

Dynamic Risk Management – Outreach feedback Cover Note

Objective

1. The objective of the session on DRM is to provide feedback to EFRAG TEG on the IASB's discussions in November 2021 and EFRAG FIWG's discussions on the meeting.

Background

2. The project aims to improve the accounting for situations where risks are managed dynamically (i.e., with frequent changes to an open portfolio of assets and liabilities). The various concerns about the current requirements are set out in paper [06-04 – An introduction to DRM core model](#) of the EFRAG TEG May 2021 meeting. Given these concerns, the IASB is considering a new model to replace fair value portfolio hedging under IAS 39.
3. The replacement is of interest to those in Europe using the EU carve out but also to those banks who currently apply the portfolio hedging option in IAS 39 as issued who require improvement to the current model.

IASB project (2014 to now)

4. The IASB started its discussions on the current project in 2010. Below is some of the highlights in the IASB project, including EFRAG activities/reports.

<u>Project stage / period</u>	<u>Further details/links</u>	<u>Reference</u>
IASB DP 2014	<ul style="list-style-type: none"> • IASB Discussion Paper: Accounting for Dynamic Risk Management: a Portfolio Revaluation Approach to Macro Hedging • EFRAG Final Comment Letter; IASB comment letter analysis; EFRAG feedback statement 	Paper 06-04 of May 2021 meeting
IASB agenda consultation/ EFRAG outreach 2015 - 2017	<ul style="list-style-type: none"> • IASB included DRM after Agenda consultation. • EFRAG report on findings on its research on Dynamic risk management 	n/a
IASB Core Model and outreach 2015 – 2021	<ul style="list-style-type: none"> • IASB development of the Core Model • EFRAG TEG/CFSS: 25 September 2019 • EFRAG FIWG: 15 November 2019 • IASB outreach (2020/2021): EFRAG attended/ arranged meetings with European banks. 	Paper 06-04 of May 2021 meeting
IFRS 17 FEA 2021	<ul style="list-style-type: none"> • Considerations around hedge accounting for insurance entities 	Appendix 5 of Appendix III

¹ The DRM team consists of the following members: Almudena Alcalá; Didier Andries, Fredré Ferreira (team leader) and Sapna Heeralall.

Core model feedback May/June 2021	<ul style="list-style-type: none"> • EFRAG TEG meeting: May 2021 • EFRAG Board meeting: June 2021 	Paper 06-02 and 06-03 of May 2021 meeting
This meeting	<ul style="list-style-type: none"> • September 2021 discussions of the IASB • IASB objections against the Carve-out • Plan for interaction with stakeholders on carve out 	Paper 09-02 Paper 09-03 This paper
Next steps	<ul style="list-style-type: none"> • The IASB will continue its deliberations in the coming months and EFRAG will do outreaches on the carve-out. • The EFRAG Secretariat will continue to update EFRAG TEG and Board on these. 	

The IASB's project plan

5. The IASB agreed at its meeting on 24 May 2021 to the following re-deliberation plan:

Indicative timeline	Topics
Q3 2021	Interaction between risk limits and target profile
Q4 2021	Designation of a proportion of prepayable assets
Q1 2022	Recognising changes in fair value of derivatives in OCI
	Decide on project direction

Previous EFRAG TEG discussions on the issue of risk limits and next steps

High-level outreach feedback

6. The core model operates on the idea of a single desired outcome for risk management purposes, but banks operate within accepted risk ranges or limits.

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7. Members welcomed the IASB's response to the messages from the EU participants.
8. EFRAG TEG members noted that the focus on a single outcome as opposed to working with risk limits is as a big obstacle in regard to the core model as proposed.
9. In addition to the discussion on risk limits, EFRAG TEG indicated that it considers the following steps as important:
 - a. After 15 years of continuing use, investigate the perception of the current carve out, including in outreaches with auditors, investors and regulators. Do users get sufficient and reliable information? Do they understand what the entity is doing?
 - b. Investigate current market practices, including how significant is the group of European banks that do not use the carve out.
 - c. Consider education sessions on risk management strategies and approaches. Consider outreach with users regarding risk management

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10. EFRAG TEG members raised the following points:
 - a. An easy solution may not be possible given the complexity of the topic, but it is clear that the project is moving in the right direction and that this development is positive. Some remained cautious given early stage of the discussions and the outcomes of the next steps are unclear;
 - b. Testing of the updated proposals is essential to assess their validity;

- c. Internal derivatives would need to be addressed given that the Banking Book is generally risk neutral (apart from some basis risk that cannot be or is preferred not to be transferred);
- d. Risk management, risk limits and risk frameworks may exist in a risk matrix and therefore, it may be difficult to apply these concepts in practice;
- e. There is a variety of possible risk management strategies and a mitigating transaction for one bank can be seen as opening a risk position in another bank. The wording around increased risk will have to be clearly defined;
- f. Change in risk limits need to be defined and the related accounting delineated;
- g. The risk framework of banks encompasses all risks, not only risks defined according to the accrual of interest; also, fair value risks are to be considered. Some banks focus on the former, other on the latter.
- h. Supports additional disclosures as where the accounting follows the risk management practices, comparability would be impacted. Still, disclosures can be highly sensitive, e.g., disclosures of risk limits would not be supported.

Next steps

- 11. The EFRAG Secretariat will continue to update EFRAG FIWG, TEG and Board on the IASB's discussions.
- 12. The EFRAG Secretariat will revert to EFRAG TEG with the results from its outreach with auditors, and regulators about the perception about the carve out at a future meeting.
- 13. A similar process with a survey is planned to understand user perceptions and needs with respect to the carve-out/dynamic risk management.

Questions to EFRAG TEG

- 14. Does EFRAG TEG have observations or questions on the next steps?

Agenda paper 10-02:

- 15. Does EFRAG TEG have comments or questions on the IASB Staff paper, the IASB's discussions or EFRAG FIWG comments?

Agenda Papers

- 16. In addition to this cover note, agenda papers for this session are Agenda paper 10-02 –September 2021 IASB discussions on Risk limits.