


IFRS® Foundation

# Dynamic Risk Management

Accounting Standards Advisory Forum meeting

ASAF Agenda Paper 2  
July 2022

- In May 2022, the IASB completed the redeliberation on the three key challenges raised during meetings with preparers in relation to the ‘core areas’ of the DRM model, and decided to move the DRM project from a research programme to a standard-setting programme. At a future meeting, the IASB will discuss the detailed project proposal and potential time line.
- We are interested in any general views ASAF members have on the progress of the DRM project, and IASB’s recent discussions and tentative decisions to respond to the three key challenges. **One question for ASAF members in this regard is on slide 6.**
- The main purpose of this session is to seek ASAF members’ view on a specific area of the potential project plan—that is, whether and if so what components of equity should be eligible for designation in the DRM model, if it is considered by an entity as part of its dynamic risk management. **Two questions for ASAF members relating to this topic are on slide 10.**



# 1—Update on the DRM project

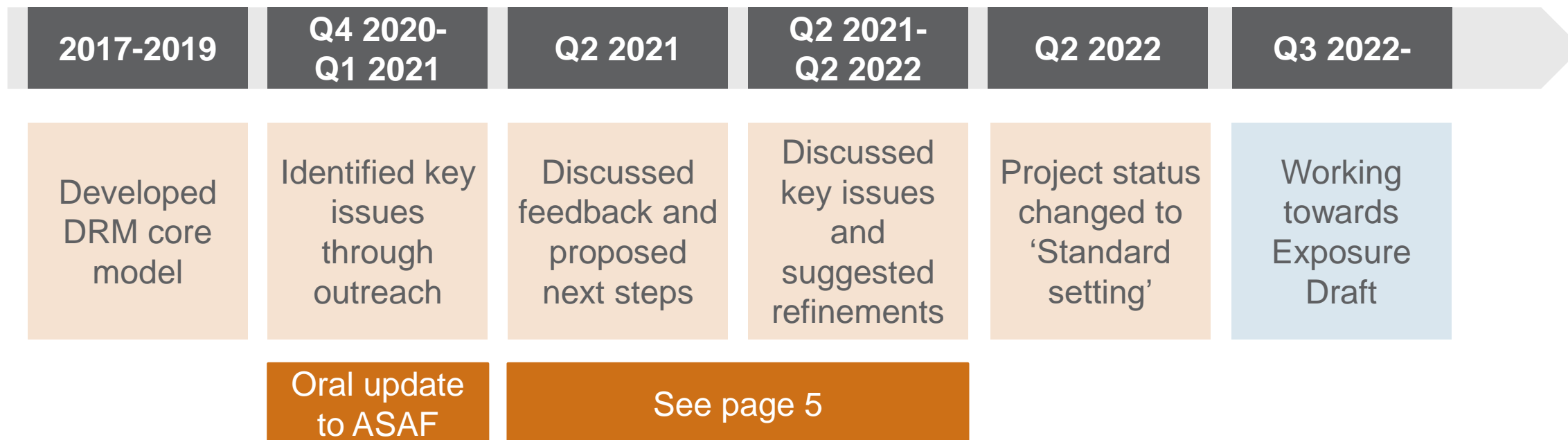
# Current stage of the DRM project

Agenda ref 2



Better reflect:

- how interest rate risk management affects amount, timing and uncertainty of cash flows
- effect of risk management activities on the financial statements



# Key issues and refinements suggested

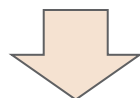
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## Key issues considered during Q3 2021–Q2 2022

### Risk limits and target profile



- Implication of risk limits vs single outcome



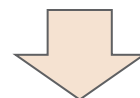
#### Refinements

- To incorporate the risk limits by introducing risk mitigation intention and redefine the target profile as a risk limit

### Layering approach



- Risk management view vs accounting view



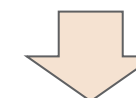
#### Refinements

- Ability to frequently change the risk mitigation intention means a layering approach is unnecessary

### OCI volatility



- Volatility in IFRS equity
- Regulatory capital treatment



#### Refinements

- DRM adjustment to be recognised in statement of financial position to represent dual objective

## Questions for ASAF members

1. Do ASAF members have any general views or comments on the IASB's recent discussions and tentative decisions to respond to the main challenges identified during 2020 outreach, as summarised in page 5?



## 2—Equity balances and the DRM core model

# Deemed interest rate risk in equity

Agenda ref 2

- For those entities applying dynamic risk management of repricing risk due to changes in interest rates (hereafter referred as ‘repricing risk’), the risk management activities typically look at the funding liabilities together with the interest generating assets, as the combination of the two is the source of any repricing risk, which give rise to variability in both earnings and economic values.
- However, we understand that some entities (in particular banks) also include equity as a source of funding for interest rate risk management purpose, and manage the ‘deemed’ interest rate risk exposure that arises from their own equity, together with the interest rate risks from their assets and liabilities.
- Some entities describe the process by disaggregating the return on equity into:
  - a) a base return that is similar to interest (base compensation to equity holders for providing funding); and
  - b) a residual return that results from the total net income that accrues to equity holders (premium for the additional risks).



# Example—deemed interest rate risk in equity

Consider the following two entities that have the same asset profile, but are funded differently:

- Entity A, has repricing risk on the notional of CU 30 million, because its net interest income and the present value of all the assets and liabilities would fluctuate as interest rate changes.
- Entity B, in comparison, would have the same variability as Entity A in terms of net interest income, but no variability in economic values because the variable position is funded by equity directly.

In order to fully reduce the variability in future net interest income, Entity A and B both need to have a 5-year vanilla receive fixed pay floating interest rate swap with a notional of CU 30 million.

## Entity A

Assets	Notional in CU millions	Liabilities	Notional in CU millions
5-year fixed rate assets	100	5-year fixed rate liabilities	130
5-year variable rate assets (reset every 1 month)	50	5-year variable rate liabilities (reset every 1 month)	20
Total Assets	150	Total Liabilities and Equities	150

## Entity B

Assets	Notional in CU millions	Liabilities	Notional in CU millions
5-year fixed rate assets	100	5-year fixed rate liabilities	100
5-year variable rate assets (reset every 1 month)	50	5-year variable rate liabilities (reset every 1 month)	20
		Equity - own fund	30
Total Assets	150	Total Liabilities and Equities	150

### Note:

In this case, equity of CU 30 million is deemed to have interest rate risk exposure similar to a 5-year fixed rate liability.

## Questions for ASAF members

2. Should the DRM model allow the inclusion of equity as an eligible item when calculating the current net open risk position?
3. If equities were to be included in the DRM model, which components of equity (or types of equity instruments) are considered or deemed to have interest rate risk exposures? Why?

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