

## 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 opening the relevant news item and clicking on the comment publication link at the bottom of the news item.

Comments should be submitted by 22 June 2026.

**EFRAG, at this stage, does not have an EFRAG tentative position on a number of aspects in the Exposure Draft *Risk Mitigation Accounting—Proposed amendments to IFRS 9 and IFRS 7* because we do not yet have all the necessary feedback/evidence to form a view. EFRAG will be gathering input from stakeholders based on the IASB field test, a second survey that EFRAG will issue on the Risk Mitigation Accounting model, questions to constituents in this Draft Comment Letter and comment letters to be received, which will provide a basis to form an EFRAG position when finalising our comment letter.**

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* (the ED), issued by the IASB on 3 December 2025.

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 proposed risk mitigation accounting (RMA) model is significantly complex, both conceptually and operationally. Considering this, the messages below are subject to field-test results, results from EFRAG's second survey on the RMA model and feedback from comment letters to be received, which will also provide information on the operational implications of the model.

The views that are provided in this letter are significantly influenced by the current application of macro fair value hedge accounting as per the IAS 39 *Financial Instruments: Recognition and Measurement* EU carve-out.

Considering the above context, our main messages are as follows.

*Objective of risk mitigation accounting*

A key objective of RMA is to faithfully represent the economic effect of an entity's interest rate risk management activities in the financial statements. There are currently challenges faced by entities to achieve this, and the RMA model, with this objective, 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 RMA – 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.

These stakeholders 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 RMA.

*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 (FVOCI) in the underlying portfolios will, through the proposed 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 are to be included in the underlying portfolios. Therefore, applying this proxy, equity instruments, including Additional Tier 1 (AT1) instruments, can be reflected in the underlying portfolios by identifying the financial assets subject to repricing risk that are backed by these equity 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

from being eligible, 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 this would be very useful.

*Effective date and withdrawal of IAS 39*

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

*Disclosure requirements*

EFRAG generally welcomes the disclosure requirements proposed in the ED as these would be a significant step forward notably in the context of the EU IAS 39 carve-out where such mandatory disclosures are not present.

*Risk management strategy for entities that apply IFRS 17 Insurance Contracts*

EFRAG welcomes the fact that the IASB is seeking feedback on the risk management strategy of entities that issue insurance contracts as per IFRS 17 *Insurance Contracts*. 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 RMA model. As insurers significantly measure their financial assets at FVOCI, 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 Sapna Heeralall.

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 *The IASB is seeking feedback, in the ED, on whether the development of risk mitigation accounting justifies the withdrawal of the remaining hedge accounting requirements in IAS 39 Financial Instruments: Recognition and Measurement.*
- 2 *The withdrawal of IAS 39 may have an impact on the EU IAS 39 carve-out which is widely used by European banks and therefore represents the current practical benchmark for many preparers.*
- 3 *The European Commission Press Release issued on 19 November 2004<sup>1</sup>, when IAS 39 was endorsed, provides additional information on the EU IAS 39 carve-out:*

*‘... 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 ...*

*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.’*
- 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.*
- 5 *EFRAG will need to assess the impact of this carve-out for transition and if IAS 39 is to be withdrawn.*

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<sup>1</sup> 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)

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

**Notes to constituents – Summary of proposals in the ED**

- 6 *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 risk<sup>2</sup>. These challenges make it difficult to faithfully reflect the effects of dynamic risk management activities in the financial statements.*
- 7 *The IASB proposes that the scope of risk mitigation accounting (RMA) be determined based on a company's business activities and risk management activities instead of the industry in which the company operates.*
- 8 *A company is permitted to apply RMA 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.*
- 9 *The IASB proposes that companies be permitted, but not required, to apply RMA. This flexibility is similar to that provided under the hedge accounting requirements in IFRS 9.*
- 10 *These proposals should enable a company to better align the amounts recognised in its financial statements with the effects of its risk management activities.*
- 11 *The IASB also proposes that RMA be applied at the level at which the company mitigates the repricing risk arising from underlying portfolios in accordance with its risk management strategy.*

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<sup>2</sup> 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.

**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*

12 EFRAG notes that having a clear primary objective or a hierarchy of objectives is important for the selection of consistent requirements for the RMA model and the subsequent consistent application of the requirements. At the same time, none of the possible objectives may be achievable in full<sup>3</sup>, 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.

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<sup>3</sup> E.g. risk management is forward-looking only and considers possible and expected exposures regardless of 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 without any adjustments) represent the economic effect of an entity's risk management activities, e.g., some banks take action to both stabilise and optimise their net interest income as indicated in [EFRAG's 2016 outreach report on how do banks manage interest rate risk](#). Full elimination of accounting mismatches will not be possible in a mixed measurement accounting model.

- 13 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 it 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](#).
- 14 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.
- 15 However, some stakeholders question whether this objective should clearly prevail over eliminating 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.
- 16 Therefore, some stakeholders, including insurers, see merit, as formulated in paragraph BC12 of the ED, in that it may be worth considering eliminating the accounting mismatches as an equally important objective of RMA. We also emphasise the importance of avoiding creating potential accounting mismatches by the RMA model itself (e.g. please refer to the issue of inflated recognitions of gains or losses in response to Question 2 and 11).
- 17 In addition, EFRAG notes that the proposed RMA model, 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 the model influences entities as to how these are conducted, which may contradict the stated primary objective of reflecting the 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 ('FVTPL') and leases 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). Having said this, it may seem contradictory to include FVTPL instruments while having equal objectives as explained in paragraphs 15 - 16 above because including them would create accounting mismatches in profit or loss with the current model. Therefore, if there is a need for a dual objective, the IASB would need to consider any impact on the model.

- 18 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.
- 19 We agree that the application of the RMA model should be voluntary. We also agree that entities that choose not to apply RMA should provide certain disclosures (refer to paragraph 20(f)).
- 20 As for the eligibility criteria to apply the RMA model as outlined in paragraph 7.1.4 of the ED, we note the following.
- (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 apply to a significant number of entities.
  - (b) The second criterion (in 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 calculate and aggregate their exposures gross based on the cash flows of the individual underlying

instruments and then work with interest rate risk limits for different kinds of stresses of those individual cash flows. The ultimate result is equivalent to 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 EU IAS 39 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 an entity's 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 the 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 only entities that manage their interest rate risk on a dynamic basis be scoped in. It is important that those required disclosures create sufficient additional benefits for users and are targeted to those entities that manage on a dynamic basis.

- 21 Given the dynamic nature of RMA, we see the significant risk that the documentation of some of the elements in paragraph 7.1.7 of the ED may become boilerplate repetition of the ED 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 (as per paragraph 7.1.7(b) of the ED) explained how it determines the net repricing risk exposure

(NRRE) and (as per paragraph 7.1.7(d)<sup>4</sup> 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 Question 1.1: For all constituents: 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 16 above that eliminating the accounting mismatches should be an equally important objective of risk mitigation accounting?
- 24 Question 1.2: Preparers, what would the practical challenges be if the ED objective prevails the objective of eliminating accounting mismatches?
- 25 Question 1.3: Preparers, if your entity performs management of interest rate risk on a gross basis and IAS 39 is to be withdrawn as described in the ED, which accounting treatment would you expect to apply? Would 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

- 26 *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;*

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<sup>4</sup> The order of paragraphs 7.1.7(c) and (d) deviates from the order of paragraphs describing RMO and designated derivatives later in the Standard.

- (b) *some future transactions that are not eligible unless it is highly probable that the individual transaction will take place/occur;*
  - (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.*
- 27 *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.*
- 28 *The IASB proposes that the following financial instruments be eligible for inclusion in the RMA model:*
- (a) *financial assets measured at amortised cost or at FVOCI;*
  - (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.*
- 29 *As per paragraphs BC49 and BC50 of the ED, equity instruments are not eligible for inclusion in underlying portfolios. However, there may be exposures to repricing risk arising from variable-rate financial assets where the entity may use internal modelling methodologies (such as replicating portfolios) as a proxy for this exposure (paragraph B7.2.17 of the ED).*
- 30 *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:

- (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*

- 31 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 FVTPL.
- 32 If the scope of items included to calculate the 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 the following.
- (a) The risk limits specified or derived from an entity’s risk management strategy may not be equal to the 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.

33 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.

34 In light of the findings from 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 being included in the underlying portfolios; however, some stakeholders have issues with the 'only if they are' requirement in paragraph 7.2.1 of the ED. Refer to our response to ED Q1 for further comments regarding the objective of RMA.

35 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 33 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.

36 In addition, EFRAG considers that insurance liabilities (fulfilment cash flows as per IFRS 17) should be eligible to be included in the underlying portfolios. Refer to our response in ED Q11.

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

- 40 EFRAG acknowledges the accounting 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. As equity per se cannot be included in the underlying portfolios, EFRAG stresses the importance of having this proxy. We question whether this proxy could be applied for other items that are not eligible for RMA.
- 41 Based on EFRAG's survey *Current practices in dynamic interest rate risk management*, 72% of respondents indicated 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.
- 42 Although IFRS Accounting Standards currently do 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 which 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, would typically have a contractually expected cash flow that is being managed as financial liabilities for interest rate risk management purposes.

43 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 or at least, the coupons would be recognised 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 40 above, AT1 instruments can be reflected in the underlying portfolios by identifying the financial assets that back these equity instruments.

44 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.

45 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.

46 Furthermore, paragraph B7.2.17 of the ED refers to variable-rate financial assets that are exposed to repricing risk which may back equity. It is unclear whether fixed-rate financial assets that may back equity may also be eligible to be reflected in the underlying portfolios.

47 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)*

48 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 proposed risk mitigation adjustment, cause inflated recognitions of the interest rate component of the fair value gains or losses which may not be a faithful representation of the economics. In other words, the financial assets measured at FVOCI

and recognised on the balance sheet contain an interest rate component of fair value gain or losses. To the extent a FVOCI exposure is in the same direction as the NRRE, this interest rate component is also (partly) present in the risk mitigation adjustment, which is also recognised on the balance sheet, thereby inflating the balance sheet. In addition, there may be an impact on the capital/solvency requirements. 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.

- 49 This inflated accounting 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*

- 50 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 a sub-level basis, e.g. at the 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 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.

### Questions to Constituents

- 51 Question 2.1: For all constituents: 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 35 - 36 above. If so, please explain why.
- 52 Question 2.2: For all constituents: Referring to paragraphs 40 to 47, do you consider that the proxy proposal in the ED appropriately addresses concerns raised on equity instruments? Please explain why or why not.
- 53 Question 2.3: For all constituents: 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 48 - 49 above?<sup>5</sup> Preparers and users, do you consider that this is an issue – please explain why? If so, what alternative solutions do you suggest?
- 54 Question 2.4: For all constituents: Do you agree with the points for clarification described in paragraph 50 above? 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.*

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<sup>5</sup> With the proposed accounting for the risk mitigation adjustment, inflated accounting would be more prominent if financial assets and liabilities measured at fair value and insurance liabilities (fulfilment cash flows) were to be eligible for inclusion in underlying portfolios. In the ED only financial assets measured at FVOCI is eligible for inclusion in underlying portfolios.

- 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 be repriced.*
- 59 *The NRRE represents the exposure to repricing risk arising from the underlying portfolios before an entity undertakes any risk management activities.*
- 60 *The entity determines the NRRE 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 NRRE must be reliably measurable. An entity shall determine the NRRE 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 NRRE 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 NRRE 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 NRRE based on reasonable and supportable information about the changes in the underlying portfolios that affect the NRRE. The NRRE shall be determined with sufficient frequency to ensure that changes in the underlying portfolios are reflected in a timely manner and that the NRRE 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 Based on 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 observes 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. 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.

65 EFRAG supports the IASB in not requiring risk limits per repricing time band and the fact that the ED does not prescribe which approach to use as long as it is used consistently.

66 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 cash flow from

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.

- 67 EFRAG notes that benchmark rates, although traded and changing continuously, are often fixed once per day<sup>6</sup>. 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 (the “shall not exceed”-requirement) 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<sup>7</sup>.
- 68 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 frequently occur 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 are differentiating unexpected changes from other changes in an environment in which the RMA model is intended to be applied.
- 69 EFRAG observes that the ED requires the NRRE 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

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<sup>6</sup> The referenced overnight, 1 month, 3 months, 6 months and 12 months benchmark interest rate is generally fixed once per day.

<sup>7</sup> See also paragraph 92(a) below.

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 entirely silent on how to consider credit risk when determining NRRE. EFRAG would expect that any credit risk be included in the expected cash flows and making this explicit would be useful so that entities are aware that they need to include credit risk when calculating the NRRE.

- 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 in 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 are 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.

**Questions to Constituents**

- 71 Question 3.1: For preparers: 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. Preparers, how do you look at credit risk in terms of determining expected cash flows which will be ultimately included in the NRRE?

72 Question 3.2: Preparers, 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

- 73 *Since the RMA model has been developed for repricing risk (which is a form of interest rate risk), the ED proposes that designated derivatives include only interest rate derivatives. The ED proposes that any interest rate derivatives, with the exception of those indicated in paragraph 75 below, could be designated derivatives for the purpose of applying RMA, including basis swaps, forward-starting swaps, forward rate agreements and interest rate futures as well as options and swaptions.*
- 74 *In addition, derivatives between entities in the same group can only be included as designated derivatives for the purposes of applying RMA in the individual or separate financial statements of those entities and not in the consolidated financial statements of the group.*
- 75 *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.*
- 76 *Also, a proportion of the notional amount of a derivative (instead of the entire derivative) could be eligible for RMA.*

#### 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*

77 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.

78 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 an operational 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 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, e.g. with respect to volume in determination of RMO and with respect to fair value changes in determining cumulative gain or loss, or whether the time value component is to be excluded.
- (c) 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).

**Questions to Constituents**

79 Question 4.1: Preparers, are there any operational complications expected for the following:

- (a) when identifying designated derivatives and differentiating them from other derivatives?
- (b) Referring to paragraph 78(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.

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| (c) if a proportion of a derivative is included as designated derivatives, as indicated in paragraph 76 above? |
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### 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*

- 80 *The IASB proposes that the RMO be expressed as an absolute, not a relative, amount of repricing risk. The RMO must be consistent with the amount of repricing risk a company mitigates using designated derivatives. The RMO is therefore specified using the measure a company uses to determine the NRRE. The RMO is not directly linked to underlying portfolios or items in these.*
- 81 *The RMO 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 the NRRE; 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.*
- 82 *A company can specify a new RMO as frequently as needed to ensure alignment with its risk management activities. Specifying a new RMO does not require the company to discontinue RMA. The RMO is specified for a period until an entity specifies a new RMO – for example, when it undertakes further activities to mitigate repricing risk or when there is a change in the NRRE.*

##### *Benchmark derivatives*

- 83 *The IASB proposes that a company replicate the repricing risk specified in the RMO through benchmark derivatives. Benchmark derivatives are theoretical derivatives that are constructed to replicate the timing and amount of repricing risk as specified in the RMO.*
- 84 *A company constructs benchmark derivatives to have an initial fair value of zero based on the mitigated rate. Although the RMO must be consistent with the amount of repricing risk the company intends to mitigate using designated derivatives, the RMO is capped by the*

NRRE in each repricing time band and thus the benchmark derivatives cannot simply replicate all the terms of the designated derivatives.

- 85 RMA 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.
- 86 If such changes reduce the NRRE to an amount below the volume of the designated derivatives, the RMO is reduced, and the company is required to adjust the benchmark derivative to capture the effects of the changes.
- 87 A company is permitted to use an approach of its choice to estimate the effect of changes to the NRRE 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*

- 88 The part of the model related to the RMO and the benchmark derivatives gives rise to multiple issues, both conceptual and operational in nature.

- 89 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 on how this requirement is to take into account uncertainties of cash flows (credit risk, prepayments, extensions and other behavioural issues) in the underlying portfolios. Furthermore, this may create issues in a situation of late hedging of past positions (e.g. hedging undertaken following a merger or an acquisition).
- 90 When defining the RMO, the RMA model, with its focus on mitigation per repricing time band and the lower of test in paragraph 7.4.8 of the ED, departs from those risk management strategies that are agnostic as to the sign of the exposure as long as it stays within the specified limit(s). In this regard, EFRAG notes the requirement in paragraphs 7.4.8 and 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 in terms of accounting.
- 91 In addition, over-hedging in one time band while under-hedging in another one may represent an entity's actual risk management<sup>8</sup>. 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 relief from the requirement in paragraphs 7.4.8 and 7.4.9 of the ED on the impact of over-hedging.
- 92 EFRAG notes that there are clarifications needed related to the operationality of the lower of test for RMO.

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<sup>8</sup> Entities placing derivatives in different time bands than their exposures may adjust the volume of the derivatives to take into consideration the expected non-constant correlation between time periods over the time horizon. This will cause an issue when assessing the volume constraint when deriving the RMO.

- (a) When NRRE occurs on different dates than designated derivatives within the same repricing time band, 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 entity's risk management strategy?
  - (c) EFRAG understands 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?
- 93 Paragraph B7.1.8 of the ED states that an entity may manage repricing risk based on different currencies and that a mitigated rate may be specified for each of the main currencies. 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 EUR) 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.
- 94 EFRAG notes that the term 'unexpected changes' is widely used throughout the ED but most notably in the section dealing with the 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 ED); and
  - (b) such wording may contradict the nature of the model, which is based on dynamic risk management and frequent changes in expectations.
- 95 EFRAG notes that the requirements in (a) paragraph 7.4.5 of the ED that new benchmark derivatives are to be constructed so 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 will operationally 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.

- 96 EFRAG notes that this part of the model may be operationally challenging, 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. In addition, 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 during the field-testing and EFRAG’s consultation is essential.
- 97 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.
- 98 All these considerations are subject to confirmation through further analysis and field testing.

#### **Questions to Constituents**

- 99 Question 5.1: For all constituents: 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? If yes, please provide examples of scenarios where such issues may arise.
- 100 Question 5.2: Preparers, in your view, how feasible operationally are the proposals of the IASB? Please explain potential significant 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*

- 101 *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.*

102 *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.*

103 *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*

104 *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 NRRE at the reporting date.*

105 *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 NRRE 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*

106 *If such an indication exists, the company is required to determine whether the risk mitigation adjustment exceeds the present value of the NRRE as of the reporting date.*

107 *The present value of the NRRE represents the maximum amount at which the risk mitigation adjustment could have been recognised if a company had fully mitigated the NRRE as at the reporting date. This present value is calculated using the mitigated rate as the discount rate.*

108 *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.*

109 *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*

110 Referring to the lower of test in paragraph 7.4.8 of 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 do not incorporate gains or losses on designated derivatives that have been derecognised. The cumulative gains or losses of the designated derivative 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.

111 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.

- 112 EFRAG acknowledges the merits of the proposed accounting treatment, notably for banks. EFRAG notes, however, that other constituents may have concerns related to the calculation and presentation of the risk mitigation adjustment – please refer to the response to Question 11 for more details about the views of insurance entities on this matter, specifically on inflated accounting.
- 113 EFRAG notes that the ED is silent on the granularity when calculating the risk mitigation adjustment. While the NRRE and RMO are calculated per repricing time band, a natural reading of paragraphs 7.4.8 and 7.4.11 of the ED leads to the conclusion that the risk mitigation adjustment and risk mitigation adjustment excess are 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 of operational challenges when a series of positive and negative adjustments of the RMO have occurred and these are linked with the recognition of the risk mitigation adjustment excess in profit or loss. For the sake of consistent application, EFRAG asks for explicit wording on the granularity when calculating the risk mitigation adjustment.
- 114 EFRAG observes that the 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).
- 115 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 the RMOs/benchmark derivatives, 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 cover the following:
- (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)?

116 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.

117 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 EFRAG's 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 in the field-testing.

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

#### Questions to Constituents

119 Question 6.1: For all constituents: In general, what are your views on the accounting treatment proposed (on how to recognise and measure the risk mitigation adjustment) in the ED? Please explain.

120 Question 6.2: For all constituents: What are your views on the risk mitigation adjustment excess as proposed in the ED? Whether and what examples of indicators should be considered when an entity performs the risk mitigation adjustment excess test? Please explain.

121 Question 6.3: Preparers, what are your views on the operational feasibility of recognising and measuring the risk mitigation adjustment? Please explain any key operational issues.

122 Question 6.4: For all constituents: What are your views on the fair value of the NRRE as proposed in the model, both from conceptual and operational points of view? Please explain.

#### Question 7 – Discontinuation of risk mitigation accounting (Section 7.5)

##### Notes to constituents – Summary of proposals in the ED

123 *RMA is intended to resolve 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 RMA would no longer align with its risk*

*management strategy and might not achieve the intended benefit or provide useful information to users of financial statements.*

124 *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 RMA are included in paragraph B7.5.3. of the ED.*

125 *However, the IASB acknowledged that changes that reflect the dynamic nature of an entity's repricing risk exposure are consistent with the objective of RMA. Therefore, such changes (e.g. changes to the RMO, risk limits, underlying portfolios, designated derivatives) should not result in an entity discontinuing the application of risk management. A company might change its risk managements activities without needing to discontinue risk management accounting.*

126 *Therefore, the IASB proposes that if a company chooses to apply RMA, it shall not discontinue applying it unless there is a change in the company's risk management strategy.*

127 *If, following the discontinuation of RMA, 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.*

128 *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.*

129 *The IASB proposes that voluntary discontinuation be prohibited to avoid an entity applying RMA 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 NRREs if these items continue to meet qualifying criteria.*

130 *The IASB concluded that, when RMA is discontinued, the financial instruments in the underlying portfolios can either be included in a new application of RMA – 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 RMA. 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*

- 131 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.
- 132 EFRAG agrees that changes in the risk management strategy should be expected to occur very infrequently.
- 133 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. For example, it may be difficult to clearly distinguish changes in 'how the entity manages the risk' from changes in the RMO, or to separate changes in the underlying

portfolios included in the NRRE from changes to the time horizon and changes in the risk management level.

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

135 With reference to the illustrative examples provided in paragraph B7.5.3 of the ED, EFRAG has the following observations.

(a) EFRAG understands the rationale for considering a reduction of the mitigated time horizon as a change in the risk management strategy, as some previously managed risk positions are no longer being risk managed. However, it is not entirely clear what the implication of an extension of the mitigated time horizon should be. Previously managed positions continue to be managed while added positions are managed with the same implications as if they were 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 EFRAG therefore asks the IASB for clarification on this<sup>9</sup>.

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

136 With regard to the examples in paragraphs B7.5.3 and B7.5.4 of the ED, EFRAG asks for clarification on whether changes to the structure of repricing time bands reflect a change in the entity's risk management strategy or a change in the entity's risk management activities.

137 EFRAG suggests including the content of paragraphs BC124 to BC126 of the ED in the application guidance because we consider that this is guidance on what the entity could do with the financial instruments when the RMA has been discontinued.

138 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

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<sup>9</sup> 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.

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 economic benefit represented by the RMA no longer remains and 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**

139 Question 7.1: For all constituents: Do you agree with EFRAG's 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**

140 *The IASB decided that, because RMA 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 are issued.*

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

- (a) the date the entity applies RMA in accordance with Chapter 7; and*
- (b) the 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*

142 There are differing views on the withdrawal of IAS 39 from banks and insurers.

- (a) Most of the constituents agree that IAS 39 should remain available, together with RMA, 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 first publishing RMA, then waiting for a number of years to see how practice develops and then deciding 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.

143 The ED states that an entity may apply RMA from the beginning of an annual reporting period starting on or after [the date the requirements are issued]. Some stakeholders suggest that an entity that is not applying IAS 39 may apply RMA as of the date of the (future) amendments instead of the beginning of the next annual reporting period. For this to be possible, it should be stated that an entity should not apply IAS 39 and RMA in the same annual reporting period.

144 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.

- 145 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 in the field testing.
- 146 Regarding when to apply the proposed disclosure requirements in paragraph 33A of IFRS 7, EFRAG's view is that entities should be able to have sufficient time to implement the disclosures.
- 147 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 that the IASB continue its efforts with insurers even if the model for banks is finalised. This may also be 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

- 148 Question 8.1: Preparers, how long do you expect the implementation period for the RMA to be?
- 149 Question 8.2: For all constituents: How much the time do you expect to be needed to transition from IAS 39?
- 150 Question 8.3: For all constituents: Do you agree with the suggested way forward for insurers in 147 above? Please explain.

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

##### Notes to constituents – Summary of proposals in the ED

- 151 *The potential requirements for the initial application of RMA 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 (paragraphs BC128 and BC129 of the ED).*
- 152 *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).*

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

154 *The transition requirements in paragraphs C2.56–C2.61 of the ED apply when an entity first applies RMA regardless 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*

155 *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).*

156 *The IASB noted that because the application of RMA 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 paragraphs 7.2.22–7.2.26 of the ED (and paragraph BC134 of the ED).*

*Transition from IFRS 9 hedging relationships*

157 *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 RMA (paragraph C2.58 of the ED).*

158 *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

159 *An entity may revoke previous FVTPL designations for financial instruments that will be included in the underlying portfolios used for RMA. When first applying RMA, 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

160 *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*

- 161 EFRAG considers the transition reliefs in paragraphs C2.58 and C2.59 of the ED useful because the application of RMA could provide the entities with a new accounting method that better and more faithfully reflects the effects of their risk management activities.
- 162 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.
- 163 As some insurers that responded the EFRAG survey indicated that a robust solution should be sought rather than targeted improvements to IFRS 9 and IFRS 17, they suggested permitting entities to revoke the previous risk mitigation option under IFRS 17 when they transition to applying 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 (VFA), as explained in paragraph 202 below.

**Question to Constituents**

- 164 Question 9.1: For all constituents: 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*

- 165 *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*

166 *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 RMA has affected the company's statement of financial position and statement of comprehensive income.*

167 *In addition, the IASB proposes a qualitative disclosure requirement for companies that are eligible to apply, but choose not to apply, RMA. 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*

- 168 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. on whether, in a situation of a discontinued risk mitigation adjustment, it should still be netted against other risk mitigation adjustments on the face of 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.
- 169 EFRAG generally welcomes the disclosure requirements proposed in paragraphs 30F–30P of the ED. EFRAG considers mandatory disclosure requirements of the RMA model a significant step forward, notably in the context of the IAS 39 EU carve-out where such mandatory disclosures are not present. In EFRAG’s view, the proposed disclosures will improve the quality of information provided to users and the comparability of financial statements.
- 170 EFRAG notes that the detailed analysis of the disclosure requirements will be undertaken during the comment period of the ED. EFRAG emphasises the importance of cost/benefit considerations in this analysis as the implementation costs may be significant. In addition, EFRAG notes previous concerns from constituents that disclosure requirements should avoid disclosing commercially sensitive information.
- 171 EFRAG notes that a significant volume of related information on the company’s risk management of interest rate risk is provided in other sources, e.g. in Pillar III reports. Therefore, in EFRAG’s 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 EFRAG’s 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 requirements<sup>10</sup>. Referring to the concerns raised on the objective of the RMA model 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.

- 172 EFRAG notes that the disclosure requirements introduced in paragraph 33A of the ED relate to companies that have decided 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 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 users, notably for comparability of the financial statements and the limited cost of implementation due to their qualitative nature.
- 173 In addition, EFRAG notes the importance of providing disclosures about discontinued RMA models and information on changes in risk management strategies that result in discontinuations of RMA models. Referring to paragraph 135, 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.
- 174 As mentioned in paragraph 69 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 the NRRE.

**Questions to Constituents**

- 175 Question 10.1: Preparers and users, how do you see the cost/benefit balance of the proposed disclosure requirements?
- 176 Question 10.2: Preparers, are there any significant operational or other concerns in providing the disclosure requirements in general?
- 177 Question 10.3: For all constituents: 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?

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<sup>10</sup> Paragraph 21B of IFRS 7

## Question 11 – Risk management strategy

### Notes to constituents – Summary of proposals in the ED

- 178 *Insurance liabilities are not eligible for inclusion in the underlying portfolios in the RMA model (refer to the Notes to Constituents in ED Question 2 for what is eligible).*
- 179 *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 the financial statements using RMA.*

#### **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 of the ED.

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*

- 180 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 project<sup>11</sup>.
- 181 EFRAG welcomes the fact that the IASB is seeking feedback from insurers in order to assess whether their interest rate risk management activities could be reflected using RMA. EFRAG is of the view that an RMA model is needed also for entities that issue insurance

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<sup>11</sup> Paragraph BC55 of IFRS 17.

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. As stated in paragraph 36, insurance liabilities (fulfilment cash flows as per IFRS 17) should be eligible to be included in the underlying portfolios. Based on 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.

182 As per the EFRAG survey, 76%<sup>12</sup> 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.

183 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 192 below.

*Current risk management strategy and activities*

184 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.

185 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.

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<sup>12</sup> 13 out of 17 respondents that replied.

- (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 may surrender contracts to seek higher returns elsewhere during periods of rising interest rates, and the insurer could be forced to sell bonds below book value and incur losses.
- 186 *Items included in the risk position.* 10 of the 12 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.
- 187 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.
- 188 *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.
- 189 *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 it based on regulatory reporting. One respondent manages it based on both internal and regulatory targets.
- 190 *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 insurer respondents (44%) assess it daily or more often.
- 191 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*

192 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, for entities that choose 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 to be recognised in other comprehensive income (OCI), the fair value changes of the derivatives used to align those cash flows are recognised in profit and loss (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, which is hard to demonstrate for very long contracts, and due to the separately identifiable and reliably measurable criteria, which require a lot of judgement for insurance liabilities. Moreover, IFRS 9 current hedge accounting issues include new businesses 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*

193 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.

194 *Inflated accounting in the financial statements for financial assets measured at FVOCI (this also relates to banks, as explained in paragraph 48 above)*. Unlike banks, insurers generally measure their assets and liabilities at fair value. In this case, a risk mitigation adjustment on the balance sheet would lead to inflated accounting<sup>13</sup> in insurers' financial statements

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<sup>13</sup> 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.

on the interest rate component of the fair value gains or losses, particularly for financial assets measured at FVOCI.

- 195 In addition, even with the risk mitigation adjustment on the balance sheet, there would still be volatility in OCI as explained in paragraph 192(a) above and paragraph BC45 of the ED. Therefore, some insurers have suggested not having 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.
- 196 A few have also suggested that, instead of recognising the risk mitigation adjustment on the balance sheet, 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 Management whereby an entity would recognise the aligned portion of gains and losses from changes in the fair value of designated derivatives<sup>14</sup> into OCI.
- 197 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.
- 198 *Items to include in the underlying portfolios in order to calculate the NRRE.* Some insurers have indicated that the contractual service margin should also be eligible to be included in the assessment of the NRRE.
- 199 In addition, it is important to define the scope of behavioural assumptions and their link to interest rate risk, similar to banks that model on prepayments.
- 200 *Operationality of the model*<sup>15</sup>. 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.
- 201 *RMO by time bands (relates also to banks as explained in paragraph 66 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 insurers<sup>16</sup> do not manage

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<sup>14</sup> [February 2022 IASB Staff paper](#)

<sup>15</sup> Also relates to banks

<sup>16</sup> And also a number of other entities, including some banks.

risk by time bands but manage risk limits on an overall basis. Therefore, there should be flexibility in defining risk limits.

- 202 *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, the 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 that 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 accounting solution to reflect the dynamic risk management of the interest rate risk of insurance contracts.
- 203 Having considered the issues described above, EFRAG highlights the need for the insurance industry to get an accounting solution that better reflects its dynamic interest rate risk management in its financial statements compared to current accounting. However, based on the extensive 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**

- 204 Question 11.1: Preparers, 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 what adaptations may be needed, if any.
- (b) If not, explain why not and suggest alternative solutions.
- 205 Question 11.2: For all constituents: Referring to paragraphs 195 and 196, which of the two proposed solutions do you support and why or please explain any other alternative solutions.
- 206 Question 11.3: Preparers, referring to paragraph 198, do you consider that the contractual service margin should be eligible to be included in the underlying portfolios? Please explain why and what is the interest rate risk being hedged.

- 207 Question 11.4: Preparers, referring to paragraph 201 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.
- 208 Question 11.5: Preparers, 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 202 above? Please explain.