EFRAG
European Financial Reporting Advisory Group

Dynamic risk management outreach 2016

Accounting Standards Advisory Forum

London, 6-7 March 2017

Dynamic risk management outreach 2016

Overview

- Purpose of the outreach – participating banks
- Findings of the outreach
- Modelling demand core deposits
- Modelling equity
- Implications for a new macro-hedge accounting solution

Purpose of the outreach

- The object of the outreach was to learn about how *banks* manage *interest rate risk* in more detail
- EFRAG hopes the findings will be a useful input to the IASB's ongoing project on *dynamic risk management*
- Questionnaires were completed by 15 European banks followed up by structured interviews
- Some data on the 15 banks:

Balance sheet total 15 banks in millions EUR	Client deposits 14 banks in million EUR	Weighted average of client deposits 14 banks
15,161,174	6,369,864	43,5%

What we have heard from the outreach

- The objective of the banks' interest rate risk management is to *stabilise the net interest margin*
  - some also refer to optimisation
- Management of interest rate risk involves *modelling* of *structural balances*
- Structural balances are primarily *core demand deposits* and *equity*
- Banks' practices have some commonalities but also various differences

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Modelling demand deposits

- 14 out of 15 participants model demand deposits
- Distinction between core/ non-core part is based on several factors, e.g:
  - Product type
  - Client type
  - How the account is used
  - Sensitivity to market rates
  - Balance of accounts
- Variations in approach to modelling volumes/time buckets

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Modelling equity

- 8 out of 15 participants model the maturity of the equity
- Explicit modelling of equity:
  - What is equity invested in?
  - What is regarded as equity (may not align with IAS 32)?
  - Division between a core and non-core part
  - Assigning maturities to equity

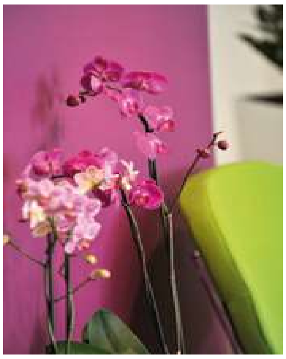
Some implications for an accounting solution

- Management of interest rate risk is *dynamic,* i.e. the risk-managed portfolio is open and instruments move in or out on a continuous basis:
  - Current hedge accounting based mainly on static positions
  - How to assess effectiveness of dynamic positions?
- Interest rate risk is managed based on *net positions*
  - IFRS 9 permits hedging of net positions in *some* circumstances
- Banks *behaviouralise* the maturities of core demand deposits and equity
  - Risk management perspective vs accounting perspective

Questions for the session

- How similar are the banks' risk management practices to the ones illustrated in the EFRAG survey?
- To what extent should an accounting solution seek to reflect the variety of risk management practices?
- Should a new macro-hedging accounting solution be mandatory or optional?

Thank you for your attention!



And now …
Questions?
… and answers…

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