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DRM: Further considerations on the current net open risk position (CNOP) – Issues Paper

Objective

- 1 The objective is to receive comments from EFRAG FR TEG members on IASB Staff paper [4C](#) to the IASB April 2023 meeting (the SP) on the above topic.

Overview of the paper

- 2 The IASB Staff in the SP recommended that the IASB (paragraphs 7 of the SP):
 - (a) requires future transactions that are the **reinvestment or refinancing** of existing financial assets or financial liabilities at the prevailing market interest rate to be included in the CNOP when they are **expected to occur**; and
 - (b) retains the requirement for **all other** future transactions to be **highly probable to occur**.
- 3 In the SP, the IASB Staff summarised the previous discussions and feedback received in paragraphs 8 to 14 and set out the analysis in paragraphs 15 to 34.
- 4 The following table compares the wording in paragraph 33 of the SP, used by the IASB Staff to illustrate the assessment whether future transactions are expected to occur and paragraph F.3.7 of the Implementation Guidance of IAS 39 related to “highly probable” transactions.

To be expected to occur <small>(paragraph 33 of the SP)</small>	To be highly probable to occur <small>(paragraph F.3.7 of the Implementation Guidance of IAS 39)</small>
When assessing whether future transactions that are the reinvestment or refinancing of existing financial assets or financial liabilities are expected to occur [...] an entity could consider information including (but not limited to):	In assessing the likelihood that a transaction will occur, an entity should consider the following circumstances:
(a) the accuracy of past expectations and the length of time until future transaction is expected to occur;	a) the frequency of similar past transactions;
(b) the financial and operational ability of the entity to reinvest or refinance;	b) the financial and operational ability of the entity to carry out the transaction;
(c) future commitments that require financing or future available funding that need to be reinvested;	c) substantial commitments of resources to a particular activity (for example, a manufacturing facility that can be used in the short run only to

	process a particular type of commodity);
(d) the extent of loss or disruption of operations that could result if the reinvestment or refinancing does not occur;	d) the extent of loss or disruption of operations that could result if the transaction does not occur;
(e) the likelihood of using other alternatives to the reinvestment and refinancing; and	e) the likelihood that transactions with substantially different characteristics might be used to achieve the same business purpose (for example, an entity that intends to raise cash may have several ways of doing so, ranging from a short-term bank loan to an offering of ordinary shares); and
(f) the entity's business plan.	f) the entity's business plan.

- 5 All 14 IASB members agreed with the staff recommendations in paragraph 2 above.

EFRAG FIWG discussions

- 6 EFRAG FIWG welcomed the IASB's tentative decision to allow entities to consider in the CNOP future transactions that are the reinvestment or refinancing of existing financial assets and financial liabilities at the prevailing market interest rate when they are expected to occur rather than when they are highly probable to occur.
- 7 In particular, members shared the arguments illustrated by the IASB Staff in the agenda paper and highlighted the following positive elements of the IASB's tentative decision:
- (a) addresses the inconsistency observed between the requirements for future transactions and the allocation of core demand deposits and prepayable assets based on expected cash flows;
 - (b) is consistent with the current risk management practices on how the different categories of future transactions are named and modelled; and
 - (c) reduces concerns related to the IASB's tentative decisions not to allow equity as eligible item in calculating the CNOP.
- 8 One member noted that allowing all future transactions to be included in the CNOP where they are expected to occur (i.e., also including future transaction resulting from expected growth in financial assets or financial liabilities) could have unintended consequences on the current practice about how entities apply cash flows hedging rules to future foreign currency transactions.

EFRAG Secretariat analysis

- 9 The EFRAG Secretariat notes that the IASB Staff's recommendations aim to solve an inconsistency raised by stakeholders between the requirements that future transactions should be highly probable (to be included in the CNOP) and the inclusion of demand deposits and prepayable assets in the DRM model.
- 10 In addition, the EFRAG Secretariat notes that due to the inherently dynamic nature of the model, a strict and rigorous set of rules – needed in the hedge accounting module – would not be in line with the concept of risk management strategy and activity. Therefore, the EFRAG Secretariat considers that the framework of the DRM model should allow for greater flexibility with respect to the hedge accounting requirements.

- 11 Therefore, the EFRAG Secretariat welcomes the IASB Staff' recommendations to allow future transactions that are the reinvestment or refinancing of existing financial assets or financial liabilities to be included in the CNOP when they are expected to occur, rather than when they are highly probable.
- 12 Nevertheless, the EFRAG Secretariat considers that introducing different requirements for different categories of future transactions would create unnecessarily complexities in the model, raising questions on how to distinguish between different future transactions in practice.
- 13 Furthermore, the EFRAG Secretariat considers that allowing **all future transaction** to be included in the CNOP where they are expected to occur would ensure adequate flexibility, without compromising the robustness of the DRM model.

Questions for EFRAG FR TEG

- 14 Does EFRAG FR TEG have any comments on the IASB's tentative decisions to require future transactions that are the reinvestment or refinancing of existing financial assets or financial liabilities at the prevailing market interest rate to be included in the CNOP when they are expected to occur, but retain the requirement for all other future transactions to be highly probable to occur?
- 15 Does EFRAG FR TEG have further comments on the IASB Staff paper and related discussions or the EFRAG Secretariat analysis as set out above?