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Dynamic Risk Management: Update on IASB tentative decisions Cover Note

Objective

- 1 The objective of the session is to update EFRAG FR TEG and obtain views on the latest IASB tentative decisions on the Dynamic Risk Management (DRM) project related to the discussion on:
 - (a) whether equity should be eligible to be included in the current net open position (November 2022 discussion);
 - (b) whether the requirement for notional alignment of designated assets and liabilities should be reconsidered (November 2022 discussion);
 - (c) whether financial assets measured at fair value through other comprehensive income ('FVOCI') or at fair value through profit or loss ('FVPL') are eligible for inclusion in the current net open position ('CNOP') (February 2023 discussion); and
 - (d) how unexpected changes could be reflected in the assessment and measurement of performance in the DRM model (February 2023 discussion).
- 2 Questions for EFRAG FR TEG are in agenda paper 05-02, 05-03 and 05-04.

Background of the IASB project

- 3 Since November 2021, the IASB discussed refinements to the DRM model and made various refinements to the original model and decided in July 2022 to add the DRM project to its standard-setting agenda. This means that the next document to be issued would be an exposure draft rather than another discussion paper.
- 4 In [AP4](#) of the July 2022 meeting, the IASB Staff set out the areas and topics that need to be further considered in order to complete the developments of the DRM model together with a proposed order of future discussions for the next stage of the project. The main areas that the IASB planned to discuss in future meetings are:
 - (a) eligible items and the determination of the current net open risk position;
 - (b) target profile and its alignment with an entity's risk management strategy;
 - (c) designated derivatives;
 - (d) risk mitigation intention and the construction of benchmark derivatives;
 - (e) performance assessment and subsequent unwinding of DRM adjustments;
 - (f) other considerations (e.g., qualifying risk management strategies, whether more than one DRM model could exist for different business units or for different currencies, and the transition requirements); and
 - (g) presentation and disclosure requirements.

- 5 In November 2022, the IASB started the discussion which will continue regularly throughout 2023. The first two topics discussed were equity as eligible items and notional alignment of designated assets and liabilities. In this regard, the IASB tentatively decided that:
- (a) equity is not an eligible item for the purpose of the DRM model as the inclusion of equity is not necessary to determine an entity's CNOP (IASB Staff paper [AP4A](#)); and
 - (b) notional alignment is not required between the designated assets and liabilities in determining an entity's CNOP (IASB Staff paper [AP4B](#)).
- 6 In February 2023, the IASB had further discussions on eligible items and unexpected changes. In this regard, the IASB tentatively decided:
- (a) that when an entity determines its current net open risk position under the DRM model, financial assets measured at FVOCI are eligible for designation in the DRM model, but financial assets measured at FVPL are not (IASB Staff paper [AP4A](#)); and
 - (b) not to require an entity to make a retrospective assessment against its target profile, but to require an entity to assess whether the current net open risk position at the end of the DRM assessment period can realise the expected benefits (in the form of reduced variability in earnings or economic value) represented by the DRM adjustment (IASB Staff paper [AP4B](#)).
- 7 A summary of past IASB tentative decisions relating to the refinements of the DRM model can be found in the Appendix to this cover note.

Background of the EFRAG discussions

- 8 The IASB's re-deliberations have been discussed at the following EFRAG meetings:

	FIWG	FR TEG
Risk limits and prepayable assets	8 December 2021	22 December 2021
DRM mechanics	15 March 2022 21 June 2022 6 September 2022	22 March 2022 28 June 2022 (FR TEG – CFSS) 14 September 2022
Project Plan	6 September 2022	14 September 2022
Equity and notional alignment	30 January 2023	16 March 2023
Eligible items and unexpected changes	1 March 2023	16 March 2023

- 9 In addition, in February 2023, the EFRAG FR TEG received an educational session from the IASB Technical Staff to describe the main features of new DRM model as tentatively decided by the IASB so far.

Next steps

- 10 The EFRAG Secretariat will continue to monitor the IASB developments on the project and provide update to the EFRAG FIWG, EFRAG FR TEG members and EFRAG FRB.

Agenda Papers

- 11 In addition to this cover note, agenda papers for this session are:

Dynamic Risk Management: Update of IASB tentative decisions – Cover Note

- (a) Agenda paper 05-02 – Issues paper – DRM - Equity and notional alignment;
- (b) Agenda paper 05-03 – Issues paper – DRM – Eligible items;
- (c) Agenda paper 05-04 – Issues paper – DRM – Unexpected changes;
- (d) [Link](#) to November 2022 IASB Staff paper AP4A on equity as eligible item – for background information;
- (e) [Link](#) to November 2022 IASB Staff paper AP4B on notional alignment – for background information;
- (f) [Link](#) to February 2023 IASB Staff paper AP4A on eligible items – for background information;
- (g) [Link](#) to February 2023 IASB Staff paper AP4B on unexpected changes – for background information; and
- (h) [Link](#) to series of eight webcasts to explain the DRM project based on the IASB’s tentative decisions to date produced by the IASB staff – for background information.

Appendix: Summary of IASB tentative decisions relating to the refinements of the DRM model

February 2023

- 1 The IASB met on 22 February 2023 to continue its discussions on the development of the Dynamic Risk Management (DRM) model. The IASB discussed:
 - (a) whether financial assets measured at fair value through other comprehensive income (FVOCI) or fair value through profit or loss (FVPL) are eligible for inclusion in the determination of an entity's current net open risk position (Agenda Paper 4A); and
 - (b) whether it is necessary to refine the requirements for the assessment of the performance of the DRM model, including how to reflect in financial statements the effects of any unexpected changes in the model (Agenda Paper 4B).

Items eligible for designation in the current net open risk position (IASB Staff Agenda Paper 4A)

- 2 The IASB tentatively decided that, when an entity determines its current net open risk position under the DRM model, financial assets measured at FVOCI are eligible for designation in the DRM model, but financial assets measured at FVPL are not. The IASB's rationale for its tentative decision is that financial assets measured at FVOCI have the same exposure to variability in future net interest income and fair value as financial assets measured at amortised cost.
- 3 All 12 IASB members agreed with this decision.

Performance assessment and unexpected changes (IASB Staff Agenda Paper 4B)

- 4 The IASB tentatively decided not to require an entity to make a retrospective assessment against its target profile because such an assessment would not provide useful information to users of financial statements. However, the IASB tentatively decided to require an entity to assess whether the current net open risk position at the end of the DRM assessment period can realise the expected benefits (in the form of reduced variability in earnings or economic value) represented by the DRM adjustment.
- 5 All 12 IASB members agreed with this decision.

November 2022

- 6 The IASB met on 23 November 2022 to begin discussions on the next phase in the development of the Dynamic Risk Management (DRM) model. The IASB discussed:
 - (a) whether equity is eligible for inclusion in determining an entity's current net open risk position (IASB Staff Agenda Paper 4A); and
 - (b) whether a previous tentative decision to require notional alignment between the asset profile and the target profile in the DRM core model is still necessary following the recent refinements to the DRM model (IASB Staff Agenda Paper 4B).

Managing equity (IASB Staff Agenda Paper 4A)

- 7 The IASB tentatively decided that in determining an entity's current net open risk position, the inclusion of equity is not necessary, and therefore, equity is not an eligible item for the purpose of the DRM model.
- 8 All 11 IASB members agreed with this decision.

Notional alignment of designated assets and liabilities (IASB Staff Agenda Paper 4B)

- 9 The IASB tentatively decided that in determining an entity's current net open risk position, notional alignment is not required between the designated assets and liabilities.
- 10 All 11 IASB members agreed with this decision.

May 2022

- 11 The IASB met on 23 May 2022 for final deliberations on three key challenges identified during meetings with preparers. The IASB:
- (a) discussed refinements to the mechanics of the Dynamic Risk Management (DRM) model, namely, which amounts to recognise and where to recognise them in financial statements (IASB Staff Agenda Paper 4A).
 - (b) discussed whether to move the Dynamic Risk Management project from the research programme to the standard-setting programme (Agenda Paper 4B).

Mechanics of the DRM model (IASB Staff Agenda Paper 4A)

- 12 The DRM model is intended to enable an entity to better reflect its dynamic risk management strategy in its financial statements and provide useful information to users of financial statements. The IASB tentatively decided to change the mechanics of the DRM model to require:
- (a) designated derivatives to be measured at fair value in the statement of financial position.
 - (b) the DRM adjustment to be recognised in the statement of financial position, as the lower of (in absolute amounts):
 - (i) the cumulative gain or loss on the designated derivatives from the inception of the DRM model; and
 - (ii) the cumulative change in the fair value of the risk mitigation intention attributable to the repricing risk from inception of the DRM model (which would be calculated using the benchmark derivatives as a proxy).
 - (c) the net gain or loss from the designated derivatives calculated in accordance with (a) and the DRM adjustment calculated in accordance with (b) to be recognised in the statement of profit or loss.
- 13 All 10 IASB members agreed with these decisions.

Project Direction (IASB Staff Agenda Paper 4B)

- 14 The IASB decided to:
- (a) add the Dynamic Risk Management project to its standard-setting programme; and
 - (b) continue using the expertise of advisory bodies instead of establishing a dedicated consultative group for the project.
- 15 All 10 IASB members agreed with these decisions.

November 2021

- 16 The IASB met on 19 November 2021 to discuss refinements to the Dynamic Risk Management model (DRM model) to address challenges identified during meetings with preparers.

Refinements to the DRM—Risk Limits (Agenda Paper 4A)

- 17 To enable an entity to better reflect its risk management strategy in the DRM model, the IASB tentatively decided:

Dynamic Risk Management: Update of IASB tentative decisions – Cover Note

- (a) to revise the definition of the target profile as the range (risk limits) within which the current net open risk position can vary while still being consistent with an entity's risk management strategy;
- (b) to introduce to the DRM model a 'risk mitigation intention' element, representing the extent of risk an entity intends to mitigate using derivatives;
- (c) to revise the requirements for construction of benchmark derivatives so that the benchmark derivatives represent the risk mitigation intention; and
- (d) to introduce prospective assessments to ensure that an entity uses the DRM model to mitigate repricing risk due to changes in interest rates and achieve its target profile, as well as similar retrospective assessments to reflect misalignment arising from unexpected changes in the DRM model.

18 All 12 IASB members agreed with these decisions.

Designation of a portion of prepayable assets in the DRM model (Agenda Paper 4B)

19 The IASB tentatively decided not to make additional refinements in the DRM model to allow an entity to designate a portion of a portfolio of prepayable assets.

20 All 12 IASB members agreed with this decision.