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CONTACT(S)	Ross Turner	rturner@ifrs.org	+44 (0) 20 7246 6920
	Fernando Chiqueto	fchiqueto@ifrs.org	+44 (0) 20 7246 6496
	Kumar Dasgupta	kdasgupta@ifrs.org	+44 (0) 20 7246 6902

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Introduction

1. The objective of this paper is to provide additional guidance in form of qualifying criteria for the financial liabilities used to determine an entity's target profile.

2. As discussed at the March 2018 Board meeting, the determination of the target profile should take into account the entity's risk management strategy which in turn is influenced by:
   (a) The contractual terms of financial liabilities where present; and
   (b) The entity's approach to core demand deposits where present.

3. While the notional of the target profile is determined by the entity's financial liabilities, the tenor of the target profile is defined based on the entity's risk management strategy when core demand deposits are present. Consequently, the model needs to consider qualifying criteria not only for which financial liabilities can be designated within the DRM model but also qualifying criteria for the target profile's tenor, if any. This paper focuses on the proposed qualifying criteria for determining which financial liabilities can be designated as part of the DRM model. Qualifying criteria for the tenor of the target profile will be discussed at the next Board meeting. The staff would like to highlight that the tenor of the asset profile is bound by the contractual terms of the assets designated within the

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asset profile and, therefore, there is no need for qualifying criteria regarding the tenor of the asset profile.

4. This paper also discusses designation and de-designation of financial liabilities within the DRM model and corresponding documentation requirements. This paper is structured as follows:

   (a) Why qualifying criteria are needed (paragraphs 5 – 9);

   (b) Qualifying criteria applicable to financial liabilities (paragraphs 10 – 25);

   (c) Core demand deposits (paragraphs 26 – 33);

   (d) Designation of financial liabilities and future transactions (paragraphs 34 – 41);

   (e) Designation of proportions (paragraphs 42 – 52);

   (f) De-designation of financial liabilities and future transactions (paragraphs 53 – 56); and

   (g) Documentation requirements (paragraphs 57 – 58).

Why qualifying criteria are needed

5. As tentatively decided at the March 2018 Board meeting, the determination of the target profile should take into account the entity's risk management strategy[1] which in turn is influenced by:

   (a) The contractual terms of financial liabilities where present; and

   (b) The entity's approach to core demand deposits where present.

6. The role of the target profile within the DRM accounting model is to define the objective management is working towards for a given asset profile. It allows for the assessment of whether the executed derivative instruments were and continue

[1] As noted in paragraph 6.329 of the Basis for Conclusions of IFRS 9 'the term 'risk management strategy' was used in the 2010 Hedge Accounting Exposure Draft as a reference to the highest level at which an entity determines how it manages risk.[…] Conversely, the term 'risk management objective' is related to how the particular designated hedging instrument is used to hedge the particular exposure designated as the hedged item.' Because DRM is undertaken on a portfolio basis, the staff believe the term 'risk management strategy' is more appropriate in the context of the DRM accounting model.

to be effective in transforming the asset profile by defining the desired end state after transformation. Furthermore, by considering financial liabilities when defining the target profile, this allows the DRM model to capture the management of interest expense.

7. To play its role within the DRM accounting model, the staff believe that the DRM accounting model should provide additional guidance in the form of qualifying criteria. This is because these criteria will allow for clear identification of which items are dynamically managed for interest rate risk. This is particularly important in the context of performance assessment, since the target profile defines the objective that management is working towards through DRM. Furthermore, qualifying criteria will help the DRM accounting model to achieve its objective to faithfully represent, in the financial statements, the impact of DRM activities. For example, because DRM is performed at a portfolio level, these criteria would preclude designation of items where interest rate risk is managed on an individual basis. Finally, as the DRM accounting model proposes a deviation from the normal accounting for derivative financial instruments under IFRS 9: *Financial Instruments* (IFRS 9), the staff believe that qualifying criteria are needed to ensure consistent application of the DRM model.

8. The staff recognise the objective of the model is not to govern or restrict risk management, but reflect the impact of risk management activities in financial reporting. While introducing qualifying criteria could create tension with that objective, the staff will endeavour to prioritise consistency between the DRM accounting model requirements and an entity's risk management objectives, whenever possible.

9. When considering which items should be taken into account when determining the target profile, the staff considered the nature of DRM and its objectives. Accordingly, the staff considered the elements outlined in paragraphs 10 – 33 as the basis for determining the target profile qualifying criteria.

Qualifying criteria applicable to financial liabilities

10. DRM is a process that involves understanding and managing how and when a change in market factors will impact interest income and interest expense. As interest expense is calculated by applying the effective interest method to financial liabilities, the staff believe that the target profile should consider financial liabilities in order to faithfully reflect DRM in financial reporting.

Financial liabilities at amortised cost

11. Interest income and interest expense are recognised in the statement of profit or loss using the effective interest rate method, which is applied to financial assets and financial liabilities measured at amortised cost. As DRM focuses on interest income and interest expense, the staff believe that financial liabilities measured at amortised cost should be the starting point to determine which financial liabilities are within scope of the DRM accounting model.

12. As discussed at the February 2018 Board meeting[2], DRM is generally undertaken for the banking book of a financial institution. While the banking book is not a term defined in IFRS Standards, it is generally accepted that the banking book mostly comprises financial instruments measured at amortised cost. According to IFRS 9, amortised cost provides relevant information for many financial liabilities because it reflects the issuer's legal obligation to pay the contractual amounts in the normal course of business and in many cases, the issuer will hold liabilities to maturity and pay the contractual amounts[3]. This, in general, is consistent with financial liabilities subject to DRM activities.

13. In particular, restricting the model to financial assets and financial liabilities measured at amortised cost will ensure the DRM model addresses one of the main concerns raised by constituents. Specifically, situations where financial instruments within the banking book are measured at amortised cost and derivatives used to manage interest rate risk are measured at fair value through

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[2] For further information, refer to paragraphs 18–19 of the February 2018 Agenda Paper 4B *Asset profile*.

[3] See paragraph 4.49 (b) of the Basis for Conclusions of IFRS 9.

profit or loss, giving rise to an accounting mismatch in the statement of profit or loss.

14. Similar to the discussions around the asset profile, the staff believe that allowing financial liabilities managed on an individual basis as part of the target profile would be inconsistent with the DRM accounting model's objective to faithfully represent, in the financial statements, the impact of DRM activities undertaken by an entity. This is because DRM is generally performed on a collective and not an individual basis. Consequently, only financial liabilities where risk is managed on a portfolio basis should be eligible for inclusion within the model.

15. Furthermore, the staff believe that hedged items and hedging instruments already designated in a hedge accounting relationship for interest rate risk should not be eligible for the DRM accounting model. This is because designation of such items under the DRM model would result in deferring gains or losses in Other Comprehensive Income for items already considered in a hedge accounting relationship and, therefore, could result in double counting.

16. It is important to note that according to paragraph 4.2.2 of IFRS 9, an entity may, at initial recognition, irrevocably designate a financial liability as measured at fair value through profit or loss when doing so results in more relevant information because it eliminates or significantly reduces an accounting mismatch (also referred to as 'fair value option'). Because these financial liabilities are not measured at amortised cost, they would not be eligible for the purpose of determining an entity's target profile. The staff acknowledge this would represent a restriction for the model. However, when these financial liabilities are part of an entity's banking book, any accounting mismatch would be addressed already and, therefore, there would be no need for using the DRM accounting model. The staff would highlight that the use of the fair value option is optional. Also, entities can instead choose to designate new financial liablities, and any associated portfolios of financial assets, in the DRM accounting model to address any accounting mismatch rather than using the fair value option. As such, while further consideration might be required on transition for those liabilities where the election has already been made, the staff note the potential impacts, if any, are expected to be limited. Nonetheless, the staff intend to seek specific feedback on

this area during outreach which is expected to take place after the core areas of the model have been discussed with the Board.

17. The staff believe that using financial liabilities measured at amortised cost as a starting point to determine the target profile would ensure that the DRM accounting model captures a significant portion of items dynamically managed for interest rate risk. Equity as a source of funding will be discussed during the second phase of the project as agreed during the December 2017 Board meeting.[4]

Future transactions

18. As discussed at the February 2018 Board meeting, an entity can designate future transactions (ie re-investments and growth) as part of the asset profile, provided the corresponding qualifying criteria are met. This is because, in practice, DRM considers present and future interest rate risk exposures. For example, in addition to exposures already recognised in the statement of financial position, financial institutions often manage exposures associated with future transactions that are expected to affect both future interest income and expense.

19. At that same meeting, the Board tentatively decided that only future transactions that are highly probable to occur should qualify for designation as part of the asset profile. While highly probable forecast transactions are transactions that are expected to occur with a high degree of probability in specified future periods, firm commitments are binding agreements with specified terms and conditions (ie there is sufficient specificity regarding the timing and amount of cash flows). The combination of forecast transactions and firm commitments that are highly probable to occur are defined as 'future transactions'.

20. In the context of the asset profile, future transactions are generally associated with re-investment of proceeds from maturing financial assets and the expected growth of a portfolio. Similarly, from the perspective of financial liabilities, future transactions are associated with refinancing of maturing financial liabilities and growth. In particular, for the purpose of this paper, refinancing occurs when the original financial liability matures and is replaced with a new financial liability.

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[4] For further information, refer to the December 2017 Agenda Paper 4 *Proposed project plan*.

21. Regarding growth, an increase in the asset profile requires additional funding. This is because an asset profile has to be funded and therefore designation of growth as part of the asset profile implies an increase in the financial liabilities used to determine the target profile. Therefore, the staff believe that allowing these future exposures for designation as part of the target profile is needed to keep consistency with the rationale used to determine the asset profile and to accomplish the DRM accounting model's objective to faithfully represent, in the financial statements, the impact of DRM activities undertaken by an entity.

22. Therefore, consistent with the discussions on the asset profile held at the February 2018 Board meeting, the staff believe that future transactions (ie refinancing and growth) should be allowed for designation as part of the target profile, provided forecast transactions and firm commitments are highly probable and will result in financial liabilities measured at amortised cost. The staff also note that firm commitments are considered to result in highly probable cash flows since they are binding agreements with specified terms and conditions (ie there is sufficient specificity regarding the timing and amount of cash flows from the future transaction).

23. It is important to note that IFRS Standards already provide guidance on how an entity should perform the assessment of the likelihood that a forecast transaction will take place and the staff believe the same guidance should be used in the context of the DRM model. While the details of performance assessment will be discussed at a future Board meeting, an entity's ability to forecast future transactions (ie refinancing and growth) will play a role in performance assessment as future transactions are designated as part of the target profile and affect interest expense.

Preliminary staff view

24. In view of the above reasons, the staff are of the preliminary view that future transactions (ie refinancing and growth) that result in financial liabilities measured at amortised cost should be allowed for designation as part of the target profile. In addition, based on the above discussion, it is the preliminary view of the staff that items would qualify as part of the target profile only if all the following criteria are met:

(a) Financial liabilities must be measured at amortised cost under IFRS 9;

(b) Future transactions (which include forecast transactions and firm commitments) must be highly probable;

(c) Future transactions (which include highly probable forecast transactions and firm comitments) must result in financial liabilities that are classified as subsequently measured at amortised cost under IFRS 9;

(d) Financial liabilities and future transactions (which include highly probable forecast transactions and firm comitments) are not designated in a hedge accounting relationship for interest rate risk; and

(e) Financial liabilities and future transactions (which include highly probable forecast transactions and firm comitments) must be managed on a portfolio basis for interest rate risk.

25. Finally, the staff are of the preliminary view that financial liability designated at fair value through profit or loss should not be eligible for the purpose of determining an entity's target profile. The staff plan to consider potential implications for transition during outreach which is expected to take place after the core areas of the model have been discussed with the Board.

Question for the Board

Question for the Board
1) Does the Board agree with the preliminary staff view in paragraphs 24 and 25?

Core demand deposits

26. As discussed at previous Board meetings, interest expense on some financial liabilities, specifically demand deposits, can be insensitive to changes in market interest rates. In addition, although they can be withdrawn at little or short notice, it is common for some customers to maintain such deposits accounts for an extended period of time. Because of this, financial institutions often identify the

portion of the demand deposit portfolio that is considered to be stable (generally referred to as 'core demand deposits') and treat them differently from the rest of the demand deposit balance for risk management purposes. In particular, given the stable nature of core demand deposits, financial institutions often treat them as perpetual fixed rate financial liabilities, while the residual portion of demand deposits (generally referred to as 'non-core demand deposits') are usually considered for DRM purposes as overnight deposits (ie floating rate financial liabilities).

27. Core demand deposits are contractual fixed rate financial liabilities with a demand feature. However, not all fixed rate financial liabilities with a demand feature are considered core demand deposits from a risk management perspective. As such, the entity's risk management policies and procedures will define when a fixed rate financial liability with a demand feature is a core demand deposit. Non-core demand deposits represent the residual portion of the entity's demand deposit portfolio. The decision to treat deposits as core or non-core can have a significant impact on the entity's target profile and the derivatives required for alignment. This is because the tenor of the target profile is determined based on the entity's risk management strategy when core demand deposits are present. Therefore, the staff have considered if the DRM accounting model should provide qualifying criteria for when deposits can be treated as core.

28. For the purpose of the DRM accounting model, a financial liability, or portfolio of financial liabilities, can be considered as a core demand deposits and its tenor based on the entity's risk management policies and procedures when:

    (a) The financial liability, or portfolio of financial liabilities, has a demand feature (ie contractually repayable on the holder's request); and

    (b) The financial liability, or portfolio of financial liabilities, will not re-price with changes in market interest rates over time.

29. The staff believe this definition is important to help entities avoid treating financial liabilities as core deposits either inappropriately or inadventently. For example, it would be inappropriate for an entity to consider a portfolio of demand deposits contractually linked to the overnight rate as core demand deposits. This is because core demand deposits are treated as fixed rate financial liabilities, while

non-core demand deposits (ie deposits linked to overnight rate) are treated as floating rate financial liabilities for DRM purposes. Treating deposits linked to the overnight rate as core demand deposits would ignore the entity's contractual obligation to re-price these deposits when there is a change in the overnight rate. As a result, the entity would align the asset and target profiles and communicate it has perfectly achieved alignment when that is not the case. The entity has not achieved alignment as the asset profile, transformed with derivatives, will not re-price, but the entity's demand deposits will re-price when there is a change in the overnight rate. The staff believe this definition ensures core demand deposits designated within the DRM accounting model are as described in paragraphs 26 - 28.

30. In practice, there are numerous methods used to determine the core portion of an entity's demand deposit portfolio. While some approaches can be more sophisticated than others, entities often consider assumptions related to customers behaviour and local regulatory requirements in order to estimate the portion of demand deposits considered to be core. Nonetheless, the process for estimating core demand deposits is often documented as part of the entity's risk management policies and procedures, and subject to external and internal review. This is often the case not only to ensure a sound approach when managing interest rate risk, but also to ensure sound liquidity risk management practices.

31. A key driver for the determination of the core element of an entity's demand deposits is the behaviour of its customers. Customer behaviour varies from jurisdiction to jurisdiction. Another key driver is the regulatory environment, which again is jurisdiction specific. Consequently, the staff is of the preliminary view that qualifying criteria focused on the estimation of the core portion of a demand deposit portfolio could be arbitrary and potentially inconsistent with the objective of the DRM model to not govern or restrict risk management, but reflect the impact of risk management activities in financial reporting. Therefore, the staff is not considereing additional qualifying criteria in this regard.

32. However, considering the the aim of the model is to faithfully represent, in the financial statements, the impact of DRM activities undertaken by an entity, the staff believe that the effects of changes to the determination of the core element of demand deposits should be reflected in performance. This will require further

consideration at a future Board meeting as this will be a critical component when discussing performance.

Preliminary staff view

33. The staff are of the preliminary view that the entity’s risk management policies and procedures will ultimately define when fixed rate financial liabilities with a demand feature are treated as core demand deposits within the DRM accounting model. However, core demand deposits must be financial liabilities with a demand feature and must not re-price with changes in market interest rates over time. The staff are also of the preliminary view that qualifying criteria focused on the estimation of the core portion of a demand deposit portfolio could be arbitrary and potentially inconsistent with the objective of the DRM model to not govern, but reflect the impact of risk management activities in financial reporting. Considering the the aim of the model is to faithfully represent, in the financial statements, the impact of DRM activities undertaken by an entity, the staff are of the preliminary view that the effects of when an entity inappropriately treats deposits as core demand deposits should be captured in performance assessment.

Question for the Board

Question for the Board
2) Does the Board agree with the preliminary staff view in paragraph 33?

Designation of financial liabilities and future transactions

34. The DRM accounting model proposes a new type of relationship based on derivatives used to transform a portfolio of financial assets such that they align with a target profile. In this context, the role of designation and de-designation within the DRM model is to define what is subject to performance assessment (ie items comprising the asset profile, derivatives used for the purpose of interest risk management as well as an entity’s target profile).

35. The staff believe that requiring formal designation of items used when determining an entity’s target profile will provide clarity regarding which items are in scope of the DRM accounting model. Furthermore, designation will play a critical role in the context of future transactions. As achieving the target profile is partially dependent upon an entity’s ability to forecast and manage future transactions, the accuracy of the entity’s forecasts will form part of performance assessment. This is applicable to future transactions designated as part of the target profile (ie refinancing and growth). As discussed at the February 2018 Board meeting, designation and documentation are the mechanisms by which an entity will demonstrate sufficient specificity to enable performance assessment in this regard.

36. Consistent with the discussions on the asset profile held at the February 2018 Board meeting, the staff propose that financial liabilities and future transactions used to determine the target profile should be designated on a portfolio basis. Considering DRM is undertaken at a portfolio level, the staff believe that designation on a portfolio basis will simplify the application of the DRM model as this eliminates the need for frequent designation and de-designation on an individual basis. This is also consistent with one of the goals of the DRM accounting model which is to reduce operational complexities associated with the application of the current hedge accounting guidance to dynamic portfolios. In particular, an entity should identify financial liabilities and future transactions that are dynamically managed for interest rate risk as per the entity’s risk management policies and procedures and designate them as portfolios within the DRM accounting model.

37. While a portfolio should be defined consistently with the entity’s risk management policies and procedures, the staff think portfolios of financial liabilities should share similar risk characteristics where that same risk is managed on a collective basis. Financial liabilities with different risk characteristics, such as currency and the portion of deposits considered ‘core’, often require different mitigating actions which implies the nature of the risk is different. As such, the staff believe that, at a minimum, financial liabilities denominated in different currencies should be allocated to separate portfolios and core demand deposits

should be segregated from other liabilities. These requirements are also applicable when an entity defines portfolios of future transactions.

38. Once portfolios are identified and designated as part of the target profile, new financial liabilities become part of the target profile as they are recognised in the statement of financial position in accordance with IFRS 9, subject to meeting the applicable qualifying criteria and designation is consistent with the entity’s risk management policies and procedures. Likewise, financial liabilities are de-designated as they are derecognised under IFRS 9 or meet any of the other de-designation criteria discussed in paragraph 53. If a portfolio of future transactions is designated as part of the target profile, when the future transactions occur and result in a financial liability, the financial liability must be allocated to a designated portfolio of financial liabilities. As time passes, future transactions are de-designated as future transactions occur, while new future transactions are designated as part of the target profile as long as they meet the qualifying criteria and designation is consistent with an entity’s risk management policies and procedures.

39. As portfolios change, an entity will update the target profile accordingly. Such updating would not represent a designation or de-designation event but instead a continuation of the existing relationship. This is consistent with the rebalancing concept in IFRS 9, where such changes are treated as adjustments to the designated quantities of the hedged item or the hedging instrument of an already existing hedging relationship for the purpose of maintaining a hedge ratio that complies with IFRS 9 hedge effectiveness requirements.

40. Further consideration will be required regarding whether designation of financial liabilities and future transactions should be optional or mandatory provided they meet the applicable qualifying criteria. Because this would ultimately result in discussing whether the DRM accounting model should be an accounting policy choice or a required accounting practice, the staff believe this discussion should take place at a future Board meeting, once the complete core version of the DRM model has been discussed with the Board.

Preliminary staff view

41. The staff are of the preliminary view that designation of financial liabilities and future transactions should occur on a portfolio basis. This is consistent with the asset profile designation mechanics agreed at the February 2018 Board meeting, which in turn is consistent with one of the goals of the DRM accounting model to reduce operational complexities associated with the application of the current hedge accounting guidance to dynamic portfolios. The staff believe that designation of financial liabilities on a portfolio basis would allow for a faithful representation of DRM in the financial statements. In particular, this would align the designation mechanics with the way risk management considers interest rate risk.

Question for the Board

Question for the Board
3) Does the Board agree with the staff preliminary view in paragraph 41?

Designation of proportions

42. The staff considered whether the DRM accounting model should permit the designation of a percentage of portfolios of financial liabilities and future transactions used to determine the target profile. Although the scope of DRM is often the entire banking book – and thus designation of 100% of the managed portfolios in the DRM accounting model would be ideal – there could be valid reasons for managing a percentage of a portfolio, as discussed at the February 2018 Board meeting in the context of the asset profile.

43. Given the relationship between existing financial liabilities and future refinancing required to achieve an entity's risk management strategy, this paper discusses designation of proportions of these two portfolios separate from growth portfolios.

Portfolios of financial liabilities and future refinancing

44. Consistent with the discussions on the asset profile held at the February 2018 Board meeting, the staff are of the preliminary view that the DRM accounting model should allow for designation of a percentage of portfolios of financial liabilities and future refinancing used to determine the target profile, provided that:

    (a) The designated percentage is consistently applied to all expected cash flows within the portfolio. This is because designation of different proportions of financial liabilities within the same portfolio would imply the liabilities are managed on an individual instead of a portfolio basis;

    (b) The same percentage of a portfolio of financial liabilities is applied to a related portfolio of future refinancing. For example, assuming an entity designates 50% of a portfolio of financial liabilities and its risk management strategy also requires designation of future transactions due to refinancing of financial liabilities, a percentage other than 50% would not be permitted as it would imply a future change in the scope of risk management; and

    (c) Designation of a percentage of a portfolio is consistent with an entity's risk management strategy. In other words, an entity cannot designate a percentage of a portfolio of financial liabilities or future refinancing that is inconsistent with the entity's risk management policies and procedures.

45. As discussed at the March 2018 Board meeting, the notional amount of portfolios of financial assets designated as part of the asset profile are required to be the same as the notional amount of financial liabilities used to determine the target profile.[5] This implies that the requirements for designation of proportions of portfolios of existing financial assets and financial liabilities should be the same. For this reason, the above requirements applicable in the context of the target

[5] For further information, refer to paragraphs 27–29 of the March 2018 Agenda Paper 4B *Target profile*.

profile are consistent with those applicable to the asset profile and discussed at the February 2018 Board meeting.

46. The requirements outlined in paragraph 45 imply there could be instances where certain financial liabilities are not within the scope of the DRM accounting model. For example, assuming a scenario where an entity has a CU 1,000 portfolio of financial assets measured at amortised cost and a CU 1,000 portfolio of equity instruments (financial assets), both funded by a CU 2,000 portfolio of financial liabilities measured at amortised cost. In this fact pattern, because only the CU 1,000 portfolio of financial assets measured at amortised cost is eligible for the DRM model, the entity could designate 100% of the CU 1,000 portfolio of financial assets at amortised cost as the asset profile and CU 1,000 of the portfolio of financial liabilities. The remaining CU 1,000 of financial liabilities are outside the scope of the DRM accounting model.

47. Finally, a change to a designated percentage can only occur when there is a change in the entity's risk management policies and procedures. As a change in the designated percentage implies a change in the scope of risk management, the staff expect such changes to occur infrequently. This is also consistent with the proposed guidance regarding the asset profile.

Portfolios of growth

48. As discussed at the February 2018 Board meeting, an entity may designate a different percentage of portfolios related to growth as part of the asset profile, provided the qualifying criteria are met and designation is consistent with the entity's risk management strategy.

49. It is important to note that designation of growth as part of the asset profile implies an increase in the notional of the target profile. In other words, for an asset profile to increase in notional, the entity would need additional funding in the same amount. In addition, at the March 2018 Board meeting the Board agreed that the notional amount of the asset profile should be the same as the target profile.

50. As a result, an entity can designate a proportion of growth in the target profile provided the designated percentage is consistent with the risk management

strategy and the designated amount is the same as the amount of growth designated as part of the asset profile.

Preliminary staff view

51. Considering the reasons explored above, the staff are of the preliminary view that the DRM accounting model should allow for designation of a percentage of a portfolio of existing financial liabilities and future refinancing, provided that:

    (a) The designated percentage is consistently applied to all expected cash flows within the portfolio;

    (b) The same percentage of a portfolio of financial liabilities is applied to a related portfolio of future refinancing; and

    (c) Designation of a percentage of a portfolio is consistent with an entity's risk management strategy.

52. Furthermore, an entity can designate a proportion of growth in the target profile provided the designated percentage is consistent with the risk management strategy, and the designated amount is the same as the amount of growth designated as part of the asset profile.

Question for the Board

Question for the Board
4) Does the Board agree with the staff preliminary view in paragraphs 51–52?

De-designation of financial liabilities and future transactions

53. Financial liabilities and future transactions should be de-designated from the target profile when one of the following events take place:

    (a) Financial liabilities are derecognised in accordance with IFRS 9. This is because when a financial liability is derecognised, that financial liability ceases to create interest rate risk exposure; and

(b) Any of the qualifying criteria discussed in paragraph 24 are no longer met.

54. The assessment on whether financial liabilities and future transactions meet the conditions for de-designation should be performed at the transaction level. For example, when a financial liability within the DRM model is derecognised in accordance with IFRS 9, this specific transaction should be removed from the designated portfolio. If all individual transactions within a defined portfolio no longer meet the qualifying criteria, then the entire portfolio would be de-designated from the DRM accounting model.

55. At the February 2018 Board meeting, the Board agreed not to allow voluntary de-designation of portfolios within the asset profile. This was on the same basis for the Board's decision to prohibit a free choice to revoke the designation of a hedging relationship under IFRS 9.[6] Consequently, the staff are of the preliminary view that the DRM model should not allow voluntary de-designation of portfolios within the target profile when the risk management objective for a particular portfolio of financial liabilities remains the same and all other qualifying criteria are still met.

Preliminary staff view

56. The staff are of the preliminary view that financial liabilities and future transactions should be de-designated from the target profile when one of the events noted in paragraph 53 occur. In addition, the staff are of the preliminary view that the DRM model should not allow voluntary de-designation of portfolios within the target profile when the risk management objective for a particular portfolio of financial liabilities remains the same and all other qualifying criteria are still met.

[6] For further information refer to paragraph 6.319 of the Basis for Conclusions of IFRS 9, where the Board noted that voluntary de-designation would allow hedge accounting to be discontinued even if the entity for risk management purposes continued to hedge the exposure in accordance with its risk management objective. The Board also considered that, in such situations, voluntary discontinuation of hedge accounting would be arbitrary and unjustifiable. The Board noted that the risk management objective had not changed and the other qualifying criteria for hedge accounting were still met, the ability to discontinue hedge accounting would undermine the aspect of consistency over time in providing information about that hedging relationship.

Question for the Board

Question for the Board
5) Does the Board agree with the staff preliminary view in paragraph 56?

Documentation requirements

57. The staff believe that formal documentation of items designated within the target profile should be required. In particular, an entity should document the following upon designation:

    (a) The portfolio(s) of financial liabilities and amounts designated under the DRM accounting model. The level of detail of the documentation should provide sufficient specificity such that when new financial liabilities are originated it is clear to which portfolio they should be allocated;

    (b) A description of the methodology and key assumptions used by the entity to estimate the core and non-core portions of its demand deposit portfolio;

    (c) The methodology used by the entity to determine the amount of future transactions and how designation as part of the target profile is consistent with risk management policies and procedures. For example, if the entity designates future transactions related to refinancing and growth, the entity should document the methodology used to forecast the amount considered highly probable and how the designated level of future transactions is consistent with the entity's risk management strategy; and

    (d) Evidence supporting the high probability of future transactions occurring. This is consistent with the documentation requirement applicable to the asset profile when an entity would prepare a cash flow maturity schedule, including the effects of the resetting of interest rates

for financial assets and liabilities, showing that there are sufficient levels of expected cash flows to establish that the future transactions are highly probable to occur. This schedule can be supported by past practice of reinvesting cash inflows and refinancing cash outflows as well as observable data used to estimate the expected growth of a designated portfolio. In addition, the time period during which the portfolio of future transactions is expected to occur should be documented within a reasonably specific and generally narrow range of time from a most probable date, as a basis for assessing performance.

58. The staff believe that documentation provided for the purpose of the DRM accounting should be supported by an entity's risk management procedures and objectives. The staff expect that changes in documentation should be infrequent and consistent with the entity's risk management practices.

Disclosures

59. The DRM accounting model will provide comprehensive disclosures regarding the target profile, the asset profile and the derivatives used for alignment. These disclosures will be discussed in aggregate once the Board have finished discussing the target profile, asset profile, and associated derivatives.