Purpose of this paper

1. The Board has expressed its intent to obtain feedback on the core elements of the DRM model before making a decision on progressing to the next phase in order to develop the other areas of the model.

2. The purpose of this paper is to set forth the proposed outreach plan to take place. This paper discusses:
   (a) the objective of the outreach;
   (b) the target audience;
   (c) format of the outreach and materials to be used; and
   (d) the timing of the outreach.

Background

3. IFRS 9 Financial Instruments introduced improved hedge accounting and disclosure requirements that enable companies to better reflect their risk management. However, those improvements did not cover specific situations in which a company uses a dynamic risk management strategy and activities to manage interest rate risk arising in open portfolios, ie when the risk position being hedged changes frequently in an open portfolio of changing assets and liabilities.
4. The purpose of the Dynamic Risk Management (DRM) project is to improve the usefulness of information provided about interest rate risk management and how it affects a financial institution’s current and future economic resources. Consequently, this would also conclude the replacement of IAS 39 Financial Instruments: Recognition and Measurement with the replacement of the macro hedge accounting models. Some of the main criticisms of the current macro hedge accounting models is that the application of these models present operational challenges and complexities for preparers and makes it difficult to reflect appropriately the effects of an entity’s dynamic risk management activities in the financial statements. This in turn makes the financial statements very difficult for analysts and investors to understand.

5. At the start of the deliberations on a proposed accounting model for DRM, at its December 2017 meeting, the Board tentatively decided to develop the DRM model in two phases. The first phase would focus on developing the ‘core areas’ that are central to the model while the second phase would address areas that are extensions of concepts developed during the first phase. In addition, as discussed at the November 2017 Board meeting, the core version of the DRM model focuses on dynamic interest rate risk management activities in financial institutions. The elements that are fundamental to the core model are the:

(a) Target profile;
(b) Asset profile;
(c) DRM derivative instruments; and
(d) Performance assessment and recycling.

6. In the Board’s view, these areas would shape the fundamentals of the core DRM accounting model (core model) and capture a significant portion of DRM activities while providing an adequate basis for an early and thorough assessment on the merits of the model. The Board therefore decided to gather external feedback on the core model first, before deciding whether to progress to the next phase in order to cover the non-core areas.

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1 For further information, refer to the December 2017 Agenda Paper 4 Proposed project plan.
2 For further information, refer to the November 2017 Agenda Paper 4 Outline of proposed DRM accounting model and next steps.
7. In developing the outreach plan set out in this paper, the staff have considered other projects on which the Board have done outreach during the development of its proposals such as IFRS 9, IFRS 15 *Revenue from Contracts with Customers* and IFRS 17 *Insurance Contracts* to identify any good practices and ideas to incorporate into this plan.

**Proposed outreach plan**

*Objective of the outreach*

8. In light of the ultimate objective of the DRM project and the Board’s phased approach for the development of the DRM accounting model, the staff believe that the objectives of the outreach are to:

   (a) perform a preliminary assessment of the viability and operability of the model;

   (b) determine whether the model enables entities to better reflect their risk management strategy and activities in the financial statements; and

   (c) identify specific areas of the core model that need reconsideration or improvement during the next phase of the project.

*Target audience*

9. As the main objectives of the outreach is to determine whether there are merits in developing the core model and whether financial institutions will be able to better reflect their risk management activities in the financial statements (see paragraph 5 of this paper), the staff is of the view that this round of outreach will focus exclusively on financial institutions, mainly banks, that manage interest rate risk using dynamic risk management strategies.

10. The staff note however that this does not imply in any way that the DRM model, once completed, will apply exclusively to banks. Previous consultations and stakeholder feedback indicated that banks constitute the majority of entities that manage interest rate risk using dynamic risk management strategies and have been the main source of feedback on the operational challenges faced in applying the current macro hedge accounting models. It is for this reason that the staff recommend targeting banks
exclusively for the outreach. If the Board decides, based on the feedback from the outreach, to further develop the core model, other entities such as insurance entities should also be consulted.

11. The Board also confirmed during the July 2019 Board meeting (and reiterated at the October 2019 ASAF meeting), that obtaining feedback from users of financial statements will be very important at a later stage, but that the preliminary view of the outreach should be to focus on banks to determine whether the model is operational due to dynamic nature of the portfolios and that it reflects performance in a way that banks can explain it to investors.

12. In light of the fact that the objective of the DRM model is to improve the usefulness of information provided about interest rate risk management and how it affects a financial institution’s current and future economic resources, the staff recommend that the banks participating in the outreach are represented by individuals from both the risk management function as well as the accounting/finance function with the relevant knowledge of, and experience in, dynamic interest rate risk management.

Format of the outreach and material to be used

13. To assess the viability and operability of the DRM model and whether it will enable banks to better reflect their risk management strategies and activities in the financial statements, the staff recommend that the outreach be done through individual meetings with the participating banks. In the staff’s view, this will enable the Board to obtain the most direct and focussed feedback but also keep the proprietary information of the participating banks confidential.

14. For the purposes of selecting banks to participate in the outreach, the staff have considered various approaches used in past outreach programmes on Standard such as IFRS 9, IFRS 15 and IFRS 17. However, the outreach on these standards were done as part of the formal consultation process on the Board’s proposals. As the outreach on the core model is being done at a completely different stage in the project lifecycle to other projects, the staff did not consider the approaches followed by other project teams to be appropriate.

15. To achieve the objectives of the DRM model, in particular whether the model enables greater alignment between the risk management strategy and the financial statements,
the staff consider it important to not only achieve geographical representation when selecting banks to participate in the outreach, but also to have participants with different strategies operating in different economic environments. The staff therefore recommend using different characteristics to select the participating banks across different geographical regions, for example:

(a) banks with different balance sheet structures, for example banks that only use term liabilities as part of their risk management strategy, those that use mainly core demand deposits and those that use a combination;

(b) banks with different interest rate risk management strategies;

(c) banks using different hedge accounting strategies, for example those that primarily apply macro cash flow hedge accounting, portfolio fair value hedge accounting, the carve-out as legislated by the European Commission; and

(d) banks from different regulatory environments.

16. With regards to the materials to be used for the outreach, the staff recommend mainly using Agenda Paper 4B DRM Model Demonstration from the July 2019 meeting as material for the outreach. However, prior to engaging outreach participants on the material, the staff will incorporate discussions on the elements of the core model from the relevant Board discussions, including the tentative decisions made at the July 2019 meeting.

17. In addition, to ensure that the Board receive feedback from participants on the same key areas, the staff recommend including some high-level questions that are linked to the objectives of the outreach as part of the outreach material. Outreach material will be shared with participants in advance of the individual meetings to ensure participants have sufficient time to prepare and gather feedback internally.

**Timing of the outreach**

18. The staff acknowledge that participants will need sufficient time to gather feedback and prepare for the outreach meetings. Consideration should also be given to banks’ reporting periods, especially year-end which place a big demand on banks’ resources.
19. The staff is also aware of the Board’s priorities with regards to some of its major standard-setting projects, including the deliberations on IBOR reform Phase 2, over the next couple of months.

20. In light of this, the staff have identified the following milestones and the expected timing by when we expect to have completed the milestones:

<table>
<thead>
<tr>
<th>Milestones</th>
<th>Expected timing</th>
</tr>
</thead>
<tbody>
<tr>
<td>Define outreach participants</td>
<td>December 2019</td>
</tr>
<tr>
<td>Perform outreach</td>
<td>January - April 2020</td>
</tr>
<tr>
<td>Feedback to the Board</td>
<td>June 2020</td>
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</table>

**Question for the Board**

Does the Board have any comments or views on the proposed DRM outreach plan set out in this paper?