EFRAG Financial reporting

EFRAG Secretariat: Sapna Heeralall, Sergey Vinogradov, Didrik Thrane-Nielsen

Optional application of the DRM model

Issues Paper

Objective

1 The objective of this session is to obtain EFRAG FIWG's views on the July 2024 IASB's tentative decision relating to an optional application of the DRM model.

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

IASB staff's analysis and recommendation

3 The IASB, in July 2019, had tentatively decided that the application of the DRM model would be optional. At that time, the IASB considered that application of the hedge accounting requirements in IAS 39 and IFRS 9 are exceptions to the normal recognition and measurement requirements in IFRS Accounting Standards. An entity is permitted to apply these exceptions if, and only if, all the qualifying criteria are met.

4 The IASB staff recommended that the application of the DRM model remains optional for the following reasons:

(a) In order for the application of the DRM model to be mandatory, the IASB would have to define and prescribe the exact dynamic risk management strategies and activities that would lead to the application of the DRM model. This would be difficult because of the diversity in the risk management strategies and activities in practice, and would be inconsistent with the objectives of a principle based approach;

(b) Some entities might choose to accept the accounting volatility that arises from their interest rate risk exposure in full, or they might consider alternatives to the DRM model (or to other hedge accounting approaches under IFRS 9) that could achieve a similar outcome. For example, designating the underlying exposures at fair value through profit or loss to reduce the accounting mismatch arising from measuring the financial instruments used for risk management at fair value through profit or loss;

(c) It is important to maintain a consistent approach between the application of the DRM model and the general hedge accounting requirements in IAS 39 and IFRS 9. The hedge accounting requirements in IAS 39 and IFRS 9 is an exception and is only permitted to be applied subject to robust safeguards;

(d) It is difficult to justify mandating the application of the DRM model for interest rate repricing risk whilst not mandating he application of a particular risk mitigation model (for accounting purposes) to other risks that might be equally significant to an entity's business activities;

(e) The DRM model could be very costly due to the complexity of the model and modelling and risk management systems;

(f) Mandating application on the DRM model would not enhance comparability between entities due to entity specific risk management strategy, level of risk appetite and risk tolerance, internal risk and cashflow models and processes.

5 The IASB staff indicated that the following may enhance comparability:

(a) The DRM adjustment and its unwinding which are both required to be presented in separate line items in the primary financial statements; and

(b) The IASB staff might further explore whether the users of financial statements would also benefit from the disclosure of an entity's interest rate risk management strategy and how it applies this strategy to manage its interest rate risk, in cases when the entity does not apply the DRM model. This may help with comparability and understandability of the different interest rate risk management activities.

July 2024 IASB tentative decision

6 The IASB tentatively decided to make applying the DRM model optional for entities with applicable risk management activities.

7 Thirteen of 14 IASB members agreed with this decision.

EFRAG Secretariat analysis

8 In previous meetings, both EFRAG FR TEG and EFRAG FIWG had concerns that the DRM model would be mandatorily applied for reasons included in paragraphs 4 above.

9 Therefore, the EFRAG Secretariat agrees with the IASB's tentative decision to make application of the DRM model optional.

10 The EFRAG Secretariat agrees that comparability between entities may be affected since some entities will apply the DRM model and some not. However, the EFRAG Secretariat is of the view that additional disclosures as suggested in paragraph 5(b) would help with comparability.

Questions for EFRAG FIWG

11 Does EFRAG FIWG agree with the IASB's tentative decision in paragraph 6 above?

12	What are your views on whether, to foster comparability, there should be additional disclosures of an entity's interest rate risk management strategy and how it applies this strategy to manage its interest rate risk, in cases when the entity does not apply the DRM model?