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Draft Comment Letter

You can submit your comments on EFRAG's draft comment letter by using the 'Express your views' page on [EFRAG's website](#), then open the relevant news item and click on the comment publication link at the end of the news item.

Comments should be submitted by 22 June 2026.

International Accounting Standards Board

7 Westferry Circus, Canary Wharf

London E14 4HD

United Kingdom

[XX Month 2026]

Dear Mr Barckow,

Re: Exposure draft: Risk Mitigation Accounting - Proposed amendments to IFRS 9 and IFRS 7

On behalf of EFRAG, I am writing to comment on the exposure draft *Risk Mitigation Accounting*, proposed amendments to IFRS 9 and IFRS 7, issued by the IASB on 3 December 2025 (the 'ED').

This letter is intended to contribute to the IASB's due process and does not necessarily indicate the conclusions that would be reached by EFRAG in its capacity as advisor to the European Commission on endorsement of definitive IFRS Accounting Standards in the European Union and European Economic Area.

The below messages are subject to the field test results and also results from EFRAG's second survey on the risk mitigation accounting model which will also inform on the operational implications of the model.

Objective of risk mitigation accounting

A key objective of the ED is to faithfully represent the economic effect of an entity's interest rate risk management activities in the financial statements. This is because of challenges faced by entities to achieve this currently and this would improve current accounting, for example, by reducing the extent of using proxy hedging. The viability of the model depends on how close risk management is to risk mitigation accounting - the more closely aligned, the better the model may be expected to work.

However, some stakeholders question whether this objective should prevail over eliminating the accounting mismatches, especially those that arise in profit or loss when financial assets and financial liabilities are measured at amortised cost and the derivatives used to manage the repricing risk are measured at fair value through profit or loss.

Without having an EFRAG view at this stage, we see advantages in considering both a faithful representation to reflect an entity's risk management activities and eliminating accounting mismatches to be equal objectives of risk mitigation accounting.

Underlying portfolios

EFRAG agrees with the proposed financial instruments to be included in the underlying portfolios. Nevertheless, EFRAG notes that, conceptually, including financial assets measured at fair value through other comprehensive income in the underlying portfolios will, through the risk mitigation adjustment, cause inflated recognitions of the interest rate component of the fair value gains or losses.

Furthermore, EFRAG acknowledges the conceptual reasons for not including equity in the underlying portfolios and acknowledges that equity can be used as a proxy to determine which variable-rate financial assets to be included in the underlying portfolios. Therefore, applying this proxy, equity instruments, including Additional Tier 1 instruments, can be reflected in the underlying portfolios by identifying the financial assets subject to repricing risk that is backed by these instruments. Since equity, per se, cannot be included in the underlying portfolios, EFRAG stresses the importance of having this proxy.

In addition, if the primary objective is for an entity to faithfully reflect its repricing risk management activities, EFRAG questions why certain financial instruments would be excluded to be eligible, for e.g., financial assets measured at fair value through profit or loss, as entities manage these instruments as part of their risk management strategy.

Risk mitigation adjustment excess test

We note that significant uncertainties exist as to how the risk mitigation adjustment excess test should be performed in practice including which indicators should be used. Additional guidance on the issue would be very useful.

Effective date and withdrawal of IAS 39

EFRAG notes mixed views of the constituents on the effective date of the risk mitigation accounting model and the date when IAS 39 should be withdrawn. We agree that the transition period should be rather long. However, differing opinions exist as to which level of flexibility of timing should be allowed at transition from IAS 39 to the risk mitigation accounting model.

Risk management strategy for entities that apply IFRS 17 Insurance Contracts

EFRAG welcomes that the IASB is seeking feedback on the risk management strategy of entities that issue insurance contracts as per IFRS 17. EFRAG highlights the importance in obtaining an accounting solution that better reflects these entities' dynamic interest rate risk management in their financial statements compared to current accounting. We have provided, in the Appendix, information on current risk management strategy and activities, significant issues currently faced and insurance aspects to consider for the risk mitigation accounting model. As insurers significantly measure their financial assets at fair value through other comprehensive income, the issue on inflated accounting, explained above, is expected to be substantial.

EFRAG's detailed comments and responses to the questions in the ED are set out in the Appendix.

If you would like to discuss our comments further, please do not hesitate to contact Serge Vinogradov, Didrik Thrane-Nielsen or me.

Yours sincerely,

Wolf Klinz

Chair of EFRAG FRB

Appendix - EFRAG's responses to the questions raised in the ED

Notes to constituents – IAS 39 carve-out

- 1 EFRAG notes that the EU IAS 39 carve-out is widely used by European banks and therefore represents the current practical benchmark for many preparers.
- 2 “On 19 November 2004, the Commission adopted a Commission Regulation endorsing IAS 39 Financial Instruments: Recognition and Measurement, with the exception of certain provisions on the use of the full fair value option and on hedge accounting...”¹
- 3 “According to the EC, the carve out of certain hedging accounting provisions reflects criticism by many European banks that the current version of IAS 39 poses a major problem for operating their risk management practises. According to these banks, the limitation of hedges to either cash flow hedges or fair value hedges and the strict requirements on the effectiveness of those hedges, prevent the continuation of risk management techniques, such as hedging a portfolio of core deposits, which are currently accepted by banking supervisors. Many European banks argue that IAS 39 in its current form would force them to carry out disproportionate and costly changes both to their asset/liability management and to their accounting systems and that it produces unwarranted volatility.”²
- 4 The carve-out affects the following paragraphs in IAS 39 Financial Instruments: Recognition and Measurement: 81A, AG99C, AG99D, AG107A, AG114, AG118, AG119, AG121, AG122, AG124, AG126, AG127, AG129 and AG130.

Question 1—Objective and scope of risk mitigation accounting (Section 7.1)

Notes to constituents – Summary of proposals in the ED

- 5 Currently, when applying the hedge accounting requirements in IFRS 9 and or IAS 39, it is difficult to account for dynamic risk management. There are practical challenges in aligning the accounting requirements with the way companies manage repricing risk³. These

¹ Source: [https://europa.eu/rapid/press-release MEMO-04-265_en.htm?locale=en](https://europa.eu/rapid/press-release_MEMO-04-265_en.htm?locale=en)

² Same source as footnote 1

³ For the purpose of this Standard, repricing risk is a type of interest rate risk that exposes a company to variability in the cash flows from, and fair value of, financial instruments, arising from differences in:

- the timing of when financial instruments reprice to benchmark interest rates; and
- the amount of financial instruments that reprice in a particular period.

challenges make it difficult to faithfully reflect the effects of dynamic risk management activities in the financial statements.

- 6 The IASB proposes that the scope of risk mitigation accounting would be determined based on a company's business activities and risk management activities, instead of the industry in which the company operates.*
- 7 A company is permitted to apply risk mitigation accounting only if:
 - (a) its business activities give rise to **repricing risk**;*
 - (b) its risk management strategy specifies **risk limits** within which repricing risk is to be mitigated, based on a **mitigated rate**; and*
 - (c) it mitigates repricing risk arising from underlying portfolios **on a net basis** using **derivatives** in accordance with its risk management strategy.**
- 8 The IASB proposes that companies would be permitted, but not required, to apply risk mitigation accounting. This flexibility is similar to that provided under the hedge accounting requirements in IFRS 9.*
- 9 The IASB believes that these proposals will enable a company to better align the amounts recognised in its financial statements with the effects of its risk management activities.*
- 10 The IASB also proposes that risk mitigation accounting be applied at the level at which the company mitigates the repricing risk arising from underlying portfolios in accordance with its risk management strategy.*

Question 1—Objective and scope of risk mitigation accounting (Section 7.1)

The IASB proposes that:

(a) the objective of risk mitigation accounting be for financial statements to represent the economic effect of an entity's risk management activities if the entity manages repricing risk on a net basis.

(b) risk mitigation accounting be applied on a voluntary basis. However, an entity would be permitted to apply risk mitigation accounting if, and only if, the entity mitigates repricing risk on a net basis and the entity's business and risk management activities have the characteristics specified in paragraph 7.1.4.

(c) an entity be required to document formally how it will apply risk mitigation accounting.

Paragraphs BC11–BC37 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree with any of these proposals, please explain what you would suggest instead and why.

EFRAG's response

11 EFRAG notes that having a clear primary objective or a hierarchy of objectives is important for the selection of consistent requirements for the risk mitigation accounting (RMA) model and the subsequent consistent application of the requirements. At the same time, none of the possible objectives may be achievable in full⁴, i.e. without a departure from the stated objective or some degree of compromise. In this case, the extent of this departure becomes an important factor to judge whether the objective has been achieved. Also, the objectives may be complementary rather than contradicting one another.

⁴ E.g. risk management is forward-looking only and considers possible and expected exposures indifferent to how these are recognised or measured in the financial statements. Accounting is more backward-looking; it relates to existing recognised values in addition to value changes and must relate to recognition criteria and different measurement criteria. Risk management is often agnostic to the direction of exposures while RMA only intends to account for reductions in exposures. With these differences, it is not possible for financial statements to (fully or unadjusted) represent the economic effect of an entity's risk management activities. Full elimination of accounting mismatches will not be possible in a mixed measurement accounting model.

- 12 EFRAG agrees with the statement in paragraph IN3 of the ED that entities have long faced challenges in faithfully representing the economic effect of dynamic and complex risk management activities in financial statements in a way that provides useful information to users of financial statements. This was confirmed by the participants of our recent survey [Current practices in dynamic interest rate risk management](#).
- 13 Therefore, representing the economic effect of an entity's interest rate risk management activities in the financial statements and a close alignment between the actual interest rate risk management practices and their reflection in the financial statements is a key objective of the model proposed in the ED. We note that this may improve the situation under the current accounting framework, for instance by reducing the magnitude of proxy hedging.
- 14 However, some stakeholders challenge whether this objective should clearly prevail over eliminating the accounting mismatches, notably those that arise in profit or loss when financial assets and financial liabilities are measured at amortised cost and the derivatives used to manage the repricing risk are measured at fair value through profit or loss. Even though the primary objective of the ED is to faithfully reflect an entity's risk management activities, it also addresses accounting mismatches, for example, including financial assets and financial liabilities measured at amortised cost in RMA to avoid accounting mismatches in profit or loss (paragraph BC40 of the ED) or scoping out financial instruments measured at fair value through profit or loss as there is no accounting mismatch in profit or loss (paragraph BC48 of the ED) when using derivatives.
- 15 Therefore, some stakeholders including insurers, see merit, as formulated in paragraph BC12 of the ED, that it may be worth considering eliminating the accounting mismatches as an equally important objective of risk mitigation accounting. We also emphasise the importance of avoiding creating potential accounting mismatches by the risk mitigation model itself (e.g., please refer to the issue of inflated recognitions of gains or losses in response to Question 2 and 11).
- 16 In addition, EFRAG notes that the RMA model as described in the ED, due to its described scope and regulations may not represent the exact way in which entities perform their interest rate risk management activities but rather influence how these are conducted which may contradict the stated primary objective of reflecting economic effect of an entity's risk management activities in the financial statements. For instance, for many respondents to the EFRAG survey, interest-bearing financial instruments measured at fair value through profit or loss are an integral part of their actual interest rate risk management activities whilst these financial instruments are not eligible to be included in

the underlying portfolios in accordance with paragraph 7.2.1 of the ED (please refer to Question 2 for more details).

- 17 EFRAG notes that when the RMA model only partially reflects the interest rate risk management activities of an entity in some dimensions (e.g. scope), then the technical validity of requiring alignment with the risk management strategy of the entity in other dimensions (e.g. risk limits) may be questioned.
- 18 We agree that the application of the RMA model should be voluntary. However, we note that entities whose business and risk management activities have the characteristics specified in the proposed paragraph 7.1.4 of IFRS 9 but that choose not to apply the RMA model will have to present additional disclosures even if they do not apply the model. This will be expected to imply additional costs to those entities. Therefore, it is important that those required disclosures create sufficient additional benefits for users and are targeted to those entities where that is expected to be the case.
- 19 As for the eligibility criteria to apply the RMA model as outlined in paragraph 7.1.4 of the ED, we note that:
 - (a) The first criterion (paragraph 7.1.4(a) of the ED) is formulated in a very broad way. A very large number of entities have business activities that give rise to recognition and derecognition of financial instruments that expose them to repricing risk. As a result, this criterion may possibly catch a significant number of entities.
 - (b) The second criterion (paragraph 7.1.4 (b) of the ED) also appears to be formulated in a wide manner that may be expected to include most entities that conduct interest rate risk management. Thus, a very large number of entities could potentially be eligible according to criterion (a) and (b) in paragraph 7.1.4 of the ED. However, EFRAG observes that a strict reading of the requirements for specification of risk limits could conversely exclude entities that only apply one overall risk limit per mitigated rate as opposed to several 'limits' that paragraph 7.1.4(b) of the ED seems to require. EFRAG therefore asks the IASB to clarify the drafting of this eligibility criterion.
 - (c) Assuming that 'net basis' in the third criterion (paragraph 7.1.4(c) of the ED) means the net of financial assets and liabilities, the RMA model could become inapplicable by entities which apply dynamic risk management on a gross basis, e.g. by calculating the effect arising from portfolios of financial assets only without the netting effect of portfolios of financial liabilities. We note that at least some banks perform interest

rate risk management on a gross basis, at least partially, even if the ultimate result is risk management on a net basis. It should be further analysed whether the existing alternatives (e.g., hedge accounting under IFRS 9) could be sufficient to address the needs of those entities, notably those which currently apply the IAS 39 EU carve-out.

- (d) The third criterion makes a reference to (i) underlying portfolios (as defined in the ED) (ii) a net basis and (iii) using derivatives in accordance with its risk management strategy. Given that these are terms and requirements of the ED, the population of entities that will fulfil these requirements without applying RMA may be very limited. If this understanding were confirmed, the application of criterion 7.1.4(c) of the ED could partially offset the wider scope resulting from the application of the two first criteria, while questioning the practical relevance of the proposed paragraph 33A to IFRS 7.
- (e) EFRAG notes that the three criteria would have to be assessed together to determine whether an entity is eligible to apply RMA and is required to provide disclosures specified in IFRS 7.
- (f) We note that none of the three criteria in paragraph 7.1.4 of the ED refers to the dynamic nature of the risk management as a requirement to apply RMA. Therefore, it may be worth adapting the text of paragraph 7.1.4 of the ED to explicitly include this key characteristic. If this is not included, there may be a risk that entities that do manage interest rate risk but not on a dynamic basis may be scoped in and if they choose not to apply RMA, they would be obliged to provide disclosures as proposed in paragraph 33A of the ED. EFRAG supports that entities that manage their interest rate risk on a dynamic basis should be scoped in.

20 We agree that formal documentation should be a mandatory requirement for applying the RMA model. However, guidance on the extent of formal documentation needed for the consolidated financial statements would be useful in cases where actual risk accounting is largely performed at the subsidiary level.

21 Given the dynamic nature of RMA, we see a significant risk that the documentation of some of the elements in paragraph 7.1.7 of the ED may become boilerplate repetition of the Standard requirements. An example of this may be the requirement (in paragraph 7.1.7(c) of the ED) to explain how the entity specifies the risk mitigation objective (RMO) for which there seems to be little expected variation in practice when the entity has already (in

paragraph 7.1.7(b) of the ED) explained how it determines the net repricing risk exposure (NRRE) and (in paragraph 7.1.7(d⁵) of the ED) how it identifies the designated derivatives.

- 22 In paragraph 7.1.3 of the ED, it is stated that the objective of RMA is for financial statements to represent the economic effect of an entity's risk management activities if the entity manages repricing risk on a net basis. We understand that the reference to an entity's risk management activities is to be a reference to an entity's interest rate risk management activities.

Questions to Constituents

- 23 What are your views on the objective of the ED given that the ED states that its primary objective is to faithfully reflect an entity's risk management activities in its financial statements to the extent possible and also given the view from some stakeholders in paragraph 15 above that eliminating the accounting mismatches should be an equally important objective of risk mitigation accounting?
- 24 If your entity performs management of interest rate risk on a gross basis and IAS 39 is withdrawn as described in the ED, which accounting treatment will you apply? Will such a solution be sufficient for your entity? Please explain.

Question 2—Underlying portfolios (paragraphs 7.2.1–7.2.4)

Notes to constituents – Summary of proposals in the ED

- 25 *Currently, challenges that arise when applying hedge accounting relate to restrictions on items that are eligible to be designated as hedged items for repricing risk, such as:*
- (a) *Liabilities that are repayable on demand, e.g., customer deposits, not qualifying as hedged items as there is no currently recognised variability in cash flows or fair value attributable to changes in market interest rates, when assessed as individual instruments.*
 - (b) *Some future transactions that are not eligible unless it is highly probable that the individual transaction will take place/occur.*

⁵ The order of paragraph 7.1.7(c) and (d) deviates from the order of paragraphs describing RMO and designated derivatives later in the Standard.

- (c) *A company's own equity not being designated as hedged items because from an accounting perspective, equity is not exposed to interest rate variability and does not impact profit or loss.*
- 26 *Challenges also arise when financial instruments expose a company to other risks together with repricing risk, for example, exposure to both foreign exchange and repricing risk.*
- 27 *The IASB proposes that the following financial instruments be eligible for inclusion in the risk mitigation accounting model:*
- (a) *financial assets measured at amortised cost or fair value through other comprehensive income;*
- (b) *financial liabilities measured at amortised cost including financial liabilities repayable on demand, e.g., customer deposits;*
- (c) *future transactions that may result in the recognition or derecognition of financial instruments of either of the two types listed in (a) and (b) above.*
- 28 *As per paragraph BC49-50 of the ED, equity instruments are not eligible for inclusion in underlying portfolios. However, exposures to repricing risk arising from variable-rate⁶ financial assets where the entity may use internal modelling methodologies (such as replicating portfolios) as a proxy for this exposure.*
- 29 *In addition, if financial instruments in the underlying portfolios expose a company to other risks apart from repricing risk, a hedged exposure that affects the company's repricing risk would be eligible for inclusion in the underlying portfolios. For example, foreign currency risk could be hedged into the underlying portfolios together with repricing risk.*

Question 2 — Underlying portfolios (paragraphs 7.2.1–7.2.4)

The IASB proposes that risk mitigation accounting be applied based on underlying portfolios—that is, portfolios of financial instruments that expose an entity to repricing risk. The IASB proposes that financial instruments be eligible for inclusion in underlying portfolios only if they are:

⁶ EFRAG understands that it is not limited to variable-rate financial assets and it also applies to fixed rate financial assets.

- (a) financial assets classified as subsequently measured at amortised cost or fair value through other comprehensive income (in accordance with paragraphs 4.1.2 or 4.1.2A of IFRS 9 Financial Instruments);
- (b) financial liabilities classified as subsequently measured at amortised cost (in accordance with paragraph 4.2.1 of IFRS 9); or
- (c) future transactions that could result in the recognition or derecognition of financial instruments specified in (a) or (b).

The IASB is also proposing that an entity apply risk mitigation accounting only to its exposure to repricing risk that is not otherwise mitigated. However, if a financial instrument is designated as a hedged item for a risk other than repricing risk, the hedged exposure would be eligible for inclusion in underlying portfolios.

Paragraphs BC38–BC63 of the Basis for Conclusions explain the IASB’s rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree with any of these proposals, please explain what you would suggest instead and why.

EFRAG’s response

- 30 In paragraph 7.1.1 of the ED, it is stated that to manage repricing risk on a net basis, an entity calculates the aggregated effect of repricing differences arising from financial assets, financial liabilities and future transactions with fixed and variable interest rates. EFRAG agrees with this statement, noting that not all financial assets and financial liabilities, are within the scope of IFRS 9 e.g. insurance liabilities are not and not all financial assets and financial liabilities within the scope of IFRS 9 are in the scope of the RMA model, e.g., financial assets measured at fair value through profit or loss (‘FVTPL’).
- 31 If the scope of items included to calculate a net position in an entity’s interest risk management differs from the scope of items included to calculate the NRRE in the RMA model, then this has several consequences, including:
- (a) The risk limits specified or derived from an entity’s risk management strategy may not be equal to those limits that the entity would have used if the entity were to conduct interest rate risk management on a net basis for the items in the scope of the RMA model. The relevance of using these risk limits in the RMA model may be questioned.

- (b) The net position(s) actually managed may not be equal to the NRRE applied in the RMA model.
 - (c) The derivatives used in an entity's actual interest risk management of net position(s) may not be equal to those derivatives the entity would have used if it were to interest risk manage the NRRE caused by items in the scope of the RMA model. The relevance of designating derivatives in the RMA model based on the derivatives used in an entity's actual interest risk management may be questioned.
 - (d) The relevance of the lower of tests, used to identify the RMO (see paragraph 7.4.1 of the ED) and risk mitigation adjustment (see paragraph 7.4.8 of the ED) may be questioned.
- 32 In EFRAG's survey [Current practices in dynamic interest rate risk management](#), bank respondents stated, either explicitly or implicitly, that they currently include all items sensitive to interest rate risk / all interest-bearing items in their interest rate risk managed position, be it at a fixed or floating rate. These items are derivatives, demand deposits, certain equity instruments, some off-balance sheet items (e.g., guarantees, undrawn credit commitments) and lease receivables or lease liabilities.
- 33 In light of the findings in the EFRAG survey and consistent with the primary objective of RMA as stated in paragraph BC13 of the ED, i.e., to faithfully reflect an entity's [repricing] risk management activities in its financial statements to the extent possible, EFRAG agrees with the proposed items to be included in the underlying portfolios, however has issues with the requirement 'only if they are' in paragraph 7.2.1 of the ED. Refer to our response to ED Q1 for further comments regarding the objective of RMA.
- 34 EFRAG notes that not all NRREs are eligible and questions why certain financial instruments would be excluded from the underlying portfolios, if they are included in an entity's risk management strategy, consistent with the ED objective. For example, the following are not eligible:
- (a) *Financial assets measured at FVTPL*. Exposure to repricing risk and the way entities manage this repricing risk is not dependent on the measurement attribute of the item.
 - (b) *Lease receivables and lease liabilities*. These positions are exposed to interest rate risk and based on the survey responses in paragraph 32 above are included in the interest rate risk managed positions of a number of banks.

(c) *Deferred taxes.* Some have pointed out that deferred taxes have exposure to interest rate risk and are used by banks to fund financial assets.

35 In addition, EFRAG considers that insurance liabilities should be included in the underlying portfolios. Refer to our response in ED Q11.

36 When items of an entity that are exposed to repricing risk are excluded from the underlying portfolios, there is no given certainty that the net exposure from the then resulting underlying portfolios is a true, or directionally correct, depiction of the net exposure of the entity or the sub-unit within the entity to which RMA is applied.

37 Furthermore, EFRAG asks for clarity on whether all financial instruments that are eligible (if it is not otherwise mitigated) should be included in the underlying portfolios or can an entity decide which financial instruments to be included. If it is the latter, EFRAG asks whether there may be any unintended consequences.

38 Also, in principle, EFRAG does agree that an entity shall apply RMA only to its exposure to repricing risk that is not otherwise mitigated. However, given the requirements in paragraph 6.4.1 of IFRS 9, the requirements in paragraph 7.1.7(a) and (b) of the ED, and the overlay nature of the RMA model, EFRAG questions the need for the introduction of this rule.

Equity instruments

39 EFRAG acknowledges the conceptual underpinnings of not being able to include equity in the model. The ED proposes that equity can be used as a proxy to determine which variable-rate financial assets to be included in the underlying portfolios. EFRAG understands that an entity would start with their internal modelling methodologies and then would identify the financial assets subject to repricing risk (be it variable-rate or fixed rate) that back the equity instruments. These financial assets would then be included in the NRRE.

40 Based on EFRAG's survey *Current practices in dynamic interest rate risk management*, 72% of respondents replied that they do include equity instruments in their interest rate risk management practices. Therefore, some stakeholders are of the view that equity as a whole should be eligible to be included in the underlying portfolios.

41 Although IFRS currently does not sub-divide equity, and at this point in time, EFRAG does not propose such a sub-division, there may be a conceptual difference between equity instruments that represent a claim on the residual net assets of an entity and equity instruments that do not but are defined as equity because the entity may defer payments indefinitely or settle in a variable number of equity instruments. In interest rate risk

management, the first group of equity instruments may be considered to finance certain groups of fixed or floating interest rate financial assets and thus get an imputed interest cost that is being managed, while the second group of equity instruments, which include Additional Tier 1 ('AT1') instruments, will typically have a contractually expected cash flow that is being managed as financial liabilities for interest rate risk management purposes.

42 Currently some entities recognise AT1 instruments as financial liabilities but depending on the IASB's Financial Instruments with Characteristics of Equity ('FICE') project, they may have to recognise them as equity instruments. These entities consider it important to include AT1 instruments in the underlying portfolio in order to align with their risk management practices. This is because, for risk management purposes, entities include them as these instruments are sensitive to interest rate risk (for example, if an entity does not pay a coupon on an AT1 instrument, this has an impact on its refinancing cost, among other effects). Many of these instruments behave like fixed interest rate cash flow liabilities. In addition, it is noted that these instruments are considered as interest rate sensitive in regulatory reporting. EFRAG notes that, in applying the proxy as explained in paragraph 39 above, AT1 instruments can be reflected in the underlying portfolios by identifying the financial assets that back these instruments.

43 Having said this, entities may not have sufficient relevant exposure in financial assets to create a solution by including financial assets from the underlying portfolios for AT1 instruments.

44 Similar to banks with AT1 instruments, entities that issue insurance contracts as per IFRS 17 also have Tier 1 instruments that may be subordinated notes and are recognised as equity.

45 Field testing is needed to determine the operationality and the boundaries for the use of proxy hedging in the RMA model (e.g. application of modelling equity for the repricing risk).

Financial assets measured at fair value through other comprehensive income ('FVOCI')

46 Conceptually, including financial assets or financial liabilities that are remeasured for changes in (fair) values caused by changes in the mitigated rate in the underlying portfolios will, through the risk mitigation adjustment, cause inflated recognitions of the interest rate component of the fair value gains or losses. Further modelling and assessments of results from field testing may be needed before concluding on the severity of this feature of the proposed RMA model.

- 47 This may be seen as a concern for both banks and insurers. For insurance specific comments – refer to the response in ED Q11. For banks, the risk mitigation adjustment as an asset could increase an entity’s capital requirements and could be expensive.

Points for clarification

- 48 Paragraph 7.1.6 of the ED states that an entity should apply RMA at the level at which the entity mitigates the repricing risk arising from underlying portfolios in accordance with its risk management strategy. Some stakeholders have asked for clarification on whether the RMA model can be applied at the consolidated level, rather than on sub-level basis, e.g. subsidiary level, as the reporting entity allocates the risk limits to the lower levels. Also, the subsidiary level underlying portfolios could have internal derivatives, and externalisation of these derivatives would be done at consolidated level.

- (a) If the group manages repricing risk as the sum of already-hedged positions of each subsidiary, there needs to be clear processes and controls to show that each subsidiary’s RMA position is effectively closed with market derivatives at group level, and intragroup derivatives often include mark-ups that could create noise in the model effectiveness.
- (b) If the group manages repricing risk by netting positions from several subsidiaries and hedging the group-wide net gap, the implementation effort is heavier. Local RMA or hedge models would effectively have to be replaced by a single consolidated RMA model, built on group-level data. This requires significant systems, data and governance work to produce one NRRE that meets the ED’s requirements. Also, there would need to be a robust, auditable mechanism to allocate the cost of the external hedge – and any ineffectiveness – back to each subsidiary whose position is included in that net exposure.

- 49 Furthermore, EFRAG has the following comments regarding future transactions:

- (a) Further clarity on the distinction or criteria in the ED between determining expected occurrence or highly probable occurrence for these future transactions would be useful, e.g. why there is a highly probably criteria in some cases and not in others and in this regard, in the Basis for Conclusions, there seems to be a distinction between fixed rate commitments versus variable rate commitments.
- (b) Non-alignment with IFRS 9 hedge accounting whereby forecast transactions must be highly probable. Alignment should be sought with an entity’s risk management practice which is not confined by a highly probable criterion.

(c) See also our comment on probabilities in determining NRRE in Question 3.

50 EFRAG notes that, in the RMA model, the underlying portfolios do not have a purpose per se except, as an intermediate step to identify NRRE per repricing time band. Issues related to determining duration of repricing time band and scope of positions included or excluded from underlying portfolios are thus interrelated with issues of determining NRRE (covered in response to Question 3 below).

Questions to Constituents

- 51 Do you consider that there are other exposures to net repricing risk, that are not proposed in the ED, which should be eligible, e.g. refer to paragraphs 34 - 35 above. If so, please explain why.
- 52 Referring to paragraphs 39 to 45, do you consider that the proxy proposal in the ED sufficiently addresses your concerns on equity instruments? Please explain why or why not.
- 53 What are your views on the issue relating to the inflated accounting for financial assets measured at fair value through other comprehensive income in paragraphs 46 - 47 above?
- 54 Do you agree with the points for clarification described in paragraphs 48 and 49? Please explain why or why not.

Question 3—Determining the net repricing risk exposure (paragraphs 7.2.5–7.2.10)

Notes to constituents – Summary of proposals in the ED

- 55 *When entities manage repricing risk on a net basis, they treat the repricing risk arising from different underlying portfolios as interchangeable for risk management purposes and do not distinguish between the sources of such risk in deciding their risk management activities.*
- 56 *The IASB proposes that an entity shall determine the repricing risk exposure by aggregating the repricing risk from the underlying portfolios using repricing time bands based on the expected repricing date.*
- 57 *The number and the length of repricing time bands over the mitigated time horizon are required to be consistent with the time bands an entity uses for risk management purposes.*

- 58 *The expected repricing date is the earlier of the dates on which financial instruments included in the underlying portfolios are expected to be settled or to reprice.*
- 59 *The net repricing risk exposure represents the exposure to repricing risk arising from the underlying portfolios before an entity undertakes any risk management activities.*
- 60 *The entity determines the net repricing risk exposure by aggregating the effects of all financial instruments in the underlying portfolios based on the mitigated rate. If an entity manages repricing risk using more than one mitigated rate, the entity shall aggregate the repricing risk arising from the relevant underlying portfolios based on reasonable and supportable information about how underlying portfolios are managed on a net basis in relation to each mitigated rate.*
- 61 *The net repricing risk exposure must be reliably measurable. An entity shall determine the net repricing risk exposure in a manner that is consistent with how it makes risk management decisions, including:*
- (a) the basis on which the entity aggregates the repricing risk arising from underlying portfolios and determines the repricing time bands (based on expected repricing dates); and*
 - (b) the measure the entity uses to quantify the net repricing risk exposure in each repricing time band—for example, a cash flow- or fair value-based measure. An entity is permitted to use different measures to quantify the net repricing risk exposure for different repricing time bands. However, the entity is required to apply the same measure to all exposures in the same repricing time band.*
- 62 *An entity shall determine the net repricing risk exposure based on reasonable and supportable information about the changes in the underlying portfolios that affect the net repricing risk exposure. The net repricing risk exposure shall be determined with sufficient frequency to ensure that changes in the underlying portfolios are reflected in a timely manner and that the net repricing risk exposure faithfully represents the entity's exposure to repricing risk.*

Question 3—Determining the net repricing risk exposure (paragraphs 7.2.5–7.2.10)

The IASB proposes that an entity determines the net repricing risk exposure by aggregating the repricing risk arising from underlying portfolios by repricing time bands based on expected

repricing dates. The expected repricing date is the earlier of the dates on which financial instruments in the underlying portfolios are expected to be settled or to reprice.

The IASB also proposes that the entity determine the net repricing risk exposure in a manner that is consistent with how it makes risk management decisions, including with regard to:

- (a) the basis on which the entity aggregates the repricing risk arising from underlying portfolios and determines the repricing time bands (based on expected repricing dates); and
- (b) the measure the entity uses to quantify the repricing risk exposure in each repricing time band.

Paragraphs BC64–BC69 of the Basis for Conclusions explain the IASB’s rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree with any of these proposals, please explain what you would suggest instead and why.

EFRAG’s response

63 In EFRAG’s survey [Current practices in dynamic interest rate risk management](#):

- (a) 65% of bank respondents currently calculate their interest rate risk position on a net basis. It should be further analysed whether the existing alternatives will be sufficient to address the needs of those entities that perform interest rate risk management on a gross basis.
- (b) 72% of the respondents manage their interest rate risk position by time buckets (the equivalent to repricing time bands in the RMA model).

64 EFRAG supports that IASB is not requiring risk limits per repricing time band and that the ED is not prescribing which approach to use as long as it is used consistently.

65 However, some banks do not calculate their interest rate risk exposure by time bands because their risk management is based on the expected maturity of each individual asset, liability, or transaction while other banks do. It is unclear how entities that do not manage their interest rate risk across time bands would apply the RMA model.

- 66 EFRAG notes that benchmark rates, although traded and changing continuously, are often fixed once per day⁷. If for accounting purposes a repricing time band of longer duration than one day is used, then:
- (a) if the NRRE for that repricing time band is considered as one number, the accounting would change rather than reflect the NRRE for that period, or
 - (b) if the NRRE for that repricing time band is considered as a vector of daily net positions, the interaction with designated derivatives to establish the RMO for that repricing time band may create operational issues and questions on whether the RMO reflects the objective of the entity for that repricing time band.
- 67 EFRAG observes that, in the environment in which the RMA model is intended to be applied, smaller and larger changes to expectations are often expected to be frequently occurring and thus are part of the expected changes. How to treat changes is therefore core to the RMA model. EFRAG notes that the RMA model has no guidance on how to treat changes, but it has extensive guidance on how to treat unexpected changes, without a description of what is differentiating unexpected changes from other changes in an environment in which the RMA model is intended to be applied.
- 68 EFRAG observes that the ED requires that the NRRE is to be determined in accordance with the entity's risk management strategy (paragraph 7.2.1 of the ED) and in a manner that is consistent with how the entity makes risk management decisions (paragraph 7.2.9 of the ED). Paragraph B7.2.11 of the ED provides further details on assessments for determining NRRE. Paragraph 7.1.7 of the ED provides requirements on how the entity shall formally document how it determines the NRRE to be mitigated, including information about the measures the entity uses to assess repricing risk arising from the underlying portfolios and to quantify the NRRE and how it captures the effects of unexpected changes in the NRRE, including information about how the entity measures the present value of the NRRE at the reporting date. Paragraph 30I of IFRS 7 requires an entity to provide disclosures that explain its risk management strategy for managing repricing risk. This explanation should enable users of financial statements to understand how the entity determines the NRRE. Apart from the references to the entity's risk management strategy and how the entity makes risk management decisions in the guidance and requirements referred to above, the ED is

⁷ That is the referenced overnight, 1 month, 3 months, 6 months and 12 months benchmark interest rate is often fixed once per day.

entirely silent on how to consider credit risk when determining NRRE. EFRAG would expect that any credit risk is included in the expected cash flows and making this explicit would be useful.

- 69 EFRAG observes that an entity shall apply RMA at the level at which the entity mitigates the repricing risk arising from underlying portfolios in accordance with its risk management strategy. EFRAG notes the lack of guidance on how to apply RMA for an entity that manages repricing risk for one mitigated rate at multiple lower levels within the reporting entity. Guidance would be welcomed on the issues of internal offsetting, how to treat inconsistencies in durations of mitigated time horizons and repricing time bands and how to apply RMA if the measure the entity uses to quantify the NRRE in one or more repricing time bands (for example, a cash flow- or fair value-based measure) varies within the reporting entity.
- 70 Another concern is that the proposed model is intended to be aligned with actual risk management practices, yet in practice it will not achieve this alignment. One main reason is the treatment of internal contracts, for example, contracts between the same legal entity in the same country, as well as transactions within the legal entity between different branches that have different functional currencies, and between the branches and the parent in its home country. The Board of the parent company sets consolidated risk limits, which are then cascaded down through the organisation and ultimately assigned to individual traders in group treasury or capital markets. The individual trader represents the lowest operational level that would need to be documented. However, at that level the open positions are the net result of both internal and external transactions and therefore do not represent the true consolidated risk positions. Although internal instruments are fundamental to real-life interest rate risk management, they cannot be included in the model. As a result, entities would be required to document positions, excluding internal transactions, that do not reflect their true risk management activities. This creates an unavoidable disconnect between accounting outcomes and the way risk is actually managed, raising questions about the model's ability to faithfully represent an entity's risk profile.
- 71 On the use of probabilities in determining the NRRE, EFRAG questions if inconsistent requirements should be removed. EFRAG observes that for the scope of exposures in the underlying portfolios, reinvestment of financial assets and financial liabilities are based on expectations while other forecast transactions to increase or decrease positions of financial assets or financial liabilities should be highly probable. For financial instruments with

prepayment or extension options and for demand deposits, exposures are based on expected (and not highly probable cash-flows).

Questions to Constituents

- 72 Paragraph 7.2.10 of the ED requires an entity to "*determine the net repricing risk exposure based on reasonable and supportable information about the change in the underlying portfolios that could affect the net repricing exposure*". Credit risk and changes in credit risk would affect NRRE. How do you look at credit risk in terms of determining expected cash flows which will be ultimately included in the NRRE?
- 73 To what extent do the IASB's proposals on determining the net repricing risk exposure (7.2.5–7.2.10 and B2.7.9–B2.7.17 of the ED) align with your current risk management practices? If they do not align, please describe the main areas of divergence and explain how the proposals would differ from, or fail to reflect, the way you currently manage repricing risk.

Question 4—Designated derivatives (Section 7.3)

Notes to constituents – Summary of proposals in the ED

- 74 *Since the risk mitigation accounting model has been developed for repricing risk (which is a form of interest rate risk), the ED proposes that designated derivatives would include only interest rate derivatives. The ED proposes that any interest rate derivatives, with the exception of those indicated in paragraph 76 below, could be designated derivatives for the purpose of applying risk mitigation accounting, including basis swaps, forward-starting swaps, forward rate agreements and interest rate futures as well as options and swaptions.*
- 75 *In addition, derivatives between entities in the same group can only be included as designated derivatives for the purposes of applying risk mitigation accounting in the individual or separate financial statements of those entities and not in the consolidated financial statements of the group.*
- 76 *Furthermore, the ED proposes that a derivative is **not** eligible for inclusion in designated derivatives*
- (a) *if its fair value changes are dominated by the effect of risks unrelated to changes in the mitigated rate, such as credit risk as this would affect the value changes of these derivatives; and*
 - (b) *if it is a net written option – consistent with IFRS 9 hedge accounting requirements.*

77 Also, a proportion of the notional amount of a derivative (instead of the entire derivative) could be eligible for risk mitigation accounting.

Question 4—Designated derivatives (Section 7.3)

The IASB proposes that only interest rate derivatives with a party external to the reporting entity that are used to mitigate the entity's repricing risk in accordance with its risk management strategy be eligible to be included as designated derivatives.

Paragraphs BC70–BC77 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree with any of these proposals, please explain what you would suggest instead and why.

EFRAG's response

78 In general, EFRAG agrees with the proposals. Externalising the interest rate derivatives is similar to IFRS 9 hedge accounting whereby qualifying hedge accounting instruments should be external to the reporting entity.

79 There are some clarifications needed/practical concerns as follows:

- (a) Some entities manage repricing risk on a gross basis, e.g., having separate hedges for different elements, e.g., AT1 instruments, mortgage loans, etc, and therefore, are able to identify the designated derivatives that are eligible for RMA. However, if entities manage on an overall/global net basis for risk management purposes, it may be difficult to identify the derivatives that are eligible for RMA separately from those that are not. For example, there may be a difficulty in separating the portion of derivatives that are eligible for RMA from the portion that is not eligible, for example, relating to the financial instruments measured at FVTPL. This issue arises when RMA is not aligned with risk management.
- (b) The ED proposals indicate that RMA should be applied at the level at which the entity mitigates repricing risk (paragraph 7.1.6 of the ED). If the repricing risk is mitigated at sub-consolidated level and the items hedged are intercompany instruments, it is not clear how these requirements interact with the IFRS accounting requirements to eliminate intra group transactions upon consolidation.
- (c) The ED proposes that any interest rate derivatives could be designated derivatives for the purpose of applying RMA including options and swaptions. It would be useful to clarify how the options would be accounted for, for e.g., with respect to volume

in determination of RMO and with respect to fair value changes in determining cumulative gain or loss (or is the time value component to be excluded?).

- (d) Furthermore, a question arises on how to deal with off-market derivatives (i.e. derivatives with a start value when used in the RMA model).

80 EFRAG questions the reasons for not allowing voluntary de-designation of a designated derivative when the entity is allowed to settle a designated derivative and to close a designated derivative with an opposite sign (in practice banks may prefer the latter).

Questions to Constituents

- 81 Are there any operational complications expected:
- (a) when identifying designated derivatives and differentiating them from other derivatives?
 - (b) Referring to paragraph 79(a) above, are preparers able to separate the portion of derivatives that are eligible for risk mitigation accounting, if entities manage their repricing risk on a global net basis? Please explain.
 - (c) if a proportion of a derivative is included as designated derivatives, as indicated in paragraph 77 above?

Question 5—Risk mitigation objective and benchmark derivatives (paragraphs 7.4.1–7.4.7)

Notes to constituents – Summary of proposals in the ED

Risk mitigation objective

82 *The IASB proposes that the risk mitigation objective be expressed as an absolute, not a relative, amount of repricing risk. The risk mitigation objective must be consistent with the amount of repricing risk a company mitigates using designated derivatives. The risk mitigation objective is therefore specified using the measure a company uses to determine the net repricing risk exposure. The risk mitigation objective is not directly linked to underlying portfolios or items in these.*

83 *The risk mitigation objective has the following key characteristics:*

- (a) *Dynamic / flexible - adjusted **prospectively**, taking the market environment into consideration;*
- (b) *Evidenced through **actions rather than intentions**—the purchase of derivatives—reflecting the effects of risk management activities;*

- (c) **Capped** at the amount of risk for each repricing time band in net repricing risk exposure; and
- (d) Measured and tracked - **benchmark derivatives** used to track the history of an entity's risk mitigation objectives and facilitate measurement of risk mitigation adjustment.

84 A company can specify a new risk mitigation objective as frequently as needed to ensure alignment with its risk management activities. Specifying a new risk mitigation objective does not require the company to discontinue risk mitigation accounting. The risk mitigation objective is specified for a period until an entity specifies a new risk mitigation objective—for example, when it undertakes further activities to mitigate repricing risk or when there is a change in the net repricing risk exposure.

Benchmark derivatives

85 The IASB proposes that a company replicate the repricing risk specified in the risk mitigation objective through benchmark derivatives. Benchmark derivatives are theoretical derivatives that are constructed to replicate the timing and amount of repricing risk as specified in the risk mitigation objective.

86 A company constructs benchmark derivatives to have an initial fair value of zero based on the mitigated rate. Although the risk mitigation objective must be consistent with the amount of repricing risk the company intends to mitigate using designated derivatives, the risk mitigation objective is capped by the net repricing risk exposure in each repricing time band and thus the benchmark derivatives cannot simply replicate all the terms of the designated derivatives.

87 Risk mitigation accounting is based on a company's expectations about its exposure to repricing risk. However, those expectations may need to be revised if there are changes to the financial instruments in the underlying portfolios due to changes in the economic environment or market conditions.

88 If such changes reduce the net repricing risk exposure to an amount below the volume of the designated derivatives, the risk mitigation objective is reduced, and the company is required to adjust the benchmark derivative to capture the effects of the changes.

89 A company is permitted to use an approach of its choice to estimate the effect of changes to the net repricing risk exposure on the benchmark derivatives. The chosen approach must be based on reasonable and supportable information including, but not limited to, the

characteristics of the underlying portfolios affected, the interest rate structure of the items and the timing of the changes.

Question 5—Risk mitigation objective and benchmark derivatives (paragraphs 7.4.1–7.4.7)

The IASB proposes that an entity:

- (a) specify a risk mitigation objective that is consistent with the amount of repricing risk the entity mitigates using designated derivatives, but does not exceed the amount of net repricing risk exposure in each repricing time band;
- (b) construct benchmark derivatives to replicate the timing and amount of repricing risk as specified in the risk mitigation objective; and
- (c) adjust the amount of repricing risk represented by the benchmark derivatives if unexpected changes in financial instruments included in underlying portfolios reduce the net repricing risk exposure to an amount below the risk mitigation objective specified at the beginning of the period.

Paragraphs BC78–BC87 of the Basis for Conclusions explain the IASB’s rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree with any of these proposals, please explain what you would suggest instead and why.

EFRAG’s response

- 90 The part of the model related to RMO and benchmark derivatives gives rise to multiple issues, both conceptual and operational in nature.
- 91 EFRAG notes that multiple issues may arise from the requirement stipulated in paragraph 7.4.5 of the ED that an entity shall construct new benchmark derivatives to have an initial fair value of zero based on the mitigated rate. For example, there are practical considerations how this requirement is to take into account uncertainties of cash flows (credit risk, prepayments, extensions and other behavioural issues) in the underlying portfolios. Also, this may create issues in a situation of late hedge of past positions (e.g., hedging undertaken following a merger or an acquisition).
- 92 When defining the RMO, the RMA, with its focus on mitigation per repricing time band and lower of, departs from those risk management strategies that are agnostic as relating to the sign of the exposure as long as it stays within the specified limit(s). In this regard, we note the requirement in paragraphs 7.4.8-7.4.9 of the ED concerning over-hedging, i.e. that any remaining gain or loss on the designated derivatives that was not recognised as part of

the risk mitigation adjustment shall be recognised in profit or loss. While such requirement represents the accounting logic, similar to existing hedge accounting rules, it may represent a departure from the actual risk management (please refer to Question 1 concerning the primary objective of the RMA model), where the difference between over-hedging and under-hedging of similar magnitude is not as significant as it is accounting-wise.

93 Also, over-hedging in one time band while under-hedging in another one may represent an actual risk management of an entity. Some entities may do this because, for example, there may not be swaps for all currencies covering different maturities. An entity may have a position in Year 11 but because of illiquidity in the market, it may trade a swap to ten years, thereby resulting in an over-hedge in Year 10 but an under-hedge in Year 11. Therefore, these stakeholders request for a relief on the requirement in paragraphs 7.4.8-7.4.9 of the ED on the impact of over-hedging.

94 EFRAG notes that there are issues related to the operationality of the lower of test for RMO when NRRE occurs on different dates than designated derivatives within the same repricing time band:

- (a) How should the RMO and thus the benchmark derivative be identified?
- (b) If the repricing time band is set to one day, how should the working of the lower of test result in an RMO that really reflects the risk management strategy of the entity?
- (c) We understand that a usual manner of interest rate risk management is by time bands with declining granularity (i.e., more granularity for short-term time bands, including daily, and less granularity for long-term time bands, including annual or more – please see details in our recent survey [Current practices in dynamic interest rate risk management](#)). How should the model address this scenario, notably the switch from less granular long-term time bands to more granular short-term time bands?

95 Paragraph B7.1.8 of the ED states that an entity may manage repricing risk based on different currencies and a mitigated rate for each of the main currencies may be specified. The last example in paragraph B7.5.3 of the ED implies that an entity may manage underlying portfolios in different currencies (e.g. GBP and Euro) against one mitigated rate (e.g. EURIBOR). EFRAG considers that further guidance on how to deal with different currencies would be useful, for example, how to define the RMO and the benchmark derivatives.

- 96 EFRAG notes that the term “unexpected changes” is widely used throughout the ED but most notably in the section dealing with RMO and benchmark derivatives. In the context of the model, the use of the word unexpected may not be needed, because:
- (a) It may be excessive (no “expected changes” are referred to in the exposure draft);
 - (b) Such wording may contradict the nature of the model which is based on dynamic risk management and frequent changes in expectations.
- 97 EFRAG notes that the requirements in (a) paragraph 7.4.5 of the ED that new benchmark derivatives is to be constructed as to have an initial fair value of zero, (b) paragraph 7.4.6 of the ED to adjust the benchmark derivatives to capture the effects of unexpected changes in the NRRE, and (c) paragraph 7.4.7 of the ED to ensure that the exposure to repricing risk represented by the benchmark derivatives does not exceed the NRRE in any repricing time band, operationally will induce entities to construct benchmark derivatives that cover no more than one repricing time band each. The fixed legs in the benchmark derivatives will thus deviate from the fixed legs in the designated derivatives which will typically cover multiple repricing time bands.
- 98 We note that this part of the model may be challenging operationally, especially in what concerns tracking issues. On the one hand, the IASB has provided some relief that if reasonable and supportable information to estimate the effect of unexpected changes on the benchmark derivatives is not available without undue cost or effort, an entity shall deem the unexpected changes to have occurred at the time when the RMO was last specified. Also, there is the risk mitigation adjustment excess to ensure that significant impacts of unexpected changes are captured. On the other hand, one may have risk mitigation adjustment excesses more often which would trigger changes to the benchmark derivatives, so some level of tracking is needed. Therefore, a thorough cost/benefit analysis is essential.
- 99 For the benefit of entities that will be updating their RMA model daily, EFRAG asks the IASB to consider if the timing of occurrence in paragraph B7.4.14 of the ED could include “or the day thereafter” (or similar text) as an addition to the first sentence in that paragraph.
- 100 All these considerations are subject to confirmation through further analysis and field testing.

Questions to Constituents

- 101 Do you think that the approach of creating risk mitigating objective and the resulting benchmark derivatives and the subsequent adjustment of benchmark derivatives to reflect unexpected changes as proposed by the IASB could result in any operational issues, accounting mismatches or economically incorrect outcomes? Please provide examples of scenarios where such issues may arise.
- 102 In your view, how feasible operationally are the proposals of the IASB? Please explain potential complications in detail.

Question 6—Recognising and measuring the risk mitigation adjustment (paragraphs 7.4.8–7.4.14)

Notes to constituents – Summary of proposals in the ED

Risk mitigation adjustment

- 103 *The IASB proposes that a company recognise a portion of gains or losses on designated derivatives as the risk mitigation adjustment in the statement of financial position. This portion is calculated as the lower of the cumulative gains or losses on the designated derivatives and the cumulative change in the fair value of the benchmark derivatives.*
- 104 *The amount accumulated as the risk mitigation adjustment shall be subsequently recognised in profit or loss in the same period during which the repricing differences arising from the financial instruments in the underlying portfolios affect profit or loss. Because the benchmark derivatives represent the repricing risk mitigated, the accrual profiles of the benchmark derivatives could be used as a proxy.*
- 105 *The risk mitigation adjustment is neither an asset nor a liability as defined in the Conceptual Framework. However, the IASB decided that the only way to achieve faithful representation of the effects of risk mitigation was to present the adjustment as part of either assets or liabilities depending on the balance at the reporting date.*

Indication of risk mitigation adjustment excess

- 106 *Sometimes a company might be unable to adjust the benchmark derivatives for the effect of unexpected changes that occurred during the reporting period. These unexpected changes and their effects could lead to uncertainty about the company's ability to realise the risk mitigation adjustment in full based on the net repricing risk exposure at the reporting date.*
- 107 *Therefore, the IASB proposes to require a company to assess at each reporting date whether there is an indication that the amount accumulated as the risk mitigation adjustment might*

not be realised in full over the mitigated time horizon. This situation would arise if there were unexpected changes in the net repricing risk exposure during the reporting period which have not been fully reflected in the adjustments to the benchmark derivatives.

Measurement and recognition of risk mitigation adjustment excess

- 108 If such an indication exists, the company is required to determine whether the risk mitigation adjustment exceeds the present value of the net repricing risk exposure as at the reporting date.*
- 109 The present value of the net repricing risk exposure represents the maximum amount at which the risk mitigation adjustment could have been recognised if a company had fully mitigated the net repricing risk exposure as at the reporting date. This present value is calculated using the mitigated rate as the discount rate.*
- 110 Any excess of the risk mitigation adjustment is recognised in profit or loss immediately by reducing the amount of the risk mitigation adjustment. The excess amount recognised in profit or loss cannot be reversed in future periods.*
- 111 Assessing whether there is a risk mitigation adjustment excess is intended to be a reasonableness assessment to ensure the accumulated risk mitigation adjustment remains representative of the effects of the repricing risk arising from the underlying portfolios at the reporting date.*

Question 6—Recognising and measuring the risk mitigation adjustment (paragraphs 7.4.8–7.4.14)

The IASB proposes that an entity:

- (a) recognise the risk mitigation adjustment in the statement of financial position based on the lower of:
- (i) the cumulative gains or losses on the designated derivatives; and
 - (ii) the cumulative change in the fair value (present value) of the benchmark derivatives;
- (b) recognise in profit or loss the amount accumulated as the risk mitigation adjustment in the same periods during which the repricing differences arising from the financial instruments in the underlying portfolios affect profit or loss;
- (c) assess, at each reporting date, whether there is an indication that the risk mitigation adjustment might not be realised in full over the mitigated time horizon; and

(d) recognise immediately in profit or loss a reduction in the amount accumulated as the risk mitigation adjustment if it exceeds the present value of the net repricing risk exposure as at the reporting date.

Paragraphs BC88–BC116 of the Basis for Conclusions explain the IASB’s rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree with any of these proposals, please explain what you would suggest instead and why.

EFRAG’s response

112 Given the limitations on the designation of the benchmark derivatives, including the first lower of test in paragraph 7.4.1 of the ED and the requirement for an initial zero fair value, there is a suggestion that the second lower of test in paragraph 7.4.8 of the ED may not be needed⁸.

113 The following are suggested benefits of excluding the second lower of test in paragraph 7.4.8 of the ED:

- (a) It would be operationally easier not to have to consider the cumulative gain or loss on the designated derivatives from the date the derivatives were designated;
- (b) Entities would not have to set up and maintain a calculation (the cumulative gain or loss on the designated derivatives from the date the derivatives were designated) that is used for this purpose only.
- (c) Excess valuation of the risk mitigation adjustment would be prevented through the risk mitigation adjustment excess test.
- (d) Excess valuation of the risk mitigation adjustment would be prevented through the frequent updates of the benchmark derivatives.
- (e) The RMA model would be less dependent upon a questionable link between the designated derivatives and the risk management strategy of the entity.

⁸ This would result in the risk mitigation adjustment to be set to the cumulative change in the fair value (present value) of the benchmark derivatives and paragraph 7.4.9 of the ED could be reduced to reflecting that changes in risk mitigation adjustment are recognised in profit or loss (presentation to be regulated in IFRS 18).

- (f) Conceptually, the risk mitigation adjustment comes closer to an overlay adjustment to the measurement of the items in the underlying portfolios and thus less as an exception to the Conceptual Framework as discussed in paragraphs BC90 to BC100 of the ED.

114 The following of this response assumes that the IASB decides to keep the lower of test in paragraph 7.4.8 of the ED.

115 Referring to the lower of test in paragraph 7.4.8 in the ED, EFRAG is concerned that a natural reading of the current wording will imply that the cumulative gains or losses on the designated derivatives will be influenced by choices an entity makes in adjusting the position of designated derivatives by either settling designated derivatives or entering into offsetting designated derivatives.

116 If this is not to be the case, then EFRAG is concerned about the amount of data that must be tracked to be able to calculate the risk mitigation adjustment and, when relevant, the risk mitigation adjustment excess.

117 EFRAG acknowledges merits of the proposed accounting treatment, notably for banks. We note, however, that other constituents may have concerns related to the calculation and presentation of the risk mitigation adjustment – please refer to response to Question 11 for more details about the views of insurance entities on this matter, specifically on inflated accounting.

118 EFRAG notes that the ED is silent on the granularity when calculating the risk mitigation adjustment. While NRRE and RMO is calculated per repricing time band, a natural reading of paragraph 7.4.8 and paragraph 7.4.11 of the ED leads to the conclusion that the risk mitigation adjustment and risk mitigation adjustment excess is calculated as an aggregate for each RMA model over the mitigated time horizon for that RMA model. EFRAG is concerned that this might be a source for operational challenges when a series of positive and negative adjustments of RMO have occurred and these are linked with the recognition of the risk mitigation adjustment excess in profit or loss.

119 EFRAG observes that evaluation of the risk mitigation adjustment excess and its effects in the financial statements raise multiple concerns from stakeholders. In particular, EFRAG notes issues related to the calculation of the present value of the NRRE which is required for the measurement of risk mitigation adjustment excess. These issues are both conceptual and operational in nature, ranging from general understanding of this new

concept to operational difficulties, both general and specific to certain elements (e.g., modelled equity and modelled demand deposits).

120 EFRAG understands that, in accordance with the ED, the risk mitigation adjustment excess serves as a final reasonability test and a method to capture any remaining excess in the value of the risk mitigation adjustment after consistent adjustments of RMOs/benchmark derivatives reflecting which are supposed to capture most of the effects of unexpected changes. Additional guidance may be needed to address questions which arise regarding the set of indicators that would evidence the existence of an “excess”, as required by paragraph 7.4.11 of the ED. There are no examples (beyond a systems-adaptation difficulty included in IE 224 of the ED) and EFRAG considers it important to have non-exhaustive examples of indicators to guide entities in performing the risk mitigation adjustment excess test. Such guidance may describe:

- (a) What other examples of indicators could there be?
- (b) Are they defined by the entity itself?
- (c) Should these indicators be documented in some way (e.g. in the entity’s policies)?

121 EFRAG notes that the risk mitigation adjustment is neither an asset nor a liability and thus may change from being a debit to being a credit and vice versa multiple times during the period when the RMA model is applied.

122 EFRAG understands that the model may be rather burdensome from the operational point of view and will require significant resource and investment. Therefore, we emphasise the role of the cost/benefit analysis.

123 EFRAG notes that, according to paragraph B7.4.16 of the ED, the risk mitigation adjustment is not required to be remeasured at the same frequency as the RMO and the benchmark derivatives. In our view, this requirement may provide flexibility and to a certain extent relieve the operational burden of running the model on a daily/weekly basis. However, practical operational consequences of such misalignment in the timing of the remeasurement should be analysed.

124 All these considerations are subject to confirmation through further analysis and field testing.

Questions to Constituents

- 125 In general, what are your views on the accounting treatment proposed in the ED? Please explain.
- 126 What are your views on the risk mitigation adjustment excess as proposed in the ED? What examples of indicators should be considered when an entity performs the risk mitigation adjustment excess test? Please explain.
- 127 What are your views on the operational feasibility of this part of the model? Please explain the key operational issues.
- 128 What are your views on the fair value of the NRRE as proposed in the model, both from conceptual and operation points of view? Please explain.
- 129 Do you agree with the suggestion made in paragraphs 112 and 113 to eliminate the lower of test in paragraph 7.4.8 of the ED? Please explain why or why not.

Question 7—Discontinuation of risk mitigation accounting (Section 7.5)

Notes to constituents – Summary of proposals in the ED

- 130 *Risk mitigation accounting is intended to resolve the challenges in applying the hedge accounting requirements for entities whose exposure to repricing risk changes frequently. However, if an entity changes how it manages repricing risk, applying risk mitigation accounting would no longer align with its risk management strategy and might not achieve the intended benefit or provide useful information to users of the financial statements.*
- 131 *Such a change typically results from identifiable internal or external factors and is demonstrable to the company's internal and external stakeholders. As an entity's risk management strategy is intended to ensure long-term stability, the IASB expects changes to this strategy to be infrequent. Examples of changes in an entity's risk management strategy that require the entity to discontinue risk mitigation accounting are included in paragraph B7.5.3. of the ED.*
- 132 *However, the IASB acknowledged that changes that reflect the dynamic nature of an entity's repricing risk exposure are consistent with the objective of risk mitigation accounting. Therefore, such changes (e.g. changes to: risk mitigation objective, risk limits, underlying portfolios, designated derivatives) should not result in an entity discontinuing application of risk management. A company might change its risk management activities without needing to discontinue risk management accounting.*

- 133 *Therefore, the IASB proposes that if a company chooses to apply risk mitigation accounting, it shall not discontinue applying it unless there is a change in the company's risk management strategy.*
- 134 *If, following the discontinuation of risk mitigation accounting, repricing risk from the underlying portfolios is still expected to affect profit or loss in future periods, the company recognises the risk mitigation adjustment:*
- (a) *in accordance with paragraph 7.4.10 of the ED; or*
 - (b) *on another systematic and rational basis, which could include a straight-line basis in profit or loss.*
- 135 *If the repricing risk is no longer expected to affect profit or loss in future periods, the adjustment is recognised in profit or loss immediately.*
- 136 *The IASB proposes that voluntary discontinuation be prohibited to avoid an entity applying risk mitigation accounting purely to achieve favourable accounting outcomes. As a result, the IASB proposes that an entity is not permitted to de-designate a derivative or to voluntarily remove underlying portfolios that were included in the determination of the net repricing risk exposures if these items continue to meet qualifying criteria.*
- 137 *The IASB concluded that, when risk mitigation accounting is discontinued, the financial instruments in the underlying portfolios can either be included in a new application of risk mitigation accounting—if the entity continues to manage repricing risk on a net basis—or designated in a new hedging relationship under IFRS 9, provided they meet the qualifying criteria. Similarly, derivatives previously designated for risk mitigation can be repurposed as hedging instruments or as designated derivatives in a new application of risk mitigation accounting. However, in all cases, only fair value changes occurring after the date of redesignation are considered when recognising and measuring the related risk mitigation adjustment.*

Question 7—Discontinuation of risk mitigation accounting (Section 7.5)

The IASB proposes that an entity discontinue risk mitigation accounting prospectively from the date on which the entity's risk management strategy changes—that is, when the entity changes how it manages repricing risk, including a change to the mitigated rate.

The IASB also proposes that an entity that discontinues risk mitigation accounting recognise the amount accumulated as the risk mitigation adjustment in profit or loss:

(a) on a systematic and rational basis over the mitigated time horizon, if the repricing differences arising from the financial instruments in underlying portfolios are still expected to affect profit or loss; or

(b) immediately, if the repricing differences arising from the financial instruments in underlying portfolios are no longer expected to affect profit or loss.

Paragraphs BC117–BC126 of the Basis for Conclusions explain the IASB’s rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree with any of these proposals, please explain what you would suggest instead and why.

EFRAG’s response

138 EFRAG agrees that changes in how an entity manages its repricing risk, which is no longer consistent with the current management risk strategy, should trigger the discontinuation of the RMA model. Changes that reflect the dynamic nature of the entity’s repricing risk should not trigger discontinuation.

139 EFRAG agrees that changes in the risk management strategy should be expected to occur very infrequently. In addition, we appreciate the consistency with existing guidance about changes in business model for managing financial assets in IFRS 9, because referring to existing guidance may reduce the complexity of the new requirements.

140 As pointed out in the ED, determining what constitutes a change in the risk management strategy is a matter of judgement. However, exercising such judgement may be difficult in some situations. E.g., it may be difficult to clearly distinguish changes in “how the entity manages the risk” from changes in RMO or to separate changes in the underlying portfolios included in the NRRE from changes to the time horizon and changes in risk management level.

141 In addition, there may be practical challenges in determining whether the risk mitigation adjustment would continue to affect future profit or loss.

142 With reference to the illustrative examples provided in paragraph B7.5.3 of the ED, we have the following observations:

(a) We understand the rationale for considering a reduction of the mitigated time horizon as a change in risk management strategy as some previously managed risk positions are no longer being risk managed. However, it is not entirely clear what should be the implication of an extension of the mitigated time horizon. Previously

managed positions are continued to be managed while added positions are managed with the same implications as if it was managed in a new RMA model. It may be claimed that an extension of the mitigated time horizon, representing a pure extension of the use, should not lead to the discontinuation of the model and therefore, we ask the IASB for clarification on this⁹.

- (b) While EFRAG notes the position on key risk metrics, we ask if the difference in changes of key risk metrics and improvements in measurement techniques remains clear.

143 With regard to the examples in paragraph 7.5.4 of the ED, EFRAG proposes that changes to the structure of repricing time bands be included in the list.

144 We note that the decision to prohibit voluntary discontinuation is consistent with the requirements in IFRS 9 that prohibit voluntary de-designation of a hedging relationship and the discontinuation of hedge accounting when the risk management objective for a particular hedging relationship remains the same, and all the other qualifying criteria are met (paragraph BC120 of the ED).

145 We note the possibility to allocate derivatives and underlying items of a discontinued RMA model to a new RMA model (see paragraphs BC124 - BC125 of the ED). This is consistent with the application guidance included in paragraph B6.5.28 of IFRS 9 that allows an entity to designate a new hedging relationship that involves the hedging instrument or hedge item of a previous discontinued hedging relationship.

146 We suggest including the content of paragraphs BC124 to BC126 of the ED in the application guidance.

147 Reading paragraph 7.5.3 of the ED it does not seem necessary to perform a risk mitigation adjustment excess assessment in the case of discontinued RMAs. Whether this is or is not the case could be made clearer in the standard. The entity is required to assess whether the repricing differences from the financial instruments in the underlying portfolios are still expected to affect profit or loss so as to continue making the adjustment set out in paragraph 7.4.10 of the ED (recycled to NII). If the repricing differences from the financial instruments in the underlying portfolios are no longer expected to affect profit or loss, the

⁹ An extension of the mitigated time horizon is expected to be important for users to be aware of and should be required to be disclosed.

economic benefit represented by the RMA no longer remains and it must therefore be recognised immediately in profit or loss. This is similar to the model used in IFRS 9 micro-hedges, both fair value and cash flow. EFRAG suggests providing additional guidance on this aspect.

Question to Constituents

148 Do you agree with the response to ED Q7? Please explain.

Question 8—Effective date and withdrawal of IAS 39 (Section C1 of Appendix C to IFRS 9)

Notes to constituents – Summary of proposals in the ED

149 *The IASB decided that because risk mitigation accounting is voluntary, an entity would be permitted to apply it from the beginning of an annual reporting period starting on or after [the date the requirements will be issued].*

150 *The IASB proposes that an entity discontinue applying IAS 39 at the earlier of:*

- (a) *the date the entity applies risk mitigation accounting in accordance with Chapter 7;*
and
- (b) *annual reporting periods beginning on or after the date on which IAS 39 is withdrawn [date to be determined].*

Question 8

The IASB proposes that an entity be permitted to apply the requirements for risk mitigation accounting from the beginning of the annual reporting period starting on or after [the date the requirements are issued].

The IASB also proposes that an entity discontinue applying the hedge accounting requirements in IAS 39 Financial Instruments: Recognition and Measurement at the earlier of:

- (a) the date on which the entity first applies the requirements for risk mitigation accounting;
and
- (b) annual reporting periods beginning on or after [the date on which IAS 39 is withdrawn].

Paragraphs BC127–BC128 of the Basis for Conclusions explains the IASB’s rationale for these proposals.

Do you agree with the proposal to withdraw IAS 39? Why or why not? If you disagree, please explain what you would suggest instead and why. If the IASB decides to withdraw IAS 39, do

you have any information for the IASB to consider in determining the withdrawal date, for example the time that is likely to be needed to transition from IAS 39?

EFRAG's response

151 There are differing views on the withdrawal of IAS 39 from banks and insurers:

- (a) Most of our constituents agree that IAS 39 should remain available for a significant long period of time (for example five years). This is because many banks may prefer to wait and see how the RMA model will work in practice.
- (b) At the same time, some other stakeholders consider that this flexibility could be problematic because it would allow banks to pick the most favourable market moment for the transition, lead to very different IAS 39 amortisation amounts depending on the timing, and create a lack of comparability since banks would not adopt the new model at the same time.
- (c) Some stakeholders suggested to first publish RMA then wait for a number of years to see how practice develops and then *decide* on the date for IAS 39 withdrawal.
- (d) Some stakeholders recommend a grandfathering clause so that existing IAS 39 individual hedge relationships can continue even when hedges of portfolios are transferred to the RMA model.

152 EFRAG considers that the transition to the RMA model is a key concern for stakeholders and recommends that the IASB devote further attention to finalising the transition requirements. Without additional clarity and deliberation, there is a genuine risk that European stakeholders may find the proposed approach difficult to support.

153 Furthermore, if what is done currently is in line with the basic principle of RMA, transition should not lead to de-designating hedging derivatives, but that is what would need to be explored with in the field testing.

154 Regarding when to apply the proposed disclosure requirements in paragraph 33A of IFRS 7, EFRAG's view is that the requirement should be introduced in the disclosures to an annual reporting period starting no less than two years after [the date the requirements are issued].

155 Even if insurers make their best effort to understand and propose adaptations to the RMA model in a cooperative way with the IASB during and after the comment period, it may

happen that this time may not be sufficient to achieve a fully formalised model meeting the insurers expectations. In this case, insurers would suggest the IASB to continue the efforts with insurers even if the model for banks is finalised. This may be also achieved through an amendment to the proposed section 7 of IFRS 9 and a withdrawal of IAS 39 at a later date for insurers.

Questions to Constituents

- 156 How long do you expect the implementation period for the RMA to be?
- 157 How much the time do you expect to be needed to transition from IAS 39?
- 158 Do you agree with the suggested way forward for insurers in 155 above? Please explain.

Question 9—Transition (Section C2 of Appendix C to IFRS 9)

Notes to constituents – Summary of proposals in the ED

159 *The potential requirements for the initial application of risk mitigation accounting relate to the transition:*

- (a) *from IAS 39 hedging relationships;*
- (b) *from IFRS 9 hedging relationships; and*
- (c) *for entities that have applied the fair value option to their financial assets or financial liabilities to eliminate accounting mismatches in their financial statements (BC128–BC129).*

160 *Although retrospective application is the preferred approach when applying new requirements for the first time under IAS 8, applying this approach to the initial adoption of hedge accounting requirements raises concerns about the use of hindsight (paragraph BC131 of the ED).*

161 *Therefore, the IASB decided that an entity shall apply the requirements in Chapter 7 prospectively (paragraph C2.54 of the ED).*

162 *The transition requirements in paragraphs C2.56–C2.61 of the ED apply when an entity first applies risk mitigation accounting, irrespective of whether the entity chooses to apply the requirements from:*

- (a) *the beginning of the first annual reporting period starting on or after (the date the requirements are issued) or;*
- (b) *the beginning of a subsequent annual reporting period.*

Transition from IAS 39 hedging relationships

- 163 An entity that previously applied IAS 39 hedge accounting shall discontinue those hedging relationships and apply paragraph 6.5.10 of IFRS 9 to the related fair value hedge adjustments and paragraph 6.5.12 of IFRS 9 to the related cash flow hedge reserves. If for the purpose of applying paragraph 6.5.10 of IFRS 9, amortising fair value hedge adjustments using a recalculated effective interest rate is impracticable, these adjustments shall be amortised on a systematic and rational basis—which include a straight-line method. The hedge adjustments shall be fully amortised by the earlier of the original end of the discontinued portfolio hedge or the derecognition of the hedged items. (paragraph C2.57 of the ED).
- 164 The IASB noted that because the application of risk mitigation accounting is optional, some entities may prefer to apply the hedge accounting requirements in Chapter 6 of IFRS 9. The IASB was of the view that such entities should apply the transition requirements for hedge accounting in accordance with paragraph 7.2.22-7.2.26 of the ED (and paragraph BC134 of the ED).

Transition from IFRS 9 hedging relationships

- 165 The IASB decided that an entity that previously applied the hedge accounting requirements in Chapter 6 of IFRS 9 is permitted to discontinue hedge accounting for hedging relationships in which some or all of the hedged items are financial instruments that will be included in underlying portfolios for the purposes of applying risk mitigation accounting (paragraph C2.58 of the ED).
- 166 Without such a relief, the discontinuation of an IFRS 9 hedging relationship would not be permitted, because the introduction of new accounting requirements would not, by itself, cause the qualifying criteria to no longer be met (paragraph BC138 of the ED).

Transition for entities that have applied the fair value option

- 167 An entity may revoke previous fair value through profit or loss designations for financial instruments that will be included in the underlying portfolios used for risk mitigation accounting. When first applying risk mitigation accounting, the entity shall revoke these designations at the start of that reporting period and use the instruments' fair value on that date as their new carrying amount or amortised cost, as well as the basis for determining the effective interest rate. For impairment purposes, this date is treated as the date of initial recognition.

Disclosure

168 An entity would be exempt from disclosing the quantitative information required by paragraph 28(F) of IAS 8 in the reporting period in which the entity first applies the amendments.

Question 9—Transition (Section C2 of Appendix C to IFRS 9)

The IASB proposes that:

- (a) an entity apply the proposed requirements for risk mitigation accounting prospectively;
- (b) an entity be permitted to revoke its previous designation of financial assets or financial liabilities as measured at fair value through profit or loss, if those financial instruments will be included in underlying portfolios that the entity uses to determine the net repricing risk exposure;
- (c) an entity making the transition from IAS 39 discontinue hedge accounting for all hedging relationships and apply paragraphs 6.5.10 and 6.5.12 of IFRS 9 to the related hedge adjustments;
- (d) an entity making the transition from the hedge accounting requirements in Chapter 6 of IFRS 9 be permitted to discontinue hedge accounting for hedging relationships in which the hedged items are financial instruments that will be included in the underlying portfolios in accordance with paragraph 7.2.1; and
- (e) an entity be exempt from disclosing the quantitative information required by paragraph 28(f) of IAS 8 Basis of Preparation of Financial Statements in the reporting period in which the entity first applies the amendments.

Paragraphs BC129–BC147 of the Basis for Conclusions explain the IASB’s rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree with any of these proposals, please explain what you would suggest instead and why.

EFRAG’s response

169 EFRAG considers the transition reliefs in paragraphs C2.58-C2.59 of the ED to be useful because the application of the RMA could provide the entities with a new accounting method that better and more faithfully reflects the effects of their risk management activities.

170 EFRAG observes that entities transitioning to the RMA model may revoke previous elections to use the fair value option in IFRS 9. EFRAG questions why entities that revoke

the use of IAS 39 should not be allowed, at that point in time, to apply the fair value option in IFRS 9.

171 As some insurers from the EFRAG survey indicated that a robust solution should be sought for rather than targeted improvements to IFRS 9 and IFRS 17, they suggest permitting entities to revoke the previous risk mitigation option under IFRS 17 when they transition to apply the RMA model. Further information is being asked in the questions to constituents in ED Question 11, as it is expected that the RMA model would particularly be used for insurance contracts that do not apply the Variable Fee Approach as explained in paragraph 212 below.

172 Additional guidance would be appreciated on how to deal with the portfolio of existing derivatives that potentially may have a large start value when designated for the first time in the RMA model.

Question to Constituents

173 Do you have other issues related to transition that should be raised to the IASB?

Question 10—Disclosure requirements (proposed amendments to IFRS 7)

Notes to constituents – Summary of proposals in the ED

Presentation requirements

174 *The IASB proposes that a company be required to present separately from other line items:*

- (a) ***in the statement of financial position***—*the risk mitigation adjustment, recognised either as part of the company’s assets (if the adjustment has a debit balance) or as part of the company’s liabilities (if the adjustment has a credit balance); and*
- (b) ***in the statement of comprehensive income***—*the amount of the risk mitigation adjustment recognised in profit or loss during the reporting period.*

Disclosure requirements

175 *The IASB proposes that a company disclose information that enables users of financial statements to understand:*

- (a) *How the company manages repricing risk according to its risk management strategy;*
- (b) *How the company’s risk management activities could affect the amount, timing and uncertainty of its cash flows; and*
- (c) *How applying risk mitigation accounting has affected the company’s statement of financial position and statement of comprehensive income.*

176 *In addition, the IASB also proposes a qualitative disclosure requirement for companies that are eligible to apply, but choose not to apply, risk mitigation accounting. This disclosure is intended to help investors understand how the company manages its exposure to repricing risk.*

Question 10—Disclosure requirements (proposed amendments to IFRS 7)

The IASB is proposing new presentation and disclosure requirements to be included in IFRS 7 Financial Instruments: Disclosures.

Paragraph 30E would require an entity to present separately from other line items:

- (a) the risk mitigation adjustment, either as part of the entity's assets (when it has a debit balance) or as part of its liabilities (when it has a credit balance) in the statement of financial position; and
- (b) the amount of the risk mitigation adjustment recognised in profit or loss during the period in the statement of comprehensive income.

Paragraphs 30F–30P would require an entity that applies risk mitigation accounting to disclose information that enables users of financial statements to understand:

- (a) how the entity manages repricing risk according to its risk management strategy;
- (b) how the entity's risk management activities could affect the amount, timing and uncertainty of its future cash flows; and
- (c) how risk mitigation accounting has affected the entity's statement of financial position and its statement of comprehensive income.

Paragraph 33A would apply to entities whose business and risk management activities have the characteristics specified in the proposed paragraph 7.1.4 of IFRS 9 but that choose not to apply risk mitigation accounting. Such entities would be required to provide a qualitative explanation of how they manage repricing risk.

Paragraphs BC148–BC171 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree with any of these proposals, please explain what you would suggest instead and why

EFRAG's response

177 EFRAG agrees with the IASB's proposals on the presentation requirements outlined in the ED (proposed paragraph 30E of IFRS 7). However, some additional guidance would be

useful, e.g. whether in a situation of a discontinued risk mitigation adjustment, it should still be netted against other risk mitigation adjustments on the face on the statement of financial position, if one of those items is an asset and another one is a liability. The Conceptual Framework indicates that offsetting is generally not appropriate (paragraph 7.10 of the Conceptual Framework). However, it would be useful to clarify this.

- 178 EFRAG generally welcomes the disclosure requirements proposed paragraphs 30F-30P of the ED. We consider mandatory disclosure requirements of the RMA model as a significant step forward, notably in the context of the IAS 39 EU carve-out where such mandatory disclosures are not present. In our view, the proposed disclosures will improve the quality of information provided to the users and the comparability of financial statements.
- 179 EFRAG notes that the detailed analysis of the disclosure requirements will be undertaken during the comment period of the ED. We emphasise the importance of cost/benefit considerations in this analysis as the implementation costs may be significant. Also, we note previous concerns from constituents that disclosure requirements should avoid disclosing commercially sensitive information.
- 180 We note that a significant volume of related information over the company's risk management of interest rate risk is provided in other sources, e.g. in Pillar III reports. Therefore, in our view, the proposed disclosure requirements in the ED should focus predominantly on the aspects introduced in the financial statements by the accounting model itself rather than duplicate information presented elsewhere. In our view, the disclosure requirements as presented in paragraphs 30F-30P of the ED are, generally, in line with such an approach, thereby minimising duplication, and in any case, entities may apply incorporation by cross-reference from the financial statements to other statements similar to current IFRS 7 requirements¹⁰. Referring to the concerns raised on the objective of the RMA and certain items not being eligible in the model, users may get confused between the new disclosures proposed in the ED and Pillar III reports.
- 181 EFRAG notes that the disclosure requirements introduced by paragraph 33A of the ED relate to companies which prefer not to apply the RMA model. In addition to the costs associated with such disclosures, such an approach is not aligned with the general hedge accounting requirements in paragraphs 21-24 of IFRS 7 where such disclosures are not required. Constituents had mixed views about these disclosures. Some disagreed with the

¹⁰ Paragraph 21B of IFRS 7

proposed disclosures in paragraph 33A of the ED insisting that only the new disclosure requirements in paragraphs 30F-30P be implemented. Others preferred to keep the proposed disclosures in paragraph 33A of the ED given the importance of this information for the users, notably for comparability of the financial statements, and the limited cost of implementation due to their qualitative nature.

182 Also, we note the importance of providing disclosures about discontinued RMA models and information on changes in risk management strategies that results in discontinuations of RMA models. Also, referring to paragraph 142, an extension of the mitigated time horizon is expected to be important for users to be aware of and should be required to be disclosed.

183 As mentioned in paragraph 68 above (Please refer to Question 3), relating to the disclosure requirement on how the entity determines the NRRE, it would be useful to be explicit on how to consider credit risk when determining NRRE.

Questions to Constituents

184 How do you see the cost/benefit balance of the proposed disclosure requirements?

185 Are there any significant operational concerns in providing the disclosure requirements in general?

186 Are there any disclosure requirements which may may result in disclosing commercially sensitive information? Please explain.

187 Do you agree with entities being in scope but choosing not to apply RMA needing to provide the disclosure requirements in the proposed paragraph 33A of IFRS 7 of the ED?

Question 11—Risk management strategy

Notes to constituents – Summary of proposals in the ED

188 *Insurance liabilities are not eligible for inclusion in the underlying portfolios in the risk mitigation accounting model (refer to the Notes to Constituents in ED Question 2 for what is eligible).*

189 *The IASB is seeking specific feedback from entities that apply IFRS 17 Insurance Contracts to assess whether these entities' risk management strategies and actions could also be reflected in financial statements using risk mitigation accounting.*

Question 11—Risk management strategy

The questions below relate specifically to entities that issue insurance contracts as defined in IFRS 17 *Insurance Contracts*. When answering these questions, respondents should assume that insurance contract assets and liabilities are eligible to be included in underlying portfolios in accordance with paragraph 7.2.1.

Based on the proposals in this Exposure Draft:

(a) please describe the extent to which your risk management strategy and activities align with, or differ from, the descriptions in paragraphs 7.1.1–7.1.2; and

(b) please describe the extent to which your business and risk management activities align with, or differ from, the characteristics described in paragraph 7.1.4.

Would the proposals for risk mitigation accounting in this Exposure Draft achieve the IASB’s objective of better representing in the financial statements the economic effects of your activities for managing repricing risk compared with the currently available accounting options? Please explain why or why not, and what you would suggest instead.

EFRAG’s response

Overall comments

190 When developing IFRS 17 *Insurance Contracts*, the IASB concluded that it would not be appropriate to develop a bespoke solution for all hedging activities for insurance contracts, noting that such a solution should form part of a broader project¹¹.

191 EFRAG welcomes that the IASB is seeking feedback from insurers in order to assess whether their interest rate risk management activities could be reflected using the RMA. EFRAG is of the view that an RMA model is needed also for entities that issue insurance contracts as defined in IFRS 17 as interest rate risk management is important to insurance entities’ business activities in order to minimise accounting volatility in profit or loss and accounting mismatches. From the EFRAG survey [Current practices in dynamic interest rate risk management](#), 47% of the respondents perform interest rate risk management on a dynamic basis with most of these exercising substantial management at both group level and subsidiary/branch level.

¹¹ Paragraph BC55 of IFRS 17.

192 As per the EFRAG survey, 76%¹² stated that the purpose of the [IASB's RMA] project should be to provide a robust solution aligning reporting under IFRS Accounting Standards with their actual practices of interest rate risk management rather than to provide targeted improvements to IFRS 9 and IFRS 17.

193 If the IASB considers the specificities of insurers as explained below, the RMA model would better represent the economic effects of the insurance activities for managing interest rate risk compared to current accounting limitations/issues reflected in paragraph 202 below.

Current risk management strategy and activities

194 The EFRAG survey *Current practices in dynamic interest rate risk management* provides a summary of current dynamic interest rate risk management practices for insurers, and some of the key messages are provided in the paragraphs below.

195 The ED focuses on repricing risk which could be viewed as specific to the banking industry. Below were the most common **significant interest rate exposures** explained by the respondents:

- (a) *Management of assets and insurance liabilities including duration gap, e.g., duration of assets being shorter than liabilities:* An example would be the risk of suffering an economic loss in the event of falling interest rates as maturing assets are reinvested at lower rates prior to the maturity of liability contracts, if the duration of the assets is shorter than the liabilities.
- (b) *Discount Rate Sensitivity:* The valuation of insurance liabilities depends on discount rates (present value of future cash flows), which are influenced by interest rates. A decrease in interest rates increases the present value of liabilities.
- (c) *Guaranteed Benefits:* Certain insurance products, such as guaranteed or variable annuities over the long-term, include crediting or guaranteed rates that may not align with prevailing market interest rates. This creates a risk of insufficient returns on underlying assets to meet these guarantees in case of a prolonged low-interest rate environment and, therefore, the entity would have to compensate the shortfall for those contractual guarantees.
- (d) *Policyholder Behaviour:* Dynamic policyholder behaviour, such as lapses or surrenders, can be influenced by interest rate changes. For example, policyholders

¹² 13 out of 17 respondents that replied.

may surrender contracts to seek higher returns elsewhere during periods of rising interest rates and the insurer could be forced to sell bonds under book value and incur losses.

- 196 **Items included in the risk position:** Ten of the twelve respondents that replied included the following items in their risk position: (financial) assets exposed to interest rate risk (mainly fixed rate assets and structured products), derivatives, insurance liabilities and financial liabilities.
- 197 The insurance products mainly affected by interest rate risk exposure are life and health contracts, life investment and savings products including traditional life insurance products with guarantees, and property and casualty reinsurance treaties.
- 198 **Management on a net basis:** Six of the eight respondents stated that they calculate the interest rate risk position(s) managed dynamically on a net basis considering the assets and liabilities / Solvency II own funds and solvency capital requirements.
- 199 **Basis for managing dynamic interest rate risk position:** Six out of nine respondents that replied to the EFRAG survey manage their dynamic interest rate risk position based on internal risk management targets while two other respondents manage based on regulatory reporting. One respondent manages based on both internal and regulatory targets.
- 200 **Frequency of assessing dynamically managed interest rate risk position for risk management purposes:** Five out of the nine insurer respondents (56%) assess the interest rate risk position managed dynamically for risk management purposes on a monthly basis while the remaining four of the insurer respondents (44%) assess it daily or more often.
- 201 Explanations regarding why it is managed on a monthly basis include that the monitoring and assessing of the interest rate risk position or cash flow matching is done on a monthly basis and that the frequency may increase on an ad-hoc basis, e.g., in case of stress scenarios.

Significant issues currently faced in accounting for interest rate risk management practices

- 202 Some stakeholders have indicated the following significant issues with current accounting:
- (a) IFRS 9 does not allow to mitigate remaining accounting volatility/mismatches. For example, fair value changes due to interest rate movements in both the insurance contract liabilities and the financial assets acquired to generate the required cash

flows are recognised in OCI, while the fair value changes of the derivatives used to align those cash flows are recognised in P&L. This results in accounting mismatches.

- (b) There is difficulty in using the insurance liabilities as a hedged item in hedge accounting because of the highly probable requirement that is hard to demonstrate for very long contracts and due to the separately identifiable and reliably measurable criteria which requires a lot of judgement for insurance liabilities. Moreover IFRS 9 current hedge accounting issues include new business not being able to be incorporated into the existing hedges unless they are highly probable and even if the hedges are highly probable, this requirement is hard to demonstrate as mentioned above. This weakens the effectiveness of the hedge and creates significant operational burden.

Insurance aspects to consider for the RMA model

203 Below are comments received, including from the EFRAG survey, *Current practices in dynamic interest rate risk management*, regarding aspects to consider when developing a RMA model for insurers.

204 **Inflated accounting in the financial statements for financial assets measured at FVOCI** (this also relates to banks as explained in paragraph 46 above): Unlike banks, insurers are generally measuring their assets and liabilities at fair value. In this case, a risk mitigation adjustment on the balance sheet would lead to inflated accounting¹³ in insurers' financial statements on the interest rate component of the fair value gains or losses particularly for financial assets measured at FVOCI.

205 In addition, even with the risk mitigation adjustment on the balance sheet, there would still be volatility in OCI as explained in paragraph 202(a) above and paragraph BC45 of the ED. Therefore, some insurers have suggested not to have a risk mitigation adjustment and instead allowing designated derivatives to apply FVOCI especially when assets are measured at FVOCI and the OCI option is chosen for the insurance liabilities.

206 Also, a few have suggested that instead of recognising the risk mitigation adjustment on the BS, it may be recognised in OCI, similar to cash flow hedge accounting under IAS 39. This was considered when the IASB was developing the core model for Dynamic Risk

¹³ Inflated accounting results from having the interest rate component of the fair value gains or losses both in (a) the financial assets measured at FVOCI and (b) the risk mitigation adjustment, which are both recognised on the Balance Sheet.

Management whereby, an entity would recognise the aligned portion of gains and losses from changes in fair value of designated derivatives¹⁴ into OCI.

- 207 Most of the insurers use OCI for discount-rate effects for insurance liabilities but there are insurers that use P&L instead. Therefore, the RMA model should work for both.
- 208 **Items to include in the NRRE:** Some insurers have indicated that it would be important to ensure the possibility of incorporating the fulfilment cash flows which includes the risk adjustment and the contractual service margin in the assessment of the NRRE.
- 209 Also, it is important to define the scope of behavioural assumptions and their link to interest rate risk, similar to banks that model on prepayments.
- 210 **Operationality of the model¹⁵:** The feasibility of operational implementation should be considered as there would be a much more complex process. For example, the model requires performing several tests to determine the risk mitigation adjustment (the "lower of" test and the risk mitigation adjustment excess test), as well as managing the recognition of different benchmark derivatives and the related adjustments.
- 211 **RMO by time bands** (relates also to banks as explained in paragraph 65 above): The IASB proposes that an entity determine the NRRE by aggregating the repricing risk arising from underlying portfolios by repricing time bands. However, some insurers¹⁶ do not manage risk by time bands but manage risk limits on an overall basis. Therefore, there should be flexibility in defining risk limits.
- 212 **Variable Fee Approach ('VFA') versus non-VFA:** It is expected that the RMA model would particularly be used for insurance contracts that do not apply the VFA. This is because there is the risk mitigation option available for these VFA contracts in order to reduce accounting mismatches that were introduced by the VFA. However, if an entity has one hedging strategy for both VFA and non-VFA contracts, a question arises on how an entity would, operationally, segregate the derivatives for accounting purposes. Some insurers have indicated that the risk mitigation option under IFRS 17 is an accounting solution and the asset and liability management is performed without making a differentiation between VFA and non-VFA contracts. Therefore, these insurers indicated that there should be a holistic

¹⁴ [February 2022 IASB Staff paper](#)

¹⁵ Also, relates to banks

¹⁶ And also a number of other entities including some banks.

accounting solution to reflect the dynamic risk management of the interest rate risk of insurance contracts.

- 213 Having considered the issues described above, EFRAG highlights the need of the insurance industry to get an accounting solution that better reflects their dynamic interest rate risk management in their financial statements compared to current accounting. However, based on the extended use of FVOCI for financial assets and remeasurements of insurance liabilities, the issue of inflated accounting is expected to be significant if insurance entities were not to be provided access to a modified RMA model.

Questions to Constituents

- 214 Do you consider that the risk mitigation accounting model, as is, would better represent the economic effects of your activities for managing interest rate risk compared to current accounting?
- (a) Please explain why including adaptations needed, if any.
- (b) If not, explain why not and suggest alternative solutions.
- 215 Referring to paragraphs 205 and 206, which of the two proposed solutions do you support and why or please explain any other alternative solutions.
- 216 Referring to paragraph 208, what items should be included in the NRRE and more specifically which type of insurance liabilities - present value of future cash flows or also risk adjustment and the contractual service margin? Please explain why and what is the interest rate risk being hedged.
- 217 Referring to paragraph 211 above, if insurers do not manage risk by time bands, please explain how they are managed and how do you include the time value of money when managing interest risk.
- 218 Should RMA focus only on non-VFA contracts or on all insurance contracts as defined in IFRS 17 that are subject to interest rate risk as explained in paragraph 212 above? Please explain.