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Presentation requirements of the DRM model

Issues Paper

Objective

1 The objective of this session is to obtain EFRAG FIWG's views on the June 2024 IASB's tentative decisions related to presentation requirements of the DRM model.

2 The IASB staff's paper can be found here.

IASB staff's analysis and recommendation

3 At its May 2022 meeting, the IASB tentatively decided that the 'DRM adjustment' is recognised in the statement of financial position, representing the extent to which the designated derivatives mitigate (i.e. reduce) the variability in both the fair value of, and the net interest income from an entity's risk mitigation intention. The latter is achieved as the DRM adjustment unwinds over time and is recognised in the statement of profit or loss (the 'unwinding of the DRM adjustment').

4 At its February 2023 meeting, the IASB tentatively decided that any excess of the DRM adjustment over the present value of an entity's current net open risk position ('CNOP'), referred to as a 'capacity assessment', is recognised in the statement of profit or loss in the period of the assessment.

Presentation of the unwinding of the DRM adjustment

5 The IASB tentatively decided in April 2019 that the unwinding of the DRM adjustment will be communicated in a way that makes it clear that it is related to interest income and interest expense; and presented **as a separate line item in the statement of profit or loss**.

6 In the IASB staff's view, presenting the unwinding of the DRM adjustment, **within the 'Net interest income' ('NII') subtotal** in the statement of profit or loss would make it clear that it is related to interest income and interest expense and would present the results of an entity's risk management activities whose key objective is the mitigation of NII variability arising from changes in interest rates.

7 As the DRM model is focused on managing the interest rate sensitivity of NII generated by all the items included in the CNOP, in the IASB staff's view, the unwinding of the DRM adjustment will have to be presented as a net number, i.e. **without allocating it into interest income and interest expense**.

8 The IASB staff observed, with reference to recent outreach events, that separate presentation of the unwinding of the DRM adjustment from the interest income or interest expense would enhance the transparency of the information provided, and enable users of financial statements to better analyse and understand the impact of an entity's risk management activities on its current and future economic resources, e.g. how much an entity relies on using derivatives to stabilise and achieve its current NII.

9 **In the context of the recently published IFRS 18 *Presentation and Disclosure in Financial Statements*,** the IASB staff noted that banks will likely continue to present NII as an additional subtotal (as an equivalent of gross profit) in their statement of profit or loss under the operating category, because doing so would provide a useful structured summary of a bank's income and expenses. At the same time, the nature of interest income or interest expense is different from that of the unwinding of the DRM adjustment. Therefore, in the IASB staff's view, separate presentation of the unwinding of the DRM adjustment on the face of the statement of financial performance would be consistent with **the disaggregation requirements of IFRS 18 and will increase understandability of the financial statement** to the users **as well as their comparability** between different entity and between the reporting periods of the same entity.

10 The IASB staff acknowledges that for the statement of profit or loss to provide a useful structure summary of its income and expenses, there may be cases, in which separate presentation of the unwinding of the DRM adjustment would not be necessary but expects such cases to be rare.

11 Therefore, the IASB staff's recommendation is to require **the unwinding of the DRM adjustment that is recognised during the reporting period to be presented, as a net amount, in a separate line item within the net interest income subtotal in the statement of profit or loss**.

Presentation of the misalignment effects

12 In its April 2019 meeting, the IASB tentatively decided that

(a) the misaligned portion of the designated derivatives will be communicated in a way that makes it clear that it is not related to interest income, interest expense, and the aligned portion; and

(b) the DRM model will not require presentation of the misaligned portion in a separate line item in the statement of profit or loss; but it will be clearly communicated to users of financial statements in the notes to the financial statements. The notes will specify the line item in profit or loss in which the misalignment is presented.

13 Accordingly, in the IASB staff's view, **it would not be appropriate for any misalignment, representing the changes in the fair value of the designated derivative that has not achieved the objective of mitigating repricing risk, to affect an entity's NII. Instead, it would be appropriate to include any such misalignment in the same line item as the fair value gains or losses arising from an entity's other derivative instruments.** This is because the characteristics of the misaligned portion of the designated derivatives are not different from the characteristics of any other derivative instrument in terms of nature, function, measurement and measurement uncertainty. At the same time, nature and source of any misalignment related to the DRM model would have to be communicated to users of financial statements in the notes to the financial statements.

14 In accordance with the IASB's proposals concerning the capacity assessment, its purpose is to ensure that amounts are not recognised as a DRM adjustment in the statement of financial position when the economic benefit in the underlying items is no longer expected to be realised (or have been realised early) due to unexpected changes in the CNOP. Therefore, in the IASB staff's view, the amount recognised in the statement of profit or loss resulting from a capacity shortfall could not be part of an entity's NII. Consequently, its **separate presentation is not necessary for the statement of profit or loss to provide a useful structured summary of the entity's income and expenses** and it would be appropriate for an entity to include this amount in the same line item as the fair value gains or losses arising from an entity's other derivative instruments.

15 Therefore, the IASB staff's recommendation is to require **any misalignment arising during the reporting period to be presented together with the changes in the fair value (fair value gains or losses) of other derivatives**.

Presentation of the DRM adjustment in the statement of financial position

16 As discussed in Agenda Paper 4A of the IASB's May 2022 meeting, **recognising the DRM adjustment in the statement of financial position is a departure from the Conceptual Framework in regard to the definition of an asset or a liability. However, the IASB tentatively agreed that it may be justified in this case** to ensure accounting for the DRM model provides useful information to the users of financial statements about the effectiveness of an entity's dynamic risk management activities and the nature, timing and uncertainties of future cash flows.

17 Furthermore, when the DRM adjustment is recognised in the statement of financial position, users of financial statements would be provided with direct information about how successful designated derivatives are, in mitigating repricing risk and providing the entity with a protection/benefit in the form of reduced variability from both earnings (ie a

stable NII) and economic value (ie protection to the fair value of underlying items in the CNOP) perspectives.

18 Similarly to the presentation of the aligned portion of designated derivatives, **the DRM adjustment will also have to be presented as a net amount (either as an asset or a liability) in the statement of financial position**. However, an entity would be expected to provide a more granular breakdown of the DRM adjustment, for example per each currency DRM model in the notes to the financial statements.

19 Therefore, the IASB staff's recommendation is to require **the DRM adjustment to be presented, as a net amount, in a separate line item in the statement of financial position at the end of the reporting period**.

June 2024 IASB tentative decisions

20 The IASB tentatively decided that an entity be required:

(a) to present the unwinding of the DRM adjustment recognised during the reporting period as a net amount in a separate line item in the statement of profit or loss;

(b) to present any misalignment (between the net gains or losses from designated derivatives and the DRM adjustment) recognised during the reporting period together with the fair value gains or losses from other derivatives; and

(c) to present the DRM adjustment as a net amount in a separate line item in the statement of financial position at the end of the reporting period.

21 All 14 IASB members agreed with these decisions.

22 The following are some of the issues discussed during the meeting:

(a) Some IASB members noted that the requirement to present the unwinding of the DRM adjustment as a separate line within the net interest income subtotal in the statement of profit or loss may be too prescriptive (there may be situations, e.g. consolidated financial statements of holding companies or conglomerates, where the NII subtotal will not be used in providing the useful structured summary as required by IFRS 18). Consequently, **the IASB's tentative decision requires its presentation as a net amount in a separate line item in the statement of profit or loss without explicitly referring to the NII subtotal**.

(b) Some IASB members mentioned that **presenting the amount of misalignment together with the fair value gains or losses from other derivatives** may obscure this important item. The IASB staff emphasised that this issue **will be addressed via**

disclosure requirements so that sufficient information is disclosed in the notes rather than presented on the face of the statement of profit or loss.

(c) Some IASB members noted that 'gross' presentation of the DRM adjustment on the face of the statement of financial performance (i.e., presenting the gross amounts of the DRM adjustment as separate assets and liabilities instead of presenting a single net amount as either an asset or a liability) has its merits, provided that they result from completely unrelated CNOPs. E.g., one IASB member explained that presenting significant gross amounts of the DRM adjustment assets and liabilities (instead of a small net amount) may be indicative of the volume of the related risk management activities. The IASB staff noted that **further information needs, including disaggregation of the DRM adjustment asset/liability, will be addressed via disclosure requirements** and provided an analogy to accounting for hedging reserves (which is presented as a single net amount).

EFRAG Secretariat analysis

23 The EFRAG Secretariat agrees with the IASB's tentative decisions on the presentation requirements of the DRM model:

(a) The EFRAG Secretariat considers that the explicit requirement to present the unwinding of the DRM adjustment recognised during the reporting period as a net amount in a separate line item in the statement of profit or loss, will improve comparability between the financial statements of entities applying the DRM model. At the same time, removing the reference to the NII subtotal from this requirement may be helpful to address cases (which will likely be relatively rare) where such a subtotal will not be included in the useful structured summary. However, where the NII subtotal is included in the useful structured summary, this separate line item should be presented within this subtotal. Therefore, the EFRAG Secretariat highlights the importance of the final wording in the Exposure draft.

(b) The EFRAG Secretariat considers the presentation of the misalignment in the statement of profit or loss together with the fair value gains or losses from other derivatives as a balanced solution, provided that sufficiently disaggregated information is disclosed in the notes to the financial statements. Therefore, the EFRAG Secretariat highlights the importance of the disclosure requirements in this area.

(c) The EFRAG Secretariat also agrees with the IASB's tentative decision to present the DRM adjustment asset/liability as a single net amount on the face of the statement of financial position, rather than presenting separately gross amounts of the related assets and liabilities, provided that sufficiently disaggregated information is disclosed in the notes to the financial statements. Therefore, the EFRAG Secretariat highlights the importance of the disclosure requirements in this area.

Questions for EFRAG FIWG

24 Does EFRAG FIWG agree with the IASB's tentative decisions in paragraph 20 above?

25 What are your views on the above-mentioned presentation requirements of the DRM model?