, and MBA's general comments. Appendix A contains MBA's response to specific IASB questions that we deem to be relevant to the mortgage banking industry in the United States.

Project Background

IASB began deliberating its hedge accounting update in 2010 as a result of difficulties in applying existing hedge accounting requirements. During the summer of 2014, IASB published its IFRS 9, *Financial Instruments* (IFRS 9). IFRS 9 contains a hedge accounting standard that relates to closed portfolios of financial instruments. The Exposure Draft, in contrast, relates to accounting for macro hedging activities of open portfolios and would apply to financial instruments and other asset classes.

A dynamic portfolio is a portfolio of assets where the portfolios change over time as new assets are purchased or originated and existing assets prepay or mature.

¹ The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 280,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,200 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, REITs, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mortgagebankers.org.

Dynamic Hedges Used in the U.S. Mortgage Banking Industry

Hedges of Pipeline and Inventory of Loans Held for Sale

Mortgage banking companies by necessity employ highly dynamic hedging practices to protect themselves from the risk of delivering loans to investors in the secondary market at a loss. Because a mortgage company on any given day may have tens of thousands of (1) interest rate lock commitments (IRLCs), (2) purchase loan commitments, and (3) loans in a hedged loan portfolio awaiting sale, its derivative holdings could correspondingly be very large. The constantly changing portfolios of commitments and loans necessitates an 'hands-on' hedging process involving near constant monitoring of risk exposures and frequent rebalancing of hedge relationships to ensure that a company is effectively protected against loss at all times.

This hedging process involves frequent allocations of derivatives or groups of derivatives to IRLCs, purchase commitments, and loans (with derivatives allocated to loans designated as hedge instruments). Although the frequency with which companies' hedge positions are rebalanced varies by company, it is fairly common practice among the largest mortgage companies for this allocation process to occur on a daily basis using highly sophisticated methods. Smaller companies may employ similar rebalancing techniques but on a less frequent basis using their own, internally developed procedures.

Nevertheless, under all scenarios, a derivative, or a portion of a derivative, that may be economically hedging an IRLC or purchase commitment on one day may be designated as a fair value hedge (or cash flow hedge of the forecasted sale) of a loan on another day during the same reporting period. On any given day, a single derivative may be allocated between a fair value hedge of a loan and an economic hedge of an IRLC or a purchase commitment. As IRLC's become closed loans, correspondents and brokers deliver loans under purchase loan commitments, and loans previously held-for-sale are delivered to investors under forward loan commitments. The dynamic hedging process described above, requires, from an accounting standpoint, a frequent (often daily) de-designation and simultaneous re-designation of hedges assigned to loans held-for-sale.

Under FAS 133, IRLCs meet the definition of a derivative. Thus, IRLCs do not require hedge accounting treatment. Rather, they are carried in the balance sheet at fair value, and the derivatives hedging IRLCs are also carried at fair value.

Under GAAP, loans held for sale may be carried at amortized cost or at fair value, at the reporting entities one-time election. Thus, hedge accounting is not required for those entities electing fair value. For those carrying loans held for sale at amortized cost, hedge accounting treatment is desirable.

Hedges of Mortgage Servicing Rights (MSRs)

Under U.S. GAAP, reporting entities capitalize an asset or liability for servicing mortgages as part of the sale or securitization accounting regime. Generally, the servicer compensation results in an asset being recognized. This asset is called a mortgage servicing right (MSR). FAS 156 allows the reporting entity to carry MSRs at amortized cost or at fair value, based upon a one-time election. Such assets and liabilities can contain multiple interest, credit, operational, regulatory and other risks. Some of these risks can be effectively hedged, while others cannot be hedged on a cost-efficient basis. For example, the overall fair value of an MSR is influenced by many factors, some affecting interest rate risk, some affecting credit risk, and some affecting the cost to service the underlying loans. Changes in laws and regulations can also impact the value of servicing rights. Because entities do not and cannot hedge all risks in MSRs, mortgage banking companies have generally elected to hedge the interest rate risk only, identifying changes in a benchmark interest rate as the specified hedged risk. They elect not to attempt to hedge the risks associated with changes in delinquency of the underlying loans and other risks that may impact fair value from time to time. The MBA believes that the ability to bifurcate-by-risk allows for an accounting recognition that mirrors the way companies manage the risks inherent in these complex assets and liabilities.

MSRs, like IRLCs and loans held for sale, are a dynamic risk situation whereby the MSR portfolio is constantly changing as new loans are added, principal is repaid, loans are prepaid, and loans are foreclosed. Thus, for MSRs, the ability to bifurcate by risk and to treat as a dynamic risk position are important when considering the Exposure Draft.

MBA's General Comments

Overarching Comment

Based upon the background section immediately above, the following are the important criteria for a dynamic hedge accounting regime to work with respect to mortgage bank accounting in the United States:

- The accounting regime must recognize the dynamic nature of the assets being hedged – that they change over time as new items are added and existing items reduce or are paid off.
- The accounting regime must allow bifurcation by risk.
- The accounting regime must apply to all asset classes, not just financial instruments.
- Hedge effectiveness criteria and regime needs to be vastly simpler and easier to apply than the current regime under FAS 133.
- The final pronouncement cannot require a mandatory revaluation of all positions within its scope, especially where the entity is not hedging.

The accounting model presented in the Exposure Draft appears to meet some of these key criteria. Page 10 of the Exposure Draft appears to describe the dynamic risk management of loans held for sale and mortgage servicing rights:

Financial institutions often manage interest rate risk dynamically based on open portfolios. For example, few loan portfolios are static, because portfolios usually change over time as new loans are added and existing loans are prepaid or mature. Consistent with this, risk management is dynamic, with frequent (for example, daily) monitoring of the net open interest rate risk positions and a corresponding reassessment of risk management activities.

Page 17, paragraph 1.33 appears to accommodate the need to bifurcate by risk:

This means that if, for example, loans are being risk managed with respect to changes in the benchmark interest rate (for example, London Inter-Bank Offered Rate (LIBOR) yield curve as part of an entity's open portfolio, they would only be revalued for the effect of changes in the benchmark interest rate.

Page 5, IN 5 would allow hedge accounting for an intangible asset like mortgage servicing rights, "the approach considered in this DP is intended to be applicable to the management of risks arising from both financial and non-financial items, when those risks are dynamically managed."

MBA has a major concern that the proposal is not specific about eligibility requirements, and possible hedge effectiveness requirements. See comment titled *Eligibility Requirements and Hedge Effectiveness Testing* below.

MBA is also concerned that the potential for mandatory application may require revaluation of all positions within scope even where an entity is not hedging. See General Comment below titled *Potential Impact of a Requirement for Mandatory Application*.

As a result of the uncertainties highlighted in the two preceding paragraphs and the General Comments below, MBA is against the proposed accounting in the Exposure Draft until these two issues are appropriately addressed by the IASB.

Eligibility Requirements and Hedge Effectiveness Testing

Section 5.4 on page 64 broaches the subject of the need for hedge effectiveness testing:

5.4.1 This DP does not consider specific eligibility criteria for the application of the PRA other than the requirement that the risk be managed dynamically. There are no requirements discussed for effectiveness tests beyond existing dynamic risk management processes. However, given the scope alternatives, additional requirements might be needed depending on which alternative is selected.

5.4.2 For example, if on one hand the PRA is mandatory and the scope is a focus on dynamic risk management then it is possible that no additional eligibility criterion is required for the application of the PRA other than for clarity on what dynamic risk management is. Alternatively, if the scope of the application is a **focus on risk mitigation**, this would introduce an additional factor and it is possible that additional criteria would need to be developed regarding what is considered risk mitigation or hedging under dynamic risk management. In addition, as mentioned previously, if the application of the PRA were optional, criteria regarding stopping and starting the application of the PRA, including the accounting mechanics, would need to be determined.

What this appears to say is that if application of the PRA is mandatory, then no hedge effectiveness or other eligibility tests would be required. But, if it is optional or applied with a focus on risk mitigation, then IASB would need to develop criteria for qualification that may include hedge effectiveness criteria.

It appears to MBA that dynamic risk management is all about **risk mitigation**. So, MBA is puzzled about the inclusion of this language in paragraph 5.4.2.

MBA points out that FAS 133 in the United States does not work out because it contains a “form over substance” hedge effectiveness criteria that tripped up hundreds of reporting entities in the United States resulting in massive restatements of financial statements and confusion and uncertainty on the part of users of financial statements.

MBA observes that FASB’s last exposure draft for accounting for financial instruments called for hedge effectiveness testing to generally require only qualitative, rather than quantitative analysis, and the effectiveness measurement would be reduced to “reasonably effective” from the present “highly effective” yardstick. In its comment letter to FASB, MBA supported these changes and continues to support these changes today.

MBA believes that IASB should more thoroughly identify the specific intended outcome expected with respect to qualification and hedge effectiveness and present these expectations in another exposure document. The potential financial reporting impact on mortgage banking companies is too important to leave this nebulous and non-specific!

Potential Impact of a Requirement for Mandatory Application.

MBA is very concerned with the discussion in section 5.3 of the Exposure Draft (pages 62 through 64). On page 63, the table under 5.3.2 indicates that one alternative for application of the proposed guidance is, “Accounting information reflects portfolio revaluation by risk for some **or all exposures** that are dynamically managed.” (emphasis added) Further, 5.3.4 on page 63 states, “Consequently, some would argue that the application of the PRA should be mandatory.” MBA is concerned that the final pronouncement could be broad enough to require revaluation of the entire interest rate risk section of the balance sheet even if only a segment is hedged. This could result in the effective elimination of amortized cost classification and significant volatility in reported income.

Treatment of IRLCs Under Exposure Draft

Page 11, paragraph 1.7 (b) of the Exposure Draft seems to address rate lock commitment hedges:

...loan commitments (at a fixed interest rate) or firm commitments to buy or sell commodities (at a fixed price) are not usually recognised for accounting purposes at the time that an entity enters into a contract. From a risk management perspective, however, such contracts expose entities to interest rate risk and price risk respectively and risk managers would include those risks when determining their net open risk positions for dynamic risk management purposes. In contrast, the derivatives transacted to mitigate those risks are recognised immediately for accounting purposes and are measured at FVTPL leading to profit or loss volatility even if those transactions actually reduce those risks.

Today, IRLCs are accounted for as derivatives and marked to fair value under U.S. GAAP, and the associated derivative hedges are likewise marked to fair value. Would the Exposure Draft change that?

Operationality of Revaluation Process for Interest Rate Exposures

The periodic revaluation of interest rate risk exposures is explained on page 43 in 4.1.2 in the Exposure Draft:

The revaluation of managed exposures for interest rate risk and that are subject to the PRA would be calculated as follows:

- (a) the cash flows that represent the exposure to the interest rate risk (numerator) that is being managed is discounted at the current rate for that risk (denominator).
- (b) the numerator is a set of cash flows whose determination depends on whether it relates to fixed or variable interest rate exposures:
 - (i) for fixed interest rate exposures, cash flows are based on the interest rate level that corresponds to the risk that the entity manages at the time when the financial instruments first gave rise to exposure to interest rate risk and do not change from the initial level.
 - (ii) for variable interest rate exposures, cash flows are based on the relevant interest rate that corresponds to the risk that the entity manages at the time of calculating the present value. These cash flows are updated by projecting future variable contractual interest cash flows using the forward curve and the most recent fixing for the current interest period (if applicable).
- (c) the discount rate in (a) representing the denominator is always updated for both fixed and variable interest rate exposures. It is the rate that is current at the time that the present value is calculated. Changes in the components of the interest rates that do not form part of the managed risk, such as those relating to credit risk and instrument liquidity, will not be part of the revaluation adjustment. Consequently, identification of the managed risk is critical for the purposes of applying the PRA.

It appears from the formula above that a ratio is developed whereby the numerator is the present value of cash flows at the time the financial instruments gave rise to the exposure and the denominator is the present value of cash flows at the measurement date. What is this ratio applied to? Another interpretation of this paragraph would result in the present value of cash flows at the time the financial instruments gave rise to the

exposure and the denominator is a current discount rate. The way this paragraph is written, it does not appear to be operational or complete.

MBA appreciates the opportunity to comment on the Exposure Draft. Any questions on MBA's letter should be addressed to me at jgross@MBA.org or 202-557-2860.

Sincerely,

A handwritten signature in black ink, appearing to read "James P. Gross". The signature is fluid and cursive, with the first name "James" being the most prominent part.

James P. Gross

Vice President of Financial Accounting and Public Policy

Responses to Select IASB Questions

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?

MBA's Response: MBA believes that there is a definite need for a specific accounting regime that is applicable to dynamic risk situations whereby the constant changing of the portfolio is recognized and dealt with in the accounting regime.

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?

MBA's Response: MBA is cautiously optimistic that the PRA may appropriately address dynamic hedging situations. MBA's caution relates to the uncertainties in how the periodic adjustment is calculated and uncertainties surrounding hedge effectiveness requirements. See general comments above titled *Operationality of Revaluation Process for Interest Rate Exposures* and *Eligibility Requirements and Hedge Effectiveness Testing*.

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?

MBA's Response: The key aspects listed in 2.1.1 appear to be on target. However, the examples in 2.1.2 appear to be too limiting and do not appear to address a frequent use of hedging – protecting value of a portfolio of assets from changes in interest rates.

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 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*.

MBA's Response: See general comment above titled *Treatment of IRLCs Under Exposure Draft*. MBA believes that the pipeline referred to in the Exposure Draft is different than loans in a mortgage banker's pipeline. Pipeline in the Exposure Draft refers to forecasted transactions at advertized rates. Pipeline in the U.S. mortgage banking vernacular is based upon actual mortgage applications and later interest rate lock commitments.

Likewise, EMB is not applicable to our industry.

MBA does believe that behavioralization needs to be taken into account in a dynamic hedge situation. Key aspects of hedging risk in mortgage banking is to estimate pull-through of loans in pipeline to actual closed loans and to estimate prepayments of mortgages serviced with respect to the MSR asset.

Question 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.

MBA's Response: Mortgage bankers in the United States must deal with prepayment risk with respect to portfolios of MSRs. Mortgage bankers identify that prepayments are driven by interest rate risk. Therefore, mortgage bankers normally deal with this risk by bifurcating by risk and hedging the impact on value of MSRs of changes in a benchmark interest rate. See background section above titled *Dynamic Hedges Used in the U.S. Mortgage Banking Industry*.

Question 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?

MBA's Response: In the mortgage banking industry, as rates go down, customers tend to prepay their mortgages. For those who carry MSR's at amortized cost, if the fair value of MSR's becomes less than amortized cost, then the reporting entity recognizes an impairment charge through profit and loss.

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 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.

MBA's Response: Not Applicable

Question 8—Risk limits

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

MBA's Response: Not Applicable

Question 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?

MBA's Response: Not Applicable

Question 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?

MBA's Response: Not Applicable

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?

MBA's Response: The revaluation guidance in the Exposure Draft does not appear to be operational. See general comment above titled *Operationality of Revaluation Process for Interest Rate Exposures*.

Question 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?

MBA's Response: Not Applicable

Question 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?

MBA's Response: MBA believes that reporting entities should select the funding index that best suits the particular asset, liability, or net position that is subject to a dynamic hedge. The appropriate index may be different for each dynamic hedge position, so “one-size-fits-all” generally will not work for many reporting entities.

Question 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?

MBA's Response: For MSR portfolios, many mortgage bankers hedge a portion of the interest rate risk by hedging changes in a benchmark interest rate. Mortgage bankers frequently hedge across the curve where the exposures are identified.

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 (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?

MBA's Response:

(a) PRA should be applied to those situations where hedge accounting is needed and desired by the reporting entity. In the United States, the reporting entity has a one-time election to account for MSRs (FAS 156) or financial instruments (FAS 157) at fair value. If fair value is elected, the reporting entity does not need hedge accounting since the hedge instrument (a derivative) and the hedged item are both marked to fair value.

(b) MBA believes that qualitative disclosures about the application of PRA limited to risk mitigation and the hedge accounting applied under IFRS 9 would provide useful information to users of financial statements.

(c) and (d) Not Applicable

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 risk mitigation? Why or why not?

MBA's Response: See MBA's responses above titled *Eligibility Requirements and Hedge Effectiveness Testing* and *Potential Impact of a Requirement for Mandatory Application*. MBA believes that

MBA has a major concern that the proposal is not specific about eligibility requirements, and possible hedge effectiveness requirements. MBA is also concerned that the potential for mandatory application may require revaluation of all positions within scope even where an entity is not hedging.

Question 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.

MBA's Response: MBA has a major concern that the proposal is not specific about eligibility requirements, and possible hedge effectiveness requirements. See MBA's response above titled *Eligibility Requirements and Hedge Effectiveness Testing*.

Question 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.

MBA's Response:

- (a) In mortgage banking, only two line items in the statement of financial position would be subject to application of PRA: loans held for sale and MSRs. MBA believes that the line-by-line gross-up would be appropriate with parenthetical disclosure of the PRA adjustment included in the balance.
- (b) MBA points out that PRA is not just about hedging interest rate risk. With that said, to the extent PRA is used to hedge interest rate risk, we believe that actual interest income and expense should be reported, and a single line item should be used to report hedging activity results.
- (c) Not Applicable

Question 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?

MBA's Response: Not Applicable

Question 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.

MBA's Response: No response.

Question 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?

MBA's Response: No response.

Question 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.

MBA's Response: No response.

Question 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.

MBA's Response: Some assets and liabilities have long contractual lives, and a lot can happen in ten, twenty, or thirty years. Reporting entities may change the way they fund an asset over time, or their use of an asset may change. For example, a reporting entity may hedge the interest rate risk of its MSR's today, but in five years it may elect to unwind the hedge and use MSR's as a natural economic hedge of the mortgage production side of the business. The final standard should allow some flexibility for changing circumstances.

Question 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.

MBA's Response: Not Applicable.

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 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.

MBA's Response: Yes. See section above titled *Dynamic Hedges Used in the U.S. Mortgage Banking Industry*.

Question 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?

MBA's Response: Not Applicable.