

To Sandra Thompson  
Senior Project Manager  
IASB

*I do not agree that a financial liability that the counterparty can redeem on demand cannot qualify for fair value hedge accounting for any time period beyond the shortest period in which the counterparty can demand payment.*

*I do agree with the Board's decision (which confirms an existing requirement in IAS 32) that the fair value of such a financial liability is not less than the amount payable on demand.*

*Our view does not result in liabilities in being recognised initially at less than the amount received from the depositor, and would not potentially giving rise to a gain on initial recognition.*

In our opinion, considering demand deposits as 'redeemable on demand' gives rise to a wrong treatment of this type of liabilities. We would like to prove that liabilities with no determined maturity, cannot (fully) be considered as having a maturity equal at the shortest period in which the counterparty can demand payment.

Although we do agree on the 'problems' as outlined in situation (a) and (b) of the second question, we would like to prove our statement by the following arguments in favour a 'portfolio approach'.

- (1) If, while managing the interest rate risk, the demand deposits would be considered as having a one day maturity, the hedge of this liability would also have a one day maturity. This would implicate that the funds of the deposits should be invested (and hence repriced) at one day maturity. However, since in practice it is not feasible to reprice the liability side of this hedge in one day, this would lead to an imperfect hedge. As stated, demand deposits cannot be considered as maturing within one day.
- (2) When looking at the pricing of a financial product with no determined maturity, one can deduct the implied maturity. In the case of the demand deposits, the Belgian market leader (Fortis) prices the 'savings account' at 2%. Taking into account the desired interest rate margin of about one percent, the implied maturity is about 3,5 years. If at this moment, one would like to generate an interest inflow of about 3%, the funds should be reinvested with a average duration of 3,5 years. In this example we consider the Euribor rates, implying an interbank credit spread.
- (3) Considering demand deposits as having a one day maturity is equal to denying the macro-economic term transformation function that bank fulfill in the economy.
- (4) Not recognising a decrease in value of the mass of demand deposits would not give a fair view of the value of the liability side of the balance sheet. When interest rates rise, a debt with a fixed interest rate, decreases in value. This (gain) decrease in debt value should partly compensate for the (loss) decreases in value of the investment

portfolio. In practice there is an average time lag of about nine months between a change in interest rate and a change in the pricing of demand deposits. If there is no such compensation, the IAS does not lead to a fair view of the balance sheet.

A possible solution to this dilemma is creating a new type of liability account, which contains the revaluation differences due to the term translation of liabilities with no determined maturity. This liability account should not be part of the equity.

The suggested booking in the case of an interest rate rise is:

Debet: Revaluation differences due to the term translation

Credit: P/L or Equity (depending on the chosen option)

The amount of this revaluation difference could be calculated by substituting the amount of demand deposits by a synthetic portfolio. This portfolio exists out of two parts:

- the variable tranche with the shortest possible maturity, containing the amount that statistically could flow away in a short period of time;
- the fixed tranche with a given theoretical time structure.

By defining this synthetic portfolio, the legislator could choose a defensive definition, which leads to revaluation differences of the demand deposits that are more conservative than the revaluation differences of the hedge (eg. part of the investment portfolio). In my opinion, this would lead to a prudent approach with a more fair view on the balance sheet value.

Although the creating of a new type of liability is a little bit controversial, it is not more 'strange' than the intangible liability of 'deferred tax liabilities'.

Illustrative example: See attachment "Illustrative example comment on ed-IAS39.xls"

If these comments do sound reasonable and useful for further discussion, please invite me to work out these ideas. I'll be glad to provide more detail, statistical evidence and illustrative examples if these efforts could contribute to the regulatory process.

Kind regards

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Suppose interest rates rise

Delta value Investment Portfolio: -10

Delta value Demand Deposits: - 6

D	Profit&Loss	C
10 Rev Investment Portfolio	Rev. Diff. Term Transformation	6
	Loss of the period	4
10		10

D	Balance sheet	C
90 Investment Portfolio	Demand Deposits	94
	Nominal Amount	100
	Rev. Diff. Term Transformation	-6
	Equity	26
	Equity	30
30 Fixed Assets	Retained Earnings	-4
120		120