STAFF PAPER

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Introduction

1. This paper continues the staff analysis from Agenda Paper 4A of this meeting and discusses potential alternative mechanics the IASB could consider for the DRM model. The paper only provides our initial analysis on two potential alternative approaches to the DRM mechanics. At this meeting, we seek the IASB's view on the direction of our future work. We will ask the IASB at a future meeting whether changes to the DRM mechanics are necessary and if so, which alternative mechanics should be applied.

2. The paper therefore only considers potential alternative approaches about the *mechanics* of the DRM model. In other words, how to account for the DRM model in the financial statements (ie which amounts and where they are recognised in financial statements). The underlying principles and elements of the model would remain unchanged.

3. This paper provides:

   (a) a reminder of the current approach;

   (b) potential alternative approaches; and

   (c) next steps and question for the IASB.

4. The paper also includes Appendix A—Illustrative Examples.

A reminder of the current approach

5. Key information about the DRM model (as discussed in Agenda Paper 4A of this meeting), including its current mechanics can be summarised as:

	DRM model
Hedged risk	Repricing risk due to changes in interest rates
'Hedged' item	Risk mitigation intention
'Hedging' instrument	Designated Derivatives
Current mechanics	Based on cash flow hedge mechanics, hence it uses the: • benchmark derivatives as proxy to calculate the change in fair value of the risk mitigation intention. • the 'lower of' test to determine the aligned portion which is recognised in other comprehensive income (OCI). The aligned portion represents the extent to which designated derivatives are successful in mitigating repricing risk and achieving the target profile (ie changes in fair value of the risk mitigation intention have been offset by changes in the fair value of the designated derivatives). • any remaining gain or loss on the designated derivatives would be the misaligned portion and be recognised in profit or loss. • the amounts recognised in OCI would be reclassified to profit or loss over time.[1]

Risk mitigation intention

6. The risk mitigation intention in the DRM model is calculated as follows:

   (a) Step 1—qualifying portfolios of (expected) cash flows from assets, liabilities, and future transactions are designated in the model; [2]

[1] The pull-to-par effect on the derivative combined with the reclassification of interest accruals to the statement of profit or loss ensure no balance is deferred beyond the contractual maturity of the derivative.

[2] Consistent with the IASB's tentative decisions in February and April 2018, future transactions such as forecast transactions and firm commitments that are highly probable to occur and meet certain qualifying criteria can be designated in the DRM model.

(b) Step 2—current net open risk position is determined as the net of designated portfolios across each time bucket; and

(c) Step 3—an entity determines the extent to which it wants to reduce (but not create) repricing risk in the current net open risk position, based on its risk management strategy. This results in the *risk mitigation intention*, ie the 'hedged' item, which could change frequently.

7. As noted in paragraph 6(c), unlike the current hedge accounting requirements in IFRS 9 and IAS 39 which are based on designation of individual items or groups of items as the hedged item, in the DRM model, the 'hedged' item is simply an extent—or said differently, a portion—of a risk exposure derived from the current net open risk position.

8. Although this is consistent with entity's risk management activities which focus on the 'risk exposure view' (not the 'individual item view'), because of the dynamic nature of the risk exposure, aggregation of portfolios, netting off in time buckets and determining the extent of risk exposures to be mitigated/reduced:

(a) it would not be possible for an entity to establish a direct link between the risk mitigation intention at a point in time and the underlying individual items that it is comprised of.

(b) without any mathematical expedient, calculating the changes in fair value (present value) of the risk mitigation intention or determining subsequent reclassification of its amount from OCI to profit or loss would create valuation challenges. For example, the underlying individual items (such as assets, liabilities, and future transactions) each might need to be measured at fair value (attributable to hedged risk). As noted in Agenda Paper 4A of this meeting, stakeholders said that doing so would be challenging for dynamic net open risk positions. This is further exacerbated given the risk mitigation intention is simply a portion of the current net open risk position.

9. The DRM model seeks to address these challenges by:

(a) recognising that dynamic risk management activities are undertaken based on a 'risk exposure view', hence the model does not contemplate monitoring of individual items that comprise the risk mitigation intention.

(b) using the benchmark derivatives as a mathematical expedient to calculate the change in fair value of the risk mitigation intention and facilitate the subsequent reclassification of the amount of risk mitigation intention from OCI to profit or loss.

Benchmark derivatives

10. In DRM model, the concept of a benchmark derivative is based on the same principles to those described in IFRS 9 about a hypothetical derivative (see paragraphs B6.5.5–B6.5.6 of IFRS 9). For example, benchmark derivatives would have terms that match the critical terms of the risk mitigation intention upon designation. Consequently, like a hypothetical derivative in IFRS 9, a benchmark derivative in the DRM model cannot be used to include features in the value of the risk mitigation intention that only exist in the designated derivatives (but not in the risk mitigation intention). Ultimately, this principle ensures the value of the hedged item is measured independently of the value of the hedging instrument.

11. Calculating the changes in fair value of the risk mitigation intention using benchmark derivatives is therefore intended to be a practical solution to the challenges that would otherwise arise on valuation, tracking, and subsequent reclassification of the risk mitigation intention.

Lower of test

12. Given the current mechanics of the DRM model (which are based on cash flow hedge mechanics) to only recognise the changes in fair value of the designated derivatives, not of the risk mitigation intention, the ‘lower of’ test is the mechanism that determines:

    (a) the portion of changes in fair value of designated derivatives that is recognised in OCI—that is, the aligned (or effective) portion; and

    (b) the portion of changes in fair value of designated derivatives that is recognised in statement of profit or loss—that is, the misaligned (or ineffective) portion.

13. Said differently, the ‘lower of’ test prevents the recognition of changes in fair value of designated derivatives in OCI, in excess of the changes in fair value of the risk mitigation intention.

Potential alternative approaches

14. The analysis in Agenda Paper 4A of this meeting highlights that there are challenges with both cash flow and fair value hedge mechanics, in the context of the DRM model, and neither mechanics, on their own, provide the optimal way to calculate the amounts recognised in the financial statements.

15. Accordingly, if the IASB were to decide to reconsider the current mechanics of the DRM model, we sought to identify alternative mechanics that would be a 'hybrid' of cash flow and fair value hedge mechanics. In this paper, we describe two potential approaches which retain the core principles and elements of the DRM model and ensure the DRM model would continue to:

    (a) be a valuation model; and

    (b) require that the value of the hedged item is measured independently of the value of the hedging instrument.

16. In this section, we analyse these approaches, including advantages, disadvantages and conceptual challenges associated with each approach.

Approach A

17. Approach A is a symmetrical approach, which is similar to the fair value hedge mechanics, but with some changes to reflect to the characteristics of dynamic risk management. Applying this approach, the DRM model would be accounted for as follows:

    (a) the designated derivatives would continue to be recognised at fair value in the statement of financial position, with gains or losses recognised in statement of profit or loss.

    (b) the risk mitigation intention would be recognised at fair value as a separate line item in the statement of financial position, with gains or losses recognised in statement of profit or loss.

18. The following table illustrates Approach A:

	What is valued?	What is recognised in statement of financial position?	What is recognised in statement of profit or loss?
'Hedged' item	Risk mitigation intention*	Fair value of the risk mitigation intention	Changes in fair value of the risk mitigation intention
'Hedging' instrument	Designated derivatives	Fair value of the designated derivatives	Changes in fair value of designated derivatives

*The fair value of risk mitigation intention is calculated using benchmark derivatives as a proxy

19. The main differences in accounting applying Approach A compared to accounting of a fair value hedge (see paragraphs 6.5.8–6.5.9 of IFRS 9) are:

(a) the unit of account for the hedged item. Unlike the hedged items in a fair value hedge for interest rate risk, which are typically individually identified and recognised items (ie recognised assets and/or liabilities), the risk mitigation intention in the DRM model is not comprised of individually recognised assets or liabilities. As noted in paragraphs 7–8, the risk mitigation is a *portion* of a net open risk position derived from underlying items that are dynamic, based on the expected cash flows and could include eligible future transactions.

(b) the use of benchmark derivatives as a proxy to calculate the change in fair value of the risk mitigation intention. The concept of a 'hypothetical derivative' (ie using a derivative as a proxy) to calculate the change in the fair value of the hedged item is not contemplated in IFRS 9 for fair value hedges. Nonetheless, Approach A uses this concept for the reasons described in paragraphs 8–11.

(c) recognising the fair value of the risk mitigation intention in the statement of financial position without adjusting the carrying amount of the underlying portfolios/items. This is different to a fair value hedge whereby the changes in fair value of hedged item are recognised in the statement of financial position by adjusting the item's carrying amount. The risk mitigation intention is a portion of the net open risk position from underlying assets, liabilities, and future transactions. Therefore, adjusting the carrying amount of *an individual item*, or even of a portfolio/group of items, in the statement of financial

position would not be appropriate (or even possible). Alternatively, any attempt to apportion the DRM adjustment between individual items will be arbitrary at best.

Rationale for Approach A

20. Applying Approach A, the DRM adjustment would represent the fair value of the risk mitigation intention (attributable to repricing risk) that would be recognised in the statement of financial position with any changes in fair value recognised in the statement of profit or loss. Designated derivatives would also continue to be recognised at fair value through profit or loss, therefore it leads to a symmetrical recognition in the statement of financial position and the statement of profit or loss.

21. The DRM adjustment in Approach A focuses on recognising the fair value of the risk mitigation intention. Along with the fact that designated derivatives would continue to be recognised at fair value through profit or loss, the outcome of this approach is a 'gross' recognition and measurement in the financial statements.

22. The fair value of the risk mitigation intention is derived from the repricing risk in the current net open risk position (being an aggregation of fixed and floating rate positions), due to changes in interest rates. Hence, it is arguably appropriate for any changes in the fair value of the risk mitigation intention to be recognised in the financial statements to provide information about the economic value inherent in the risk mitigation intention.

23. Some stakeholders may argue the fair value of risk mitigation intention is an approximation of the fair value of underlying individual items, hence recognising the fair value of the risk mitigation intention would be similar to the concept of a 'fair value hedge adjustment' applying IFRS 9 and IAS 39. However, in the DRM model, the fair value of the risk mitigation intention does not necessarily equate to the fair value of the individual underlying items for the reasons explained in paragraph 19(a).

Advantages

24. The main advantages of Approach A are:

    (a) symmetrical recognition:

        (i) in the statement of financial position. As noted in paragraph 20, the outcome of this approach is recognition of the fair value of both the risk mitigation intention (attributable to repricing risk)

and the designated derivatives in the statement of financial position. This would provide useful information about the fair value of the gross exposure to repricing risk and the designated derivates, enabling users of financial statements to calculate the extent that fair value of risk mitigation intention is offset by fair value of designated derivatives. It would also reduce accounting mismatches in statement of financial position.

(ii) in the statement of profit or loss. Similarly, the outcome of Approach A is that all the changes in fair value of the risk mitigation intention (attributable to repricing risk) and the changes in fair value of the designated derivatives would be recognised in the statement of profit or loss. This would reduce accounting mismatches in the statement of profit or loss.

(b) no volatility in equity. There would be no gain or loss on the designated derivatives deferred in OCI, hence no resulting volatility in equity.

(c) uses the benchmark derivatives as practical expedient:

(i) to address the valuation challenges of the risk mitigation intention as noted in paragraphs 8–9; and

(ii) to facilitate the documentation and tracking of the risk mitigation intention which may frequently change.

Disadvantages

25. The main disadvantages of Approach A are that:

(a) it does not necessarily provide useful information in context of the dual purpose of DRM model. This approach focuses on providing information about the fair value of the risk mitigation intention. However, as noted in Agenda Paper 4A of this meeting, the purpose of DRM model is to hedge exposure of risk mitigation intention to *both fair value* and *cash flow variability* due to changes in interest rates, in the same accounting model.[3] Therefore, by focusing only on the fair value of the of the risk mitigation intention, the DRM adjustment in Approach A does not faithfully represent

[3] As explained in Agenda Paper 4A of this meeting, an entity is hedging its cash flow exposure (ie the variability in the statement of profit or loss of its net interest income), while at the same time managing the change of the fair (present) value of the of the risk mitigation intention by aiming for a particular transformation objective.

the effects of the DRM model. It fails to depict the fact that the actual purpose of DRM model is also about hedging an entity's cash flow exposure. Therefore, it does not faithfully represent the fact that DRM model would have also reduced variability in the statement of profit or loss of its (future) net interest income.

(b) there are conceptual challenges with recognising the fair value of the risk mitigation intention attributable to repricing risk in the statement of financial position. As noted in paragraphs 7–8, the risk mitigation intention is simply a portion of the current net open risk position the entity wants to mitigate and can frequently change (ie based on an entity's discretion). In contrast to a fair value hedge where the hedge adjustment is directly related to recognised assets or liabilities, the risk mitigation intention cannot be directly related to the underlying individual items/portfolios. Consequently, it is challenging to justify the recognition of the fair value of the risk mitigation intention.

(c) there are further conceptual challenges relating to future transactions. As previously noted, the risk mitigation intention could also include future transactions such as firm commitments and highly probable forecast transactions. Recognising the fair value (attributable to hedged risk) of future transactions is not appropriate because the future transaction itself is not yet a recognised asset or liability. As noted in Agenda Paper 4A of this meeting, conceptual challenges relating to future transactions were one of the reasons the IASB tentatively decided to use the cash flow hedge mechanics for the DRM model.

Approach B

26. Approach B is based on mechanics that are a combination of cash flow and fair value hedging mechanics. Applying this approach, the DRM model would be accounted for as follows:

(a) the designated derivatives would be recognised in the statement of financial position at fair value.

(b) the DRM adjustment would be recognised in the statement of financial position, determined as the lower of:

(i) the cumulative gains or losses on the designated derivatives from inception of the hedge; and

(ii) the cumulative change in fair value (present value) of the risk mitigation intention from inception of the hedge (measured by using the benchmark derivative as a proxy).

(c) the DRM adjustment therefore represents the portion of the gain or loss on the designated derivatives that offsets the gain or loss on the risk mitigation intention (the aligned portion). Any remaining gain or loss on the designated derivates, including any changes to the DRM adjustment calculated in accordance with (b) would be recognised in the statement of profit or loss.

27. The following table illustrates Approach B:

	What is valued?	What is recognised in statement of financial position?	What is recognised in statement of profit or loss?
'Hedged' item	Risk mitigation intention*	N/A	N/A
'Hedging' instrument	Designated derivatives	Fair value of the designated derivatives	Misaligned portion resulting from the 'lower of test'
DRM adjustment	The 'lower of' of the above (see paragraph 26(b))	Aligned portion resulting from the 'lower of test', as a separate line item	

*The fair value of risk mitigation intention is calculated using benchmark derivatives as a proxy

Rationale for Approach B

29. Applying Approach B, the DRM adjustment represents the aligned portion, in other words, it indicates directly the extent to which the designated derivatives have been successful in mitigating the repricing risk due to changes in interest rates. In short, Approach B aims to provide direct information about the effect of the DRM model.

30. This approach is similar to the current mechanics of the DRM model, however the DRM adjustment is recognised in the statement of financial position rather than in OCI. This is consistent with the fact that the purpose of the DRM model is to hedge the risk mitigation intention for both cash flow variability (ie future net interest income) and fair value variability (ie economic value). From this perspective, the DRM adjustment

ultimately represents the extent to which the derivatives hedged the variability in net interest income and economic value to be realised in the future. It is for this reason that changes in the fair value of such derivatives would not be recognised immediately in statement of profit or loss but would be recognised in future periods to provide an offset when the net interest income and/or economic value inherent in the underlying items is realised, ie when it affects profit or loss.

31. The DRM adjustment would be measured using the 'lower of' test described in paragraph 26(b), to ensure that cumulative changes in fair value of the designated derivatives that exceed the cumulative changes in fair value of the risk mitigation intention are immediately recognised in profit or loss. Accordingly, the 'lower of' test prevents the recognition of cumulative changes in fair value of designated derivatives in statement of financial position, in excess of the cumulative changes in fair value of the risk mitigation intention.

32. In applying Approach B, the designated derivatives would continue to be classified and measured at fair value, with changes in fair value recognised in profit or loss subject to the 'lower of' test. No remeasurement of the underlying items would be recognised in the financial statements.

Advantages

33. The main advantages of Approach B are that:

    (a) it provides useful information about the dual effects of the DRM model, consistent with its purpose of hedging exposure to *both* fair value and cash flow variability due to changes in interest rates:

        (i) in the statement of financial position. The DRM adjustment in this approach provides more useful information by recognising in statement of financial position only the extent to which an entity successfully mitigated repricing risk due to changes in interest rates. As noted in paragraph 30, the DRM adjustment would in effect represent the future 'offset' (ie benefit) to be recognised in profit of loss when the net interest income and/or economic value affects profit or loss.

        (ii) similarly, in the statement of profit or loss. The changes in fair value of designated derivatives would be recognised in profit or loss immediately, to the extent that the purpose of the DRM

model is not achieved. To the extent the purpose of the DRM model is achieved, such changes would be recognised in the same (future) period when the net interest income and/or economic value affects profit or loss. This would provide faithful representation of the effects of the DRM model.

(iii) overall, direct information about effectiveness of DRM model. In Approach B, direct information would be provided about the extent to which an entity achieved the objective of mitigating repricing risk (ie aligned portion in financial position), and the extent it did not achieve it (misaligned portion in profit or loss). This conveys direct information how the risk management actions have affected the entity's current and future economic resources. Ultimately, this information would facilitate users' understanding of effectiveness of entity's DRM activities.[4]

(b) it does not lead to volatility in equity. Recognition of the aligned portion in statement of financial position, instead of OCI, addresses the issue of volatility in equity arising from the DRM model and is more consistent with the purpose of the DRM model.

(c) similar to Approach A, this approach uses benchmark derivatives as a practical expedient to measure the changes in the fair value of the risk mitigation intention.

Disadvantages

34. The main disadvantage of Approach B is that is an asymmetrical recognition in financial statements. Recognising in the statement of financial position *only the lower of* the cumulative gain or loss on the designated derivatives and the cumulative change in fair value of the risk mitigation intention, instead of all fair value of risk mitigation intention, would result in an asymmetrical view. Similarly, what is recognised in statement of profit or loss is the misaligned portion calculated using the 'lower of' test. However, as noted in paragraph 33(a), because of the dual purpose of DRM model, information resulting from this approach (albeit asymmetrical) would provide more useful information about the purpose of DRM model.

[4] As noted in Agenda Paper 4 of November 2017 meeting, one of the objectives of DRM model is to provide understandable and reliable information about the effectiveness of dynamic risk management activities.

Examples illustrating Approach A and Approach B

35. To facilitate the understanding of each approach, in Appendix A of this paper we provide examples illustrating the mechanics of Approach A and Approach B.

36. As noted in Appendix A, both approaches:

    (a) use the same elements of the DRM model (for example, risk mitigation intention, benchmark derivatives and designated derivatives); and

    (b) require measurement of the value of the hedged item and the hedging instruments.

    However, the approaches use different mechanics which result in a difference in the location and, in some scenarios, in the amount of the DRM adjustment.

37. The staff would like to highlight that, while in some scenarios the values recognised in financial statements might be similar in both approaches (eg see paragraphs A6–A7 of Appendix A), the difference ultimately lies in the information conveyed by the DRM adjustment. Specifically, what the DRM adjustment purports to represent and whether that is useful information in context of the dual purpose of the DRM model:

    (a) in Approach A, the DRM adjustment recognises fair value of risk mitigation intention, regardless the extent to which an entity is successful in mitigating repricing risk of the risk mitigation intention. Therefore, the amount of DRM adjustment is the entire fair value of risk mitigation intention. This conveys information about hedging variability in fair value of risk mitigation intention.

    (b) in Approach B, the DRM adjustment recognises only the extent an entity was successful in mitigating repricing risk. Therefore, the DRM adjustment is limited to the fair value of designated derivatives that achieved the dual purpose of hedging variability in fair value and cash flows of the risk mitigation intention.

Next steps and question for the IASB

38. Subject to the IASB's feedback at this meeting, we plan to further analyse some aspects of the potential alternative approaches discussed in this paper and bring back further analyses at a future meeting. In particular, we would like to further analyse aspects related to the usefulness of information resulting from the DRM adjustment under the approaches discussed in this paper.

Question for the IASB

39. The staff would like to ask the IASB the following question.

Question for the IASB

1. Do IASB members have any comments or questions about the potential alternative approaches and next steps discussed in this paper? In particular:

(a) is there any significant advantage or disadvantage that is not considered in staff analysis on Approach A or Approach B?

(b) are there any points or potential implications that you would like staff to research further for re-deliberations?

Appendix A—Illustrative Examples

A1. In the following paragraphs we provide a comparison of Approach A and Approach B through illustrative examples.

A2. Consider **Scenario 1** for an entity with a target profile (risk limits) of -50 to +50 and with the following information, expressed in PV01[5] terms, at the 5-year bucket:

	Beginning of 1st period	**End of 1st period**	**PV change on 20bps shift**
	(X)	**(Y1)**	**(Y1 x 20bps)**
Current net open risk position	500	440	
Risk mitigation intention	490		
Effect of unexpected changes		(50)	(1,000)
Benchmark derivative	490	490	9,800
Designated derivative	(490)	(490)	(9,800)

A3. In Scenario 1, we illustrate the effect of unexpected changes in circumstances when such changes result in failure to meet the first retrospective assessment in the DRM model—that is, whether the entity has **mitigated interest rate risk**.[6]

A4. As noted in the table above, the entity's current net open risk position unexpectedly decreased by 60 (ie from 500 to 440) during the first period. However, given the entity designated its risk mitigation intention at 490, the decrease in risk exposure of 50 (ie difference of 490 risk mitigation intention and 440 current net open risk position at the end of period) is the minimum effect of unexpected changes to be captured. The effect of 50 represents the extent to which the entity did not mitigate risk as intended.

A5. Applying the 'lower of' test, the entity would calculate the lower of cumulative changes in value of (in absolute terms):

(a) the designated derivatives of CU9,800; and

(b) the combination of benchmark derivatives CU9,800 and effect of unexpected changes CU1,000 decrease in risk position, ie total of CU8,800 (CU9,800 – CU1,000).

[5] Present value change of 1 bps move in interest rates.

[6] Agenda Paper 4A of November 2021 meeting discusses the two retrospective assessments in the DRM model—those are, whether the entity has mitigated interest rate risk; and whether the entity achieved target profile.

A6. For Scenario 1, the amounts reported in financial statements at the end of 1st period applying the two approaches would be as follows:

Debit / (Credit)	Approach A		Approach B	
At the end of 1st period	Financial position	Profit or loss	Financial position	Profit or loss
Risk mitigation intention (using total of benchmark derivative as proxy) and unexpected changes	8,800		N/A	
Change in value of the risk mitigation intention		(8,800)		N/A
Designated Derivative	(9,800)		(9,800)	
Change in value of designated derivative		9,800		1,000
DRM adjustment (aligned portion)			8,800	
Net effect	**(1,000)**	**1,000**	**(1,000)**	**1,000**

A7. In Scenario 1, the net effect in financial statements is the same under both approaches. The difference lies in different information that the components represent in financial statements.

A8. However, the net effect would be different between these approaches in scenarios where the cumulative value of the benchmark derivatives and effect of unexpected changes exceeds the cumulative value of the designated derivatives.

A9. For example, consider **Scenario 2** for an entity with the same target profile (risk limits) of -/+50 and with the following information expressed in PV01 terms, at the 5-year bucket:

	Beginning of 1st period	End of 1st period	PV change on 20bps shift
	(X)	(Y2)	(Y2 x 20bps)
Current net open risk position	500	550	
Risk mitigation intention	490		
Effect of unexpected changes		10	200
Benchmark derivative	490	490	9,800
Designated derivative	(490)	(490)	(9,800)

A10. In Scenario 2, we illustrate the effect of unexpected changes in circumstances when such changes result in failure to meet the second retrospective assessment in the DRM model—that is, whether the entity has **achieved its target profile**.

A11. As noted in table above, the entity's current net open risk position increased by 50 (ie from 500 to 550) during the first period. However, given the entity's target profile is -/+50 and risk mitigation intention of 490, the increase in risk exposure of 10 (ie the difference of

540, being the maximum current net open position that would still be acceptable (tolerable), in order to achieve entity's target profile, and 550 being the current net open risk position at the end of period) is the effect of unexpected changes that should be captured. The effect of 10 represents the extent to which the entity did not achieve its target profile (ie risk limits of -/+50).

A12. Based in the above information, the lower of cumulative changes in value of (in absolute terms) would be calculated as follows:

(a) the designated derivatives of CU9,800; and

(b) the combination of benchmark derivatives CU9,800 and effect of unexpected changes CU200 increase in risk position, ie total of CU10,000.

A13. For Scenario 2, the amounts reported in financial statements at the end of 1st period applying the two approaches would be as follows:

Debit / (Credit)	**Approach A**		**Approach B**	
At the end of 1st period	**Financial position**	**Profit or loss**	**Financial position**	**Profit or loss**
Risk mitigation intention (using total of benchmark derivative as proxy) and unexpected changes	10,000		N/A	
Change in value of risk mitigation intention		(10,000)		N/A
Designated Derivative	(9,800)		(9,800)	
Change in value of designated derivative		9,800		Nil
DRM adjustment (aligned portion)			9,800	
Net effect	**200**	**(200)**	**Nil**	**Nil**

A14. Net effect of CU200 would be recognised applying Approach A but not recognised applying Approach B. This is because, Approach B aims to provide information about the extent to which the designated derivatives mitigated repricing risk. In Scenario 2, the effect of unexpected changes is an increase in risk position (colloquially referred as 'under hedge'). As the designated derivatives have fully mitigated the repricing risk as intended, the increase in risk exposure would not affect the effectiveness of DRM activities—therefore, no change in fair value of designated derivatives would be recognised in statement of profit or loss. However, the increase in risk exposure might affect the 'lower of' test of future periods because the test is done on a cumulative value basis.