

## Dynamic Risk Management Cover Note

### Objective

1. The objective of the session on DRM is to provide feedback to EFRAG FR TEG on:
  - a. the IASB's February 2022 meeting and EFRAG FIWG's reactions to that meeting; as well as
  - b. the feedback received about the perception and use of the EU carve out.

### Executive summary of papers

#### *Hedge accounting mechanism (paper 03-02)*

2. In its February meeting, the IASB were not asked to make any decisions. The Staff paper discussed two approaches to the hedge accounting mechanics of the DRM. Approach A is a symmetrical approach, which is similar to the fair value hedge mechanics, but with some changes to reflect to the characteristics of dynamic risk management. Approach B is based on mechanics that are a combination of cash flow and fair value hedging mechanics.

#### *Feedback re carve out (paper 03-03)*

3. In summary, the outreach confirmed that the carve-out is widely used in many European countries, mostly for consolidated groups but in some cases, such as in Italy, also for the separate accounts of banks. Practices have been established and have commonalities mainly at country level. Disclosures about the use of the carve out is not uniform and unclear. In the absence of specific disclosure requirements, the information about hedging accounting practices is not often presented. However, the use of carve-out is not an area of focus in the communication to the market or an area that raises questions from users. Users have suggested some possible additions to consider in terms of disclosure of interest rate risk management as described in Paper 03 - 03. Preparers also confirmed comments made during the earlier outreach with the IASB.
4. The quantification of the use of the carve out has proven to be complicated by several factors and it is difficult to form an overarching view of the importance of the topic to the industry on an overall basis.

### Background

5. The project aims to improve the accounting 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. These concerns are the reason for the current project to replace portfolio hedging under IAS 39.
6. The replacement is important to all preparers using the EU carve out or those EU banks using IAS 39 portfolio hedging who require improvement to the current model.

---

<sup>1</sup> The DRM team consists of the following members: Didier Andries, Fredré Ferreira (team leader) and Sapna Heeralall.

IASB project (2014 to now)

7. 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  EFRAG outreach 2016	<ul style="list-style-type: none"> <li>• <a href="#">IASB Discussion Paper: Accounting for Dynamic Risk Management: a Portfolio Revaluation Approach</a> to Macro Hedging</li> <li>• EFRAG <a href="#">Final Comment Letter</a>; IASB <a href="#">comment letter analysis</a>; EFRAG <a href="#">feedback statement</a></li> <li>• EFRAG <a href="#">report</a> on findings on its research on Dynamic risk management</li> </ul>	Paper <a href="#">06-04</a> of May 2021 meeting
IASB Core Model, outreach and feedback 2015 – 2021	<ul style="list-style-type: none"> <li>• IASB developed model and EFRAG attended meetings with European banks for feedback</li> <li>• EFRAG TEG meeting: <a href="#">May 2021</a></li> <li>• EFRAG Board meeting: <a href="#">June 2021</a></li> </ul>	Paper <a href="#">06-02</a> , <a href="#">06-03</a> and <a href="#">06-04</a> of May 2021 meeting
IFRS 17 FEA 2021	<ul style="list-style-type: none"> <li>• Considerations around hedge accounting for insurance entities</li> </ul>	Appendix 5 of <a href="#">Appendix III</a>
IASB redeliberation 2021	<ul style="list-style-type: none"> <li>• EFRAG TEG December 2021 meeting</li> </ul>	Paper <a href="#">10-02</a>
This meeting	<ul style="list-style-type: none"> <li>• <b>February 2022 discussions of the IASB</b></li> <li>• <b>Stakeholder feedback on EU carve out</b></li> </ul>	Paper 03-02 Paper 03-03
Next steps	<ul style="list-style-type: none"> <li>• The IASB will continue its re-deliberations in Q2 to determine project direction<sup>2</sup>.</li> <li>• The EFRAG Secretariat will continue to update EFRAG FR TEG and Board on these.</li> </ul>	

**The IASB’s project plan**

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

<i>Indicative timeline</i>	<i>Topics</i>
Q3 2021	Interaction between risk limits and target profile
Q4 2021	Designation of a proportion of prepayable assets
Q2 2022	Recognising changes in fair value of derivatives in OCI
	Decide on project direction

**Previous EFRAG TEG discussions on the issue of hedge accounting mechanism**

*High-level outreach feedback*

9 The core model envisaged the use of a cash flow hedge mechanism with changes in the fair value of the derivative being recognised in OCI.

10 This was universally opposed by participants in the outreach and by some more strongly than others. While the strongest concern related to the impact on CET1 and whether a filter would be possible, there were also some concern for the implications

---

<sup>2</sup> The IASB Staff indicated previously that Phase 2 of the project would include topics such as hedging of equity, pipeline transactions and items measured at FVOCI.

of the IFRS equity. For the detailed feedback reported to EFRAG TEG, please consult Appendix 1 of paper 03-02.

**11. Questions to EFRAG FR TEG are in the relevant papers.**

**Agenda Papers**

12. In addition to this cover note, agenda papers for this session include:
- a. Agenda paper 03-02 – February 2022 IASB discussions on hedge accounting mechanism;
  - b. Agenda paper 03-03 – Feedback received from stakeholders about perception and extent of use of the EU carve out; and
  - c. Agenda paper 03-04 – DRM - Slides for presentation.