IFRS Accounting

Staff paper

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This paper has been prepared for discussion at a public meeting of the International Accounting Standards Board (IASB). This paper does not represent the views of the IASB or any individual IASB member. Any comments in the paper do not purport to set out what would be an acceptable or unacceptable application of IFRS® Accounting Standards. The IASB's technical decisions are made in public and are reported in the IASB *Update*.

Introduction

1. Following the decision to add the Dynamic Risk Management (DRM) project to its standard-setting programme in May 2022, the IASB discussed in July 2022 a list of outstanding topics to be considered further to complete the development of the DRM model. This month we bring two papers to the IASB meeting covering the first two topics for deliberations.

2. **Agenda Paper 4A – Managing equity:** This paper analyses whether equity should be included as an eligible item in the determination of the current net open risk position.

3. **Agenda Paper 4B – Notional alignment of designated assets and liabilities:** This paper revisits the tentative decision taken during the development of the DRM core model on the requirement for the notionals (of what was originally called the asset and the target profile) to be the same. This is because of feedback received during the outreach on the DRM core model.

4. These two topics are presented together for discussion at this IASB meeting because they are closely related to each other in our view. As discussed in the July 2022 IASB meeting, we assess each topic against the overall objective of the project, which is to better reflect the risk management. While we frequently refer to an entity's risk management activities and practices in these papers and explore whether they could be represented in the DRM model, we also acknowledge the importance of having a robust accounting model that would provide useful information to the users.

Summary of key decision to date

5. We also use this paper to summarise the IASB's key tentative decisions since the DRM core model was presented to the IASB in July 2019. Following the feedback from the informal outreach with preparers, the IASB has revisited some of the previous tentative decisions.

These are summarised in paragraph 6 to 9 of this paper. Apart from these refinements, the original tentative decision remains valid and can be found in Agenda paper 4A of April 2019 IASB meeting.

Refinements made to the DRM core model

Risk limits

6. Agenda Paper 4A for the November 2021 IASB meeting introduced the concept of risk limits into the DRM model by redefining the key elements of the DRM model and introducing particular compliance assessments in order to operationalise such a concept. Specifically, the IASB tentatively decided to:

   (a) revise the definition of the target profile as the range (risk limits) within which the current net open risk position can vary while still being consistent with the entity's risk management strategy;

   (b) introduce the risk mitigation intention as a new single-outcome element to the DRM model, representing the extent of risk to be mitigated through the use of derivatives, ie the portion of the current net open risk position the entity intends to mitigate through the use of derivatives;

   (c) revise the construction of benchmark derivatives so that they represent the risk mitigation intention; and

   (d) introduce prospective assessments to ensure the DRM model is used to mitigate interest rate risk and achieves the target profile, supplemented by similar retrospective assessments designed to capture the potential misalignment arising from unexpected changes.

7. The revised elements of the DRM model are illustrated in Appendix 1.

8. With the introduction of those refinements to the core model no further action was required to address feedback received about the designation of portion of prepayable assets in the DRM model, commonly referred to as the 'bottom layer'[1].

[1] The rationale for this tentative decision was summarised in Agenda Paper 4B for the November 2021 IASB meeting.

Mechanics of the DRM model

9. Agenda Paper 4A for the May 2022 IASB meeting presented analysis on the alternative approaches to the mechanics of the DRM model, and the IASB tentatively decided to change the mechanics of the DRM model to require:

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

   (b) the DRM adjustment to be recognised in the statement of financial position, as the lower of (in absolute amounts):

      (i) the cumulative gain or loss on the designated derivatives from the inception of the DRM model; and

      (ii) the cumulative change in the fair value of the risk mitigation intention attributable to repricing risk from inception of the DRM model. This would be calculated using the benchmark derivatives as a proxy.

   (c) the net gain or loss from the designated derivates calculated in accordance with (a) and the DRM adjustment calculated in accordance with (b) would be recognised in the statement of profit or loss.

Appendix 1 – Elements of the refined DRM model