



IFRS[®]
Accounting

December 2025

Exposure Draft

IFRS[®] Accounting Standard

Basis for Conclusions on Risk Mitigation Accounting

Proposed amendments to IFRS 9 and IFRS 7

Comments to be received by 31 July 2026



Basis for Conclusions on Exposure Draft
Risk Mitigation Accounting

Proposed amendments to IFRS 9 and
IFRS 7

Comments to be received by 31 July 2026

This Basis for Conclusions accompanies the Exposure Draft IASB/ED/2025/1, which is published by the International Accounting Standards Board (IASB) for comment only. Comments need to be received by **31 July 2026** and should be submitted by email to commentletters@ifrs.org or online at <https://www.ifrs.org/projects/open-for-comment/>.

All comments will be on the public record and posted on our website at www.ifrs.org unless the respondent requests confidentiality. Such requests will not normally be granted unless supported by a good reason, for example, commercial confidence. Please see our website for details on this policy and on how we use your personal data.

Disclaimer: To the extent permitted by applicable law, the IASB and the IFRS Foundation (Foundation) expressly disclaim all liability howsoever arising from this publication or any translation thereof whether in contract, tort or otherwise to any person in respect of any claims or losses of any nature including direct, indirect, incidental or consequential loss, punitive damages, penalties or costs.

Information contained in this publication does not constitute advice and should not be substituted for the services of an appropriately qualified professional.

© 2025 IFRS Foundation

All rights reserved. Reproduction and use rights are strictly limited. Please contact the Foundation for further details at licensing@ifrs.org.

Copies of IASB publications may be ordered from the Foundation by emailing customerservices@ifrs.org or by visiting our shop at <https://shop.ifrs.org>.



The IFRS Foundation has trade marks registered around the world including 'FSA®', the 'Hexagon Device' logo®, 'IAS®', 'IASB®', 'IFRIC®', 'IFRS®', the 'IFRS®' logo, 'IFRS for SMEs®', 'ISSB®', 'International Accounting Standards®', 'International Financial Reporting Standards®', 'International Financial Reporting Standards Foundation®', 'IFRS Foundation®', 'NIIF®', 'SASB®', 'SIC®', 'SICS®', and 'Sustainable Industry Classification System®'. Further details of the IFRS Foundation's trade marks are available from the IFRS Foundation on request.

The Foundation is a not-for-profit corporation under the General Corporation Law of the State of Delaware, USA and operates in England and Wales as an overseas company (Company number: FC023235) with its principal office in the Columbus Building, 7 Westferry Circus, Canary Wharf, London, E14 4HD.

CONTENTS

from paragraph

BASIS FOR CONCLUSIONS ON EXPOSURE DRAFT *RISK MITIGATION ACCOUNTING*

BACKGROUND

Why the IASB started the project BC1

History of the project BC4

OBJECTIVE AND SCOPE OF RISK MITIGATION ACCOUNTING

Objective of risk mitigation accounting BC11

Optional application of risk mitigation accounting BC14

Scope of risk mitigation accounting BC19

Levels at which risk mitigation accounting is applied BC33

Formal documentation requirements BC35

NET REPRICING RISK EXPOSURE

Underlying portfolios BC38

Determining the net repricing risk exposure BC64

DESIGNATED DERIVATIVES BC70

APPLYING RISK MITIGATION ACCOUNTING

Risk mitigation objective BC78

Benchmark derivatives BC83

Recognition and measurement of the risk mitigation adjustment BC88

Risk mitigation adjustment excess BC101

DISCONTINUATION OF RISK MITIGATION ACCOUNTING BC117

EFFECTIVE DATE AND TRANSITION

Effective date BC127

Transition BC129

PROPOSED AMENDMENTS TO IFRS 7 *FINANCIAL INSTRUMENTS: DISCLOSURES*

Statement of comprehensive income BC148

Statement of financial position BC151

Disclosure objectives BC153

Disclosure of risk management strategy BC156

Disclosure of the amount, timing and uncertainty of future cash flows BC157

Disclosure of the effects on financial position and performance BC165

AMENDMENTS TO OTHER IFRS ACCOUNTING STANDARDS

Proposed amendments to IFRS 1 *First-time Adoption of International Financial Reporting Standards* BC172

Proposed amendments to IFRS 18 *Presentation and Disclosure in Financial Statements* BC176

continued...

...continued

Proposed amendments to IFRS 19 *Subsidiaries without Public Accountability: Disclosures*

BC177

ANALYSIS OF THE EFFECTS OF RISK MITIGATION ACCOUNTING

BC179

Basis for Conclusions on Exposure Draft *Risk Mitigation Accounting*

This Basis for Conclusions accompanies, but is not part of, Exposure Draft Risk Mitigation Accounting. It summarises the considerations of the International Accounting Standards Board (IASB) when developing the Exposure Draft. Individual IASB members gave greater weight to some factors than to others.

Background

Why the IASB started the project

- BC1 IFRS 9 *Financial Instruments* introduced hedge accounting requirements and disclosure requirements that enable entities to better reflect their risk management activities in their financial statements. However, these requirements do not cover portfolio (or macro) hedge accounting of open portfolios, which is the approach commonly used to manage repricing risk.¹
- BC2 For purposes of this project, repricing risk is the risk that cash flows from, and fair value of, financial instruments will vary due to differences in the timing or amount of their repricing to benchmark interest rates. Stakeholder feedback to the IASB suggested that users of financial statements need a better understanding of entities' repricing risk management activities. Therefore, the IASB decided to start a project that would explore a comprehensive accounting model for repricing risk management.
- BC3 The IASB will consider the feedback on Exposure Draft *Risk Mitigation Accounting* to decide whether the proposed requirements should replace the current requirements in IAS 39 *Financial Instruments: Recognition and Measurement* for macro hedge accounting and whether IAS 39 could therefore be withdrawn.

History of the project

- BC4 The IASB originally explored whether the requirements in IAS 39 related to fair value hedge accounting for a portfolio hedge of interest rate risk could be amended or included in IFRS 9 to better reflect risk management in the financial statements. However, stakeholder feedback suggested it was important for the IASB to address situations in which entities use a dynamic risk management strategy. Financial institutions also emphasised the need for requirements related to dynamic risk management because some of their risk exposures only qualify for hedge accounting in an open portfolio context (for example, financial liabilities contractually repayable on demand).
- BC5 The IASB noted that dynamic risk management for open portfolios is a complex topic that warrants thorough research and feedback from interested parties. Therefore, the IASB decided not to address accounting for dynamic risk management activities as part of the new hedge accounting model in

¹ In this document, 'risk management' refers to all activities undertaken by an entity when managing its repricing risk without any reference to the accounting implications. However, 'risk mitigation' refers to aspects that are required by the accounting model proposed in Exposure Draft *Risk Mitigation Accounting*.

IFRS 9. Instead, it decided to explore a more comprehensive solution to dynamic risk management in a separate project. The IASB decided to retain the current approach to macro hedge accounting under IAS 39 while the project was in process, so that entities would not be disadvantaged in the meantime.

- BC6 In April 2014 the IASB published the Discussion Paper *Accounting for Dynamic Risk Management: a Portfolio Revaluation Approach to Macro Hedging* (Discussion Paper). This Discussion Paper set out a ‘portfolio revaluation approach’—a possible way of accounting for an entity’s dynamic interest rate risk management activities and reflecting those activities in the financial statements. However, after considering feedback to the Discussion Paper, the IASB decided not to pursue the portfolio revaluation approach, which resembled fair value hedge accounting.
- BC7 Instead, the IASB decided to develop a new accounting model that does not follow the fair value or cash flow hedge accounting approaches, and to limit its application to repricing risk only.
- BC8 The IASB acknowledged that repricing risk management activities are not exclusive to banks and may also be carried out by other types of entities. However, to increase the viability of the model, the IASB decided to focus on how banking institutions manage repricing risk, because prior consultations and feedback indicated that most entities that manage repricing risk are banks. Banks have also been the main source of feedback on challenges related to macro hedge accounting methods.
- BC9 As set out in paragraph BC55 of the Basis for Conclusions on IFRS 17 *Insurance Contracts*, the IASB decided to consider the risk management activities of entities with insurance activities as part of the broader project on dynamic risk management. The IASB is therefore seeking specific feedback about insurers to assess whether these entities’ risk management strategies and actions could also be reflected in financial statements using risk mitigation accounting.
- BC10 The IASB also specifically decided to focus first on developing an accounting model for the mitigation of repricing interest rate risk. Once the IASB has determined the model to be operational, it will consider extending the model to other businesses that are also subject to dynamic risks (for example, those in the energy and commodities sectors) at a later stage.

Objective and scope of risk mitigation accounting

Objective of risk mitigation accounting

- BC11 The IASB acknowledged that risk mitigation accounting would not achieve a complete reflection of all aspects of risk management in financial reporting. As paragraph 1.6 of the *Conceptual Framework for Financial Reporting* states, ‘financial reports do not and cannot provide all of the information that existing and potential investors, lenders and other creditors need’. Risk mitigation accounting aims to faithfully represent in the financial statements

the effects of an entity's repricing risk management activities, rather than to capture all risk management activities. The IASB also decided that risk mitigation accounting would focus on representing an entity's risk management activities to manage its exposure to repricing risk rather than on governing or restricting risk management.

- BC12 Throughout the development of the proposals in the Exposure Draft, most stakeholders supported this objective. However, some stakeholders were of the view that an equally important objective for risk mitigation accounting would be to eliminate the accounting mismatches 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.
- BC13 As explained in paragraph BCZ4.63 of IFRS 9, 'In the IASB's view, financial reporting is best served by providing entities with the opportunity to eliminate perceived accounting mismatches whenever that results in more relevant information'. Therefore, the IASB concluded that although applying risk mitigation accounting would result in the elimination of accounting mismatches, the primary objective of the proposed requirements is to faithfully reflect an entity's risk management activities in its financial statements to the extent possible.

Optional application of risk mitigation accounting

- BC14 The IASB considered whether the application of risk mitigation accounting should be required or permitted. The IASB noted that requiring entities to apply risk mitigation accounting would mean defining and describing specific risk management strategies and activities that would trigger its application. Furthermore, because of the diversity of entities' business models, this approach would also have resulted in less transparency regarding their risk management activities.
- BC15 With regard to optional application, the IASB acknowledged the importance of maintaining consistency between the hedge accounting requirements in IFRS 9, which are optional, and the risk mitigation accounting requirements. Like the hedge accounting requirements, the requirements for risk mitigation accounting are exceptions to the recognition and measurement requirements in IFRS Accounting Standards. Therefore, an entity is only permitted to apply risk mitigation accounting (or hedge accounting) if robust eligibility criteria are met.
- BC16 The IASB also noted that risk mitigation accounting is inherently complex. The expertise required in risk modelling and the related investment in systems and processes could impose high costs on entities. Mandatory risk mitigation accounting requirements would mean that entities that lack the necessary expertise or processes would have to apply risk mitigation accounting. If risk mitigation accounting were optional, such entities could choose not to apply it and thereby avoid incurring the associated costs.

- BC17 The IASB also considered whether improved comparability would be a potential benefit of requiring entities to apply risk mitigation accounting. However, the IASB concluded that the increased comparability under mandatory application would not be expected to outweigh the related costs.
- BC18 Therefore, the IASB has concluded that the incremental benefits, if any, of requiring entities to apply risk mitigation accounting would not outweigh the implementation and ongoing application costs and accordingly proposes that risk mitigation accounting be optional.

Scope of risk mitigation accounting

- BC19 The IASB observed that most entities manage repricing risk arising from financial assets and financial liabilities by aggregating the repricing risk from the financial instruments to determine the net exposure to repricing risk. They then use the net repricing risk exposure as the starting point for their risk management activities. If the net repricing risk exposure arising from the underlying portfolios of financial instruments changes frequently, an entity's risk management activities will also change frequently.
- BC20 The extent to which changes in market interest rates affect the financial performance of an entity depends on its mix of fixed-rate and variable-rate financial assets and financial liabilities. Many entities carry out risk management activities (which commonly involve the use of derivatives) to achieve their risk management strategy.
- BC21 To keep repricing risk within an entity's specified risk limits, the entity usually reduces variability:
- (a) in earnings—by reducing variability in the difference between interest income and expense when the market interest rate changes, an entity in effect reduces exposure to variability in its earnings for a period;
 - (b) in economic value—by 'protecting' the fair value of its financial assets, financial liabilities and future transactions, an entity in effect reduces its exposure to changes in the economic value of these financial instruments when the benchmark interest rate changes;² or
 - (c) in both but during different time bands.
- BC22 As part of their risk management strategy, some entities might focus on earnings in the short term and economic value in the long term.
- BC23 Because risk management strategies and activities vary by entity, the IASB focused on common characteristics for which risk mitigation accounting would provide the most useful information to users of financial statements.

Business activities that give rise to repricing risk

- BC24 In the IASB's view, for risk mitigation accounting to achieve its objective, it should be permitted for entities whose business activities result in financial instruments with frequent changes to their repricing risk exposure.

² In the financial services sector, 'economic value' is sometimes referred to as 'economic value of equity'—a risk metric widely used by banks.

Managing repricing risk on a net basis against the mitigated rate

- BC25 The IASB acknowledged that for an entity to manage repricing risk on a net basis, it needs to identify a rate against which it aggregates and mitigates the repricing risk from different underlying portfolios in accordance with its risk management strategy (mitigated rate).
- BC26 The mitigated rate is often a specific benchmark interest rate that an entity uses to aggregate and mitigate its repricing risk exposure. An entity might have specified more than one mitigated rate; for example, if it manages the repricing risk arising from underlying portfolios denominated in different currencies separately.
- BC27 When an entity mitigates its repricing risk exposure, it effectively reduces the potential variability in cash flows from, or fair value of, the underlying portfolios attributable to the movements in the mitigated rate. The IASB considered whether to require the mitigated rate to be a separately identifiable and reliably measurable risk component of the financial instruments within the underlying portfolios. Such an approach would align with the requirement in paragraph 6.3.7(a) of IFRS 9, which relates to designation of an interest rate risk component as the hedged item. Although this requirement is well understood in practice, the IASB concluded that risk mitigation accounting does not have to be consistent with the current hedge accounting requirements.
- BC28 Moreover, in the IASB's view, the mitigated rate used for risk mitigation accounting must be consistent with the actual benchmark interest rate considered for risk management purposes, in accordance with the objective of risk mitigation accounting. The IASB therefore concluded that it would not be appropriate to require the mitigated rate to be a separately identifiable risk component of the underlying portfolios, as in hedge accounting.

Systematic process for determining the net repricing risk exposure

- BC29 The IASB noted that an entity would determine the net repricing risk exposure by aggregating the repricing risk exposure arising from portfolios of financial instruments. An entity determining its net repricing risk exposure in this way might transfer risk from individual business divisions to a central treasury function, based on its internal funding or transfer pricing mechanisms.
- BC30 This systematic process for determining the net repricing risk exposure is the starting point for an entity's risk management activities. Some entities might use internal derivative positions or proxy internal loan or deposit positions between business divisions and the treasury department to replicate the repricing risk arising from the underlying portfolios originated or issued by those business units. Despite the varying contractual features of the financial instruments included in the underlying portfolios, for the purpose of repricing risk management, instruments are aggregated and fully fungible.

- BC31 The IASB concluded that determining the net repricing risk exposure requires a more comprehensive approach than simply combining a few individual items or portfolios and managing them together. The latter approach would be more appropriately reflected by applying the hedge accounting requirements for a group of items (in accordance with paragraphs 6.6.1–6.6.6 of IFRS 9).

Nature of risk management activities

- BC32 The IASB understood that entities might focus on various aspects of repricing risk when determining their risk management strategies, depending on their circumstances. When quantifying repricing risk, some entities might focus on changes in the cash flows, others might focus on changes in fair value and yet others might aim to achieve a balance by considering both. In the IASB's view, risk mitigation accounting could help to reflect the effects of an entity's risk management activities in all cases.

Levels at which risk mitigation accounting is applied

- BC33 The IASB concluded that for risk mitigation accounting to achieve the objective stated in paragraph 7.1.3 of the Exposure Draft, it must be applied at the level at which repricing risk is managed. Risk mitigation accounting therefore differs from hedge accounting, which is applied at the level of the individual instrument or group(s) of instruments.
- BC34 Risk mitigation accounting reflects the risk management strategy of the reporting entity, which might be based on a centralised or decentralised model. Therefore, any differences in risk management strategy between entities within a consolidated group should be considered when the reporting entity decides how to apply risk mitigation accounting.

Formal documentation requirements

- BC35 Risk mitigation accounting, like hedge accounting, involves exceptions to some of the recognition and measurement requirements in IFRS 9. Furthermore, the IASB concluded that because an entity chooses to apply risk mitigation accounting based on its risk management strategy, the entity should be required to provide formal documentation about how it applies risk mitigation accounting to avoid the use of hindsight or practices to achieve an arbitrary accounting outcome.
- BC36 However, the IASB decided that because of the frequently changing nature of many entities' risk management activities, formal documentation should focus on explaining the methods and approaches used by the entity to mitigate repricing risk and apply risk mitigation accounting, rather than specifying amounts of repricing risk to be mitigated.
- BC37 Formal documentation would provide evidence of how an entity manages repricing risk, including how it identifies and mitigates the repricing risk, defines its risk mitigation objective and captures the effects of unexpected changes in the net repricing risk exposure. The documentation would also provide evidence that the entity is eligible to apply risk mitigation accounting.

Net repricing risk exposure

Underlying portfolios

- BC38 The IASB acknowledged the importance of an entity clearly identifying its underlying portfolios. For the purpose of applying risk mitigation accounting, an entity's exposure to repricing risk is referred to as the net repricing risk exposure, and the entity is required to include all underlying portfolios that it manages for repricing risk on a net basis.
- BC39 The IASB considered whether setting eligibility criteria for the financial instruments to be included in the underlying portfolios could create a tension between risk mitigation accounting and the entity's risk management activities. However, the IASB concluded that doing so would be necessary to ensure that risk mitigation accounting is applied only if:
- (a) financial instruments affect an entity's exposure to repricing risk; and
 - (b) the use of derivatives to mitigate repricing risk results in an accounting mismatch in profit or loss.

Financial assets and financial liabilities measured at amortised cost

- BC40 The IASB concluded that financial assets and financial liabilities measured at amortised cost affect an entity's exposure to repricing risk because changes in market interest rates give rise to variability in either the instrument's cash flows or fair value. The IASB also decided that these financial instruments represent the majority of instruments to which entities currently apply hedge accounting to hedge interest rate risk. Furthermore, if risk mitigation accounting is not applied, using derivatives to mitigate the repricing risk arising from these financial instruments will result in accounting mismatches in profit or loss.
- BC41 The IASB acknowledged that some financial assets or financial liabilities only affect an entity's exposure to repricing risk if assessed on a portfolio basis and not on an individual basis. The example most often raised by stakeholders is financial liabilities that are repayable on demand, such as demand deposits. IFRS 13 *Fair Value Measurement* states that the fair value measurement of a financial liability with a demand feature cannot be less than the present value of the amount that is payable on demand. Consequently, for accounting purposes, financial liabilities that are repayable on demand are measured at the nominal or demand amount, because they can be withdrawn immediately.
- BC42 However, the IASB observed that although demand liabilities can be withdrawn with little or no notice by the instrument holders, in practice they can be quite stable and long term, despite holders receiving no interest or interest at a low rate. The nominal amount and tenor of these demand liabilities are typically affected by various factors, including macroeconomic factors and the expected behaviour of existing and new holders. Because of this customer behaviour, entities often identify a portion of their demand deposit portfolio that is considered to be insensitive to changes in market

interest rates and treat this portion as fixed-rate liabilities for risk mitigation purposes.

- BC43 The IASB decided that determining the effect financial instruments have on an entity's exposure to repricing risk on a portfolio basis is consistent with managing repricing risk on a net basis. Therefore, financial instruments that affect an entity's exposure to repricing risk only when assessed on a portfolio basis are eligible for inclusion in underlying portfolios.

Financial assets measured at fair value through other comprehensive income

- BC44 Stakeholders have also said that as part of an entity's risk management strategy, financial assets measured at fair value through other comprehensive income are often considered together with those measured at amortised cost when managing repricing risk. This approach reflects the fact that both types of financial assets affect the entity's exposure to repricing risk and they have similar profiles in profit or loss.
- BC45 The IASB acknowledged that although these financial assets and the related derivatives are measured at fair value in the statement of financial position, entities applying the current measurement requirements would still have accounting mismatches in the statement of profit or loss. The accounting mismatches arise because fair value gains or losses on the financial assets are recognised in other comprehensive income (apart from the interest amount recognised in profit or loss using the effective interest method set out in paragraph 5.7.10 of IFRS 9), whereas the fair value gains or losses on the derivatives are recognised in profit or loss.
- BC46 Consequently, the IASB decided that financial assets measured at fair value through other comprehensive income are eligible for inclusion in underlying portfolios for the purpose of determining the net repricing risk exposure. In reaching this decision, the IASB noted that:
- (a) risk mitigation accounting does not affect the measurement of the underlying portfolios. Therefore, the risk mitigation adjustment would not lead to potential double-counting of the fair value changes of the underlying portfolios.
 - (b) the application of risk mitigation accounting would eliminate the accounting mismatches in profit or loss in much the same way as it does when applied to financial instruments measured at amortised cost. However, a mismatch in other comprehensive income might remain.

Financial instruments measured at fair value through profit or loss

- BC47 The IASB also considered whether financial assets or financial liabilities measured at fair value through profit or loss should be eligible for inclusion in underlying portfolios for the purpose of determining the net repricing risk exposure. Some financial instruments that are measured at fair value through profit or loss could affect an entity's exposure to repricing risk like those measured at amortised cost—for example, financial assets that do not have

contractual cash flows that are solely payments of principal and interest on the principal amount outstanding.

- BC48 However, the IASB noted that the fair value gains or losses on such financial instruments are recognised in profit or loss in the same period that gains or losses on risk mitigating derivatives would be recognised. There would therefore be no accounting mismatch in profit or loss to which risk mitigation accounting could be applied. Therefore, the IASB decided that financial instruments measured at fair value through profit or loss are not eligible for inclusion in underlying portfolios.

Equity instruments

- BC49 Some equity instruments have debt-like features similar to financial liabilities—for example, instruments with discretionary contractual interest or coupon rates. For risk management purposes, entities often include these equity instruments when determining their exposure to repricing risk. If derivatives are used to mitigate the resulting repricing risk, an accounting mismatch in profit or loss would arise because the discretionary interest payments are recognised in equity.

- BC50 However, the IASB decided that, despite the effect equity instruments might have on an entity's exposure to repricing risk, they are not eligible for inclusion in underlying portfolios because the interest or coupon payments recognised in equity would not affect profit or loss at any time. Therefore, applying risk mitigation accounting would not eliminate or reduce the accounting mismatch resulting from the measurement of derivatives through profit or loss.

Future transactions

- BC51 Entities that manage repricing risk on a net basis commonly also consider the exposure to repricing risk associated with future transactions that are expected to occur during the mitigated time horizon. Future transactions could affect an entity's exposure to repricing risk in various ways, and the effect of repricing is included to the extent that an entity can reliably identify, measure and manage the risk.

- BC52 The IASB noted that future transactions include both committed (firm commitments) and uncommitted (forecast) future transactions. As defined in Appendix A to IFRS 9, firm commitments (for example, loan commitments) are binding agreements that specify the interest rate (price) related to future transactions. Such transactions are by definition highly probable to occur and therefore the effect they would have on an entity's exposure to repricing risk can be determined in the same way as for recognised financial assets and financial liabilities. The IASB therefore decided that such future transactions are eligible for inclusion in underlying portfolios.

- BC53 However, if future transactions are anticipated but not yet committed, there is greater uncertainty about how such transactions could affect an entity's exposure to repricing risk. Stakeholders said, because of the dynamic nature of their exposure to repricing risk, they expect that some financial

instruments will be reinvested or refinanced when they are settled. Because these future transactions have not yet been contractually agreed, entities treat such expected reinvestments or refinancing as variable-rate exposures.

- BC54 The IASB was of the view that this assumption is equivalent to assuming that the cash receipts from the repayment of financial assets will be invested, or the cash required to settle financial liabilities will be borrowed, as variable-rate instruments. The IASB also noted that if an entity is able to reinvest or refinance financial instruments included in underlying portfolios as variable-rate instruments, the entity should be able to reliably determine the effect of the reinvestment or refinancing on its exposure to repricing risk. The IASB therefore decided not to require that such transactions must be highly probable to be eligible for inclusion in underlying portfolios. The IASB therefore decided that future transactions that represent the reinvestment or refinancing of financial instruments within underlying portfolios are eligible for inclusion in underlying portfolios if an entity expects such transactions to occur based on reasonable and supportable information.
- BC55 In contrast, the IASB noted that there is significant uncertainty associated with uncommitted future transactions (forecast transactions) that are expected to affect an entity's exposure to repricing risk as fixed-rate instruments. The IASB acknowledged that the effect of such future transactions on the exposure to repricing risk is determined on a portfolio basis, which is more reliable than assessment on an individual-instrument basis. However, under the hedge accounting requirements in IFRS 9, to qualify as a hedged item, a forecast transaction must be highly probable to occur. The IASB therefore decided to require that forecast transactions be highly probable to be eligible for inclusion in underlying portfolios.

Hedged exposures

- BC56 During its deliberations, the IASB considered whether an entity could include financial instruments already designated as in a qualifying hedging relationship for a risk other than repricing risk when determining the net repricing risk exposure. The IASB also considered whether the underlying portfolios should include only financial assets and financial liabilities denominated in the same currency.
- BC57 The IASB noted that underlying portfolios denominated in different currencies typically have different risk characteristics as a result of being linked to different economic environments. Therefore, if the underlying portfolios include financial instruments denominated in different currencies, foreign currency risk could be introduced into the portfolios alongside repricing risk.
- BC58 Stakeholders explained that they commonly raise funding or originate loans in currencies other than their functional currencies due to lack of market liquidity in their functional currencies. However, for risk management purposes, these financial assets or financial liabilities denominated in foreign currencies are not necessarily assessed separately when managing repricing risk. These stakeholders were therefore concerned that if the IASB were to require allocation of financial instruments to different underlying portfolios

based purely on the currency the instrument is denominated in, for many financial instruments this allocation would be arbitrary and would not faithfully represent how an entity manages repricing risk.

- BC59 The IASB noted that its objective in developing risk mitigation accounting was to reflect in the financial statements the economic effect of how entities manage repricing risk. For this reason, the IASB decided instead to permit an entity to allocate financial instruments to the underlying portfolios and apply risk mitigation accounting based, as closely as possible, on how the entity manages repricing risk.
- BC60 An entity might have financial instruments that expose it to more than one risk, for example, interest rate risk and foreign currency risk (see paragraph BC6.160 of the Basis for Conclusions on IFRS 9). However, the entity might have a different risk management strategy for each risk. For example, the entity might manage the currency risk on an individual-instrument basis with a cross-currency swap and then consider the resulting functional currency position on a net basis with other financial instruments when managing repricing risk. Similarly, an entity might decide to hedge the cash flow or fair value variability attributable to interest rate risk on an individual-instrument basis and consider the combined effect of the hedged item and hedging instrument when determining its exposure to repricing risk on a net basis.
- BC61 The IASB noted that paragraph 6.3.4 of IFRS 9 permits an entity to designate as hedged items aggregated exposures that are a combination of an exposure and a derivative. Although derivatives in isolation are not eligible for inclusion in the underlying portfolios, the IASB acknowledged that the combination of a derivative with a financial asset or a financial liability could affect an entity's exposure to repricing risk. The IASB therefore decided that some hedged exposures are eligible for inclusion in the underlying portfolios. To include a hedged exposure, an entity would be required to designate a hedging relationship in accordance with Chapter 6 of IFRS 9.
- BC62 The IASB decided that a hedged exposure is eligible for inclusion in the underlying portfolios if:
- (a) the hedged items themselves are financial instruments that are eligible for inclusion in the underlying portfolios.
 - (b) the combined effect of the hedged item and hedging instrument changes an entity's exposure to repricing risk. In other words, the effects of the hedging relationship in its entirety must be included in the underlying portfolios.
- BC63 The IASB is of the view that requiring an entity to designate a hedging relationship would minimise the risk of double-counting between different risk exposures because applying risk mitigation accounting would not change how the entity measures financial instruments included in the underlying portfolios.

Determining the net repricing risk exposure

- BC64 The IASB observed that 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. The IASB also noted that an entity determining the net repricing risk exposure would aggregate the repricing risk from the underlying portfolios using repricing time bands based on the expected repricing date. The IASB concluded that because the net repricing risk exposure must be consistent with the repricing risk exposure used to inform risk management activities, requiring the use of expected repricing dates to aggregate repricing risk would provide a robust basis for applying risk mitigation accounting.
- BC65 The IASB observed that net repricing risk exposure can be measured using various methods, depending on an entity's risk management strategy. Some risk measures focus on cash flow variability (for example, maturity gap analysis), whereas others focus on fair value variability (for example, present value of one basis point or PV01). The IASB decided to require an entity to determine the net repricing risk exposure using the measures the entity uses to quantify repricing risk as part of its risk management strategy. In the IASB's view, requiring entities to use the same measure they use to undertake risk management activities would be consistent with its objective to better reflect in the financial statements how entities manage repricing risk.
- BC66 The IASB considered whether to specify the level of detail entities would be required to use in defining the repricing time bands (often referred to as time buckets) to ensure greater comparability between entities that apply risk mitigation accounting. However, the IASB decided not to include specific requirements in this regard, because doing so would not necessarily reflect entities' risk management practices and therefore would be inconsistent with the objective of risk mitigation accounting. Instead, the IASB decided that an entity would be required to determine the length and number of repricing time bands in a manner consistent with how the entity determines its exposure to repricing risk for risk management purposes.
- BC67 The IASB proposes that the net repricing risk exposure is the repricing risk position (by repricing time band) derived from the aggregation of the repricing risk from financial instruments included in the underlying portfolios over the mitigated time horizon. Entities would therefore need to consider reasonable and supportable information to determine the net repricing risk exposure, including all relevant factors. Such factors would include contractual and behavioural characteristics of the financial instruments in the underlying portfolios.

Managing equity

- BC68 During the development of the proposals in the Exposure Draft, stakeholders said they model equity (that is, the residual between their financial assets and financial liabilities) as stable funding of cash and highly liquid financial assets as part of their repricing risk management activities. These stakeholders consider equity to be a non-interest-bearing source of funding and regard it as

a fixed-rate liability that provides funding to the entity at an effectively 0% interest rate (much like financial liabilities repayable on demand). This approach is commonly referred to as equity modelling or an equity model book.

- BC69 The IASB acknowledged that an entity could use various approaches to determine the extent to which repricing risk arises from the entity's variable-rate financial assets. In the IASB's view, modelling equity as a proxy for the repricing risk arising from cash and highly liquid financial assets (if they are eligible for inclusion in the underlying portfolios) as part of an entity's repricing risk management activities is different from mitigating exposure to repricing risk arising from the entity's equity instruments. Therefore, the IASB concluded that the approach described in paragraph BC68 does not change the economic effects of an entity's risk mitigation activities as reflected in its financial statements. The IASB maintains that equity is a residual for financial reporting purposes (see paragraph 4.63 of the *Conceptual Framework*) and therefore is not eligible for inclusion in the underlying portfolios—even if it may be used as a proxy in risk mitigation accounting.

Designated derivatives

- BC70 Entities mitigating their exposure to repricing risk arising from underlying portfolios often rely on derivatives to mitigate their exposure to variability in cash flow and fair value attributable to repricing risk. The risk mitigation accounting model is specifically developed for repricing risk, which is a form of interest rate risk; therefore, the IASB decided that designated derivatives would include only interest rate derivatives.
- BC71 The IASB acknowledged that simple interest rate swaps are the most common type of interest rate derivative used for managing repricing risk. However, the Exposure Draft proposes that any interest rate derivatives could be designated derivatives for the purpose of applying risk mitigation accounting, including basis swaps, forward-starting swaps, forward rate agreements and interest rate futures as well as options and swaptions.
- BC72 When developing the proposals in the Exposure Draft, the IASB noted that risk mitigation accounting and hedge accounting (as described in Chapter 6 of IFRS 9) are similar with regard to the use of derivatives to mitigate risk. The IASB was therefore of the view that some hedge accounting requirements might be relevant in the context of risk mitigation accounting—for example, the requirement for there to be an economic relationship between the hedged item and hedging instrument, and the requirement that the effect of credit risk not dominate the value changes that result from that economic relationship.
- BC73 However, the IASB noted that an entity would be required to apply risk mitigation accounting in a manner consistent with its risk management strategy and the activities it undertakes to mitigate repricing risk by using derivatives. The IASB therefore concluded that the existence of an economic relationship between the designated derivatives and the amount of repricing risk being mitigated is an inherent part of the risk mitigation accounting

requirements. A specific requirement pertaining to an economic relationship is therefore unnecessary.

- BC74 The IASB also considered whether to include a specific requirement relating to the effects of credit risk. Designated derivatives are required to be with a counterparty external to the reporting entity and therefore credit risk might affect the value changes of these derivatives. The IASB acknowledged that it is increasingly common for derivatives to be transacted through central clearing parties to minimise the risk of default by either counterparty. Consequently, credit risk would not be expected to affect the value changes of most designated derivatives. However, not all derivatives are transacted through central clearing parties and credit risk might affect the value changes of those that are not. The IASB therefore decided to specify that a derivative is not eligible for inclusion in designated derivatives if its fair value changes are dominated by credit risk (see paragraph 7.3.2 of the Exposure Draft).
- BC75 The IASB proposed a restriction on the use of written options as designated derivatives, consistent with the restriction imposed by the hedge accounting requirements in IFRS 9. This restriction is intended to ensure that the designated derivatives are used to mitigate, rather than increase, repricing risk.
- BC76 The IASB also decided to specify that a proportion of the notional amount of a derivative could be eligible for risk mitigation accounting (see paragraph 7.3.6 of the Exposure Draft). However, an entity would not be permitted to designate a derivative for only a portion of the period during which the derivative is outstanding because a derivative instrument has a single fair value measure.
- BC77 The IASB proposes that an entity would not be permitted to voluntarily exclude a derivative that has been included as a designated derivative if that derivative is held for the purpose of mitigating repricing risk. This requirement would prevent entities from including or excluding derivatives to achieve a particular accounting outcome. However, the IASB also acknowledged that an entity's exposure to repricing risk changes frequently, which could necessitate changes or adjustments to designated derivatives. Such changes could include entering into offsetting or new derivatives, or closing out a designated derivative with the counterparty, and would not result in the discontinuation of risk mitigation accounting.

Applying risk mitigation accounting

Risk mitigation objective

- BC78 Stakeholders have said that when managing repricing risk on a net basis, their objective is to achieve a residual exposure to repricing risk that is within their risk limits. However, they do not aim to achieve a particular risk exposure consistently from one period to the next and their target exposure changes frequently based on various factors.

RISK MITIGATION ACCOUNTING

- BC79 The IASB therefore decided to define the risk mitigation objective as the amount of repricing risk an entity intends to mitigate by using derivatives. However, to ensure that risk mitigation accounting is robust, the IASB decided to require that the risk mitigation objective:
- (a) aims to mitigate the net repricing risk exposure to an amount that is within the risk limits set out in the entity's risk management strategy;
 - (b) is evidenced by the amount of repricing risk the entity intends to mitigate by using designated derivatives; and
 - (c) does not exceed the amount of net repricing risk exposure available in a repricing time band.
- BC80 In the IASB's view, these requirements related to the risk mitigation objective will ensure that risk mitigation accounting faithfully represents the extent to which designated derivatives mitigate repricing risk. Otherwise, the derivatives may create repricing risk the entity would not be exposed to based on its underlying portfolios.
- BC81 The IASB also considered whether to stipulate a minimum or maximum period for which the risk mitigation objective is specified or require an entity to specify the risk mitigation objective at a frequency consistent with the entity's internal reporting periods (for example, weekly or monthly). However, the IASB noted that the frequency with which entities undertake risk management activities might vary depending on circumstances, such as changes to the financial instruments included in underlying portfolios or changes in economic conditions. In the IASB's view, stipulating a minimum or maximum period would be arbitrary. Requiring the risk mitigation objective to be specified based on the frequency with which an entity reports internally to management could, in turn, create unjustifiable differences between the entity's actual risk management activities and what is reflected in the entity's financial statements. Therefore, to achieve its objective of reflecting how entities manage repricing risk, the IASB decided to require that an entity specify the risk mitigation objective each time it undertakes risk mitigation activities.
- BC82 Because entities' risk management activities are forward-looking, the IASB decided that changes in the risk mitigation objective from one period to the next would apply prospectively only and would not affect the application of risk mitigation accounting in prior periods.

Benchmark derivatives

- BC83 The risk mitigation objective is an absolute amount of repricing risk based on the measures an entity uses to quantify the net repricing risk exposure; it is not a representation of identifiable financial instruments or carrying amounts. The IASB noted that an entity would be unable to measure the value changes of the risk mitigation objective by reference to the financial instruments included in the underlying portfolios.

- BC84 The IASB therefore proposes that an entity construct theoretical derivatives to represent the timing and amount of the repricing risk specified in the risk mitigation objective. In the IASB's view, basing benchmark derivatives on the timing and amount of the repricing risk represented by the risk mitigation objective, rather than simply mirroring the designated derivatives, will ensure that the value changes of the benchmark derivatives are measured independently from the value changes of the designated derivatives. The benchmark derivatives are therefore similar to the hypothetical derivative used in cash flow hedging (see paragraphs B6.5.5–B6.5.6 of IFRS 9).
- BC85 The risk mitigation objective is determined at a point in time based on an entity's expectations with regards to the repricing dates of financial instruments included in underlying portfolios, as well as current and future economic conditions. However, the actual outcomes will often be different from an entity's expectations and financial instruments included in the underlying portfolios might reprice earlier or later than expected.
- BC86 Such unexpected changes to the net repricing risk exposure might result in the designated derivatives no longer mitigating the repricing risk. Instead, they could inadvertently create synthetic repricing risk positions. The IASB therefore decided that after an entity has constructed the benchmark derivatives, it is required to adjust them if unexpected changes occur that reduce the net repricing risk exposure to below the risk mitigation objective.
- BC87 Not all entities have access to reasonable and supportable information that will allow them to determine the adjustments necessary to capture the effect of unexpected changes without incurring undue cost or effort. An entity's ability to capture such information depends on the specificity and level of detail with which it tracks changes in the underlying portfolios. The IASB therefore proposes that if such information is not available without undue cost or effort, an entity would deem the unexpected changes to have occurred when the most recent risk mitigation objective was specified. In the IASB's view, this operational simplification would be equivalent to adjusting the net repricing risk exposure as though the amount of repricing risk affected by the unexpected changes did not exist at that date, meaning the risk mitigation objective specified at that time would have been lower by that amount.

Recognition and measurement of the risk mitigation adjustment

- BC88 When an entity manages fixed-rate and variable-rate financial assets and financial liabilities together without considering the origin of the repricing risk and uses derivatives to do so, the entity's repricing risk management activities usually serve a dual purpose, namely:
- (a) reduced variability in fair value, which is reflected by deferring the fair value gains or losses from derivatives to the extent the entity has successfully mitigated repricing risk; and
 - (b) reduced variability in cash flows, which is reflected by the subsequent recognition of interest income and interest expenses in profit or loss.

- BC89 Therefore, in the IASB's view, the risk mitigation adjustment would represent the extent to which the designated derivatives mitigated the variability related to the repricing risk due to changes in market interest rates. If an entity's designated derivatives have not achieved its risk mitigation objective, the gains and losses not included in the risk mitigation adjustment would be recognised in profit or loss immediately. This approach is similar to the treatment of hedge ineffectiveness under the hedge accounting requirements in IFRS 9.

Recognising the risk mitigation adjustment

- BC90 When the IASB proposed that an entity would recognise the risk mitigation adjustment in the statement of financial position, it acknowledged that no rights or obligations would be associated with the risk mitigation adjustment beyond the rights or obligations already accounted for through the underlying portfolios and the designated derivatives. As such, the IASB noted that recognition of the risk mitigation adjustment as an asset or a liability in the statement of financial position would not be consistent with the definition of an asset or a liability in the *Conceptual Framework*.
- BC91 However, the *Conceptual Framework* acknowledges that in some circumstances it might be appropriate for the IASB to depart from aspects of the *Conceptual Framework* to meet the objective of general purpose financial reporting (see paragraphs SP1.2–SP1.3 of the *Conceptual Framework*).
- BC92 The IASB concluded that departing from the *Conceptual Framework* on the definition of an asset or a liability might be justified to fulfil the objective of risk mitigation accounting, noting that:
- (a) the alternative to recognising the risk mitigation adjustment in the statement of financial position would be recognising volatile gains or losses in other comprehensive income. This approach would not faithfully represent the economic phenomenon of risk management activities. Furthermore, it would be the result of mixed accounting measurement requirements and, therefore, would provide less useful information for users of financial statements than the proposed approach.
 - (b) the scope of the departure would be limited to specific risk management strategies and activities (see paragraph 7.1.4 of the Exposure Draft).

The 'lower of' requirement

- BC93 The IASB proposes that an entity measure the risk mitigation adjustment in the statement of financial position at the lower of the cumulative fair value gains or losses of the designated and benchmark derivatives (also called the 'lower of' requirement; see paragraph 7.4.8 of the Exposure Draft). This requirement would ensure that any cumulative fair value gains or losses of the designated derivatives that exceed the cumulative changes in fair value of the benchmark derivatives (representing the net repricing risk exposure) are immediately recognised in profit or loss.

- BC94 This requirement is similar to the ‘lower of’ requirement for cash flow hedges in paragraph 6.5.11 of IFRS 9. The rationale for the latter requirement, as expressed in paragraphs BC6.371–BC6.374 of the Basis for Conclusions on IFRS 9, should also apply to risk mitigation accounting, even if the risk mitigation adjustment is recognised in the statement of financial position instead of other comprehensive income. Risk mitigation accounting and cash flow hedge accounting requirements both permit the designation of highly probable forecast transactions and existing financial assets and financial liabilities. The IASB also noted the similarities between the two approaches regarding recognition of gains and losses on underlying portfolios that do not yet exist and recognition of gains and losses arising when an entity has under-mitigated its repricing risk exposure.
- BC95 The IASB deliberated the advantages and disadvantages of adapting this requirement for risk mitigation accounting. The main advantage is that it would provide useful information about the dual purpose of repricing risk management. By applying this requirement, an entity would report the effects of its risk management:
- (a) in the statement of financial position—by recognising the risk mitigation adjustment only to the extent to which it has successfully mitigated the repricing risk. This approach provides useful information about the entity’s risk management efforts. The risk mitigation adjustment would in effect represent the future benefit to be recognised in profit or loss when the mitigated cash flows from, or fair value changes of, the underlying portfolios affect profit or loss.
 - (b) in the statement of profit or loss—by immediately recognising the gains or losses not included in the risk mitigation adjustment in profit or loss. To the extent that the risk has been mitigated, the fair value changes are recognised in the same (future) period(s) as when the net interest income or economic value of underlying portfolios affect profit or loss. This approach faithfully represents the effects of risk mitigation accounting.
- BC96 Another benefit of the requirement would be the provision of more direct information about the effectiveness of risk management activities. Risk mitigation accounting conveys information about how an entity’s risk management actions will affect the timing and amount of its future cash flows and about the effectiveness of the entity’s repricing risk management activities.
- BC97 In the IASB’s view, the main disadvantage of the requirement under cash flow hedge accounting does not arise in risk mitigation accounting. In cash flow hedge accounting, the requirement leads to asymmetrical recognition in the financial statements ‘because the hedge ineffectiveness arising from the larger change in fair value on the hedged item compared to that on the hedging instrument would not be recognised’ (see paragraph BC6.250(b) of the Basis for Conclusions on IFRS 9).

- BC98 However, in risk mitigation accounting, the risk mitigation objective reflects the notional of the designated derivatives that an entity uses to manage its repricing risk. The risk mitigation objective in turn determines the notional of the benchmark derivatives, which model the net repricing risk exposure, meaning that there is little to no risk of a notional mismatch (excluding the effect of any risk mitigation adjustment excess). Any gains or losses arising from maturity mismatches, basis risk or other differences between the designated and benchmark derivatives that are not included in the risk mitigation adjustment are immediately recognised in profit or loss. Such gains or losses provide information about the designated derivatives, which are often selected for liquidity and other economic factors.
- BC99 The IASB proposes that an entity disclose the extent of risk mitigation in accordance with the proposed requirements for IFRS 7 *Financial Instruments: Disclosures* in paragraphs 30L and 30M of the Exposure Draft. The proposed disclosure, combined with the statement of financial position, would provide an insight into the unmitigated balances that persist after the entity has carried out its risk management strategy and related activities. Updating the benchmark derivative to take into account unexpected changes to the net repricing risk exposure will result in any gains and losses not included in the risk mitigation adjustment being recognised immediately in profit or loss, and will provide useful information about such changes to users of financial statements.
- BC100 During its deliberations, the IASB emphasised that the ‘lower of’ requirement in paragraph 7.4.8 of the Exposure Draft would be a cumulative requirement, beginning from an entity’s initial application of risk mitigation accounting. Any gains and losses not included in the risk mitigation adjustment for a particular period would continue to be taken into account when the entity applies the ‘lower of’ requirement in future periods and would be reported in the statement of profit or loss over time.

Risk mitigation adjustment excess

- BC101 Some stakeholders raised concerns that if an entity were to adjust the benchmark derivatives constructed as if unexpected changes to the net repricing risk exposure had occurred at the date the risk mitigation objective was last specified, the risk mitigation adjustment might not capture the full effects of all unexpected changes. Because an entity might change its risk mitigation objective frequently, the unexpected changes in the net repricing risk exposure could also affect the benchmark derivatives related to previous periods.
- BC102 If an entity had adjusted the benchmark derivatives for unexpected changes for the current and previous periods, the risk mitigation adjustment would be expected to be realised in full. However, if an entity were unable to determine the effect of unexpected changes in the net repricing risk exposure or if reasonable and supportable information were not available without undue cost or effort, the risk mitigation adjustment might not be realised in full. For example, prepayments or other unexpected changes to the underlying

portfolios could influence the extent to which the designated derivatives mitigate cash flow and fair value variability in future periods.

- BC103 The IASB noted that when specifying the risk mitigation objective, most entities do not aim to mitigate the net repricing risk exposure in full. The IASB therefore expects that, in most instances, unexpected changes in the net repricing risk exposure would not affect the realisation of the risk mitigation adjustment. However, the IASB acknowledged that, in some circumstances, the extent of unexpected changes might be so high that an entity would not be able to realise the risk mitigation in full.
- BC104 The IASB therefore proposes that an entity be required to assess at each reporting date whether there is an indication that the risk mitigation adjustment will not be realised in full because of the effect of unexpected changes in the underlying portfolios for which the benchmark derivatives have not been adjusted.
- BC105 The IASB's intention was for this assessment to serve as a reasonableness test based on a snapshot of the underlying portfolios included in the net repricing risk exposure at the reporting date. The assessment and the recognition of the excess of the risk mitigation adjustment in profit or loss ensure that the risk mitigation adjustment continues to represent the expected effects of repricing risk on the cash flows from, or the fair value of, the underlying portfolios to be realised over the mitigated time horizon.

Calculating the present value of the net repricing risk exposure

- BC106 The IASB concluded that if an entity does not expect to realise the risk mitigation adjustment in full over the mitigated time horizon, the entity must recognise the excess amount in profit or loss immediately. In deliberating the most appropriate way to calculate this excess amount, the IASB noted that the measure should be consistent with the underlying principles of risk mitigation accounting and should not require undue cost or effort.
- BC107 The IASB concluded that the best way to determine whether the risk mitigation adjustment could be realised in full would be to compare the amount in the statement of financial position with the theoretical maximum amount the risk mitigation adjustment could have been if the entity had mitigated the net repricing risk exposure as at the reporting date in full. The IASB proposes that the maximum amount of the risk mitigation adjustment is the present value of the net repricing risk exposure.
- BC108 The IASB noted that the net repricing risk exposure is an important element of risk mitigation accounting. Because it is based on the information and measures an entity uses to make risk management decisions, the IASB expects that requiring entities to calculate the present value of the net repricing risk exposure at the reporting date would not result in significant costs or complexity.
- BC109 The IASB acknowledged that calculating the present value of the net repricing risk exposure involves more than simply calculating the present value of the financial instruments in the underlying portfolios. Conceptually, the present value of the net repricing risk exposure would be represented by the value of a

theoretical derivative (such as a benchmark derivative) that is constructed on the basis that the net repricing risk exposure is mitigated in full at the period end. However, the IASB concluded that it would not be appropriate to require entities to construct another theoretical derivative solely for the purpose of calculating the present value of the net repricing risk exposure.

- BC110 The IASB therefore considered what the main drivers for changes in the present value of the net repricing risk exposure would be to assess whether the calculation of this value could be simplified. The IASB noted that calculating the present value of the net repricing risk exposure would be more straightforward for fixed-rate financial instruments. However, an entity would need to consider the effects of risk mitigation on variable-rate instruments in the net repricing risk exposure. The IASB noted that many entities have methodologies in place to determine the effects of risk mitigation on variable-rate instruments. The IASB therefore proposes that an entity be permitted to use various approaches to measure the present value of the net repricing risk exposure at the reporting date. All such approaches must be based on reasonable and supportable information that is available without undue cost or effort.

Recognising the excess in profit or loss

- BC111 The IASB proposes that the excess of the risk mitigation adjustment be recognised in profit or loss (see paragraph 7.4.14 of the Exposure Draft). However, the IASB observed that an entity would only recognise the excess in profit or loss when the benchmark derivatives have not been adjusted for unexpected changes. Therefore, an entity might not be able to determine the reporting periods in which to make corresponding adjustments when the effects of repricing risk are expected to affect profit or loss.
- BC112 Calculating the present value of the net repricing risk exposure is intended to be a reasonableness test. Accordingly, the IASB noted that the recognition of any excess of the risk mitigation adjustment is an approximation of the extent to which the risk mitigation adjustment will not be realised. Therefore, the IASB proposes that after an entity had recognised an excess in profit or loss, for the purpose of applying paragraph 7.4.10, the entity would adjust the recognition of the risk mitigation adjustment in profit or loss in future periods. The entity would make such adjustments on a systematic and rational basis, which could include a straight-line basis.
- BC113 The IASB acknowledged that reducing the risk mitigation adjustment by the excess amount could give rise to challenges when applying the requirements in paragraph 7.4.8 of the Exposure Draft in future periods. However, the IASB expects that entities would recognise an excess of the risk mitigation adjustment in profit or loss infrequently. Furthermore, the benefits of risk mitigation accounting for preparers and users of financial statements would outweigh the costs of any complexity that might arise for preparers.

Reversing a previously recognised excess

- BC114 After recognition of an excess in the risk mitigation adjustment, subsequent changes in the net repricing risk exposure could potentially lead to a situation in which the present value of the net repricing risk exposure at the next reporting date would exceed the risk mitigation adjustment at that later date. The IASB therefore considered whether subsequent changes in the present value of the net repricing risk exposure should result in the reversal of a previously recognised excess (like the reversal of an impairment loss).
- BC115 The IASB took into account that subsequent increases in the present value of the net repricing risk exposure are likely to be the result of various factors, for example, new financial assets originated, new financial liabilities issued or subsequent favourable changes in market interest rates.
- BC116 The IASB also acknowledged that permitting or requiring the reversal of such an excess could lead to potential earnings management. For example, if an entity recognised the excess of risk mitigation adjustment in profit or loss, the entity might have an incentive to reduce the risk mitigation objective in future periods (to leave more headroom in valuation) in the hope of reversing the excess. However, such a reversal would not provide useful information because it would be based on management actions rather than reinstatement of the original risk positions. In some cases, it might also lead to continuous recognition and reversal of amounts in profit or loss, which could be misleading for users of financial statements. Therefore, the IASB concluded that reversal of the excess should not be permitted.

Discontinuation of risk mitigation accounting

- BC117 Risk mitigation accounting is intended to resolve the challenges in applying the hedge accounting requirements for entities whose exposure to repricing risk changes frequently. However, if an entity changes how it manages repricing risk, applying risk mitigation accounting would no longer align with its risk management strategy. In the IASB's view, it is important to distinguish between changes in how an entity manages repricing risk and changes caused by the dynamic nature of the entity's repricing risk exposure. Therefore, the IASB proposes that an entity discontinue applying risk mitigation accounting only if the entity changes how it manages repricing risk.
- BC118 Like a change in the business model used to manage financial assets (see paragraph B4.4.1 of IFRS 9), changes in how an entity manages repricing risk are expected to result from factors that are likely to affect the entity's operations and are demonstrable to stakeholders. Because an entity's risk management strategy is intended to ensure long-term stability, the IASB expects changes to this strategy to be infrequent.
- BC119 On the other hand, the IASB noted that changes that reflect the dynamic nature of an entity's repricing risk exposure are consistent with the objective of risk mitigation accounting. Therefore, such changes should not result in an entity discontinuing application of risk mitigation accounting. Examples include changes to:

RISK MITIGATION ACCOUNTING

- (a) the risk mitigation objective;
 - (b) the risk limits;
 - (c) the underlying portfolios; or
 - (d) the designated derivatives.
- BC120 The IASB proposes that voluntary discontinuation be prohibited to avoid an entity applying risk mitigation accounting purely to achieve favourable accounting outcomes. This decision is consistent with the requirements in IFRS 9 that prohibit voluntary de-designation of a hedging relationship and the discontinuation of hedge accounting when the risk management objective for a particular hedging relationship remains the same, and all the other qualifying criteria are met (see paragraph B6.5.23 of IFRS 9 and paragraphs BC6.314–BC6.331 of the Basis for Conclusions on IFRS 9).
- BC121 As a result, the IASB proposes that an entity not be permitted to de-designate a derivative or to voluntarily remove underlying portfolios that were included in the determination of the net repricing risk exposure if these items continue to meet the qualifying criteria.
- BC122 The IASB proposes that upon discontinuing risk mitigation accounting, an entity continue to recognise the risk mitigation adjustment in the statement of profit or loss over the mitigated time horizon. This approach would ensure the effects of previous risk management activities continue to be recognised until the repricing risk is no longer expected to affect the cash flows from, or fair value of, the relevant underlying portfolios.
- BC123 In the IASB's view, these proposals would ensure that if the financial instruments included in the underlying portfolios no longer gave rise to repricing risk (for example, because the financial instruments had expired or were settled), any remaining amount of the risk mitigation adjustment would immediately be recognised in profit or loss.
- BC124 The IASB also concluded that financial instruments included in underlying portfolios for which risk mitigation accounting has been discontinued could be:
- (a) included in a new application of risk mitigation accounting if the entity continues to manage its exposure to repricing risk on a net basis under its revised risk management strategy; or
 - (b) designated in a new hedging relationship under the hedge accounting requirements in Chapter 6 of IFRS 9, provided all the qualifying criteria have been met.
- BC125 When an entity discontinues applying risk mitigation accounting following a change in risk management strategy, the IASB proposes that the entity be permitted to repurpose previously designated derivatives as:
- (a) hedging instruments in a new hedging relationship (applying the hedge accounting requirements in Chapter 6 of IFRS 9); or

- (b) designated derivatives in a new application of risk mitigation accounting, provided the qualifying criteria have been met.
- BC126 However, the IASB emphasised that an entity would consider only the fair value changes arising after the date of redesignation when recognising and measuring the risk mitigation adjustment related to such underlying portfolios or designated derivatives.

Effective date and transition (Appendix C of the Exposure Draft)

Effective date

- BC127 The IASB decided that because risk mitigation accounting is voluntary, an entity would be permitted to apply it from the beginning of an annual reporting period starting on or after [the date the requirements will be issued].
- BC128 The feedback from the consultation will inform the IASB's decision on whether risk mitigation accounting should replace the remaining hedge accounting requirements in IAS 39. The IASB therefore proposes to specify the date from which entities would no longer be permitted to apply those requirements (see paragraph C1.17 of the Exposure Draft). If the IASB decides to withdraw the remaining IAS 39 requirements, it will decide that date taking into consideration the feedback on the Exposure Draft.

Transition

- BC129 When considering potential transition requirements for the initial application of risk mitigation accounting, the IASB noted that these requirements should not only relate to the transition from IAS 39 hedging relationships, but also the transition from IFRS 9 hedging relationships.
- BC130 Furthermore, the IASB noted that some entities might previously have chosen not to apply hedge accounting because the limitations of the current requirements meant that they were unable to faithfully reflect the effects of their risk management activities in their financial statements. Although some of these entities might have decided to accept the accounting mismatches in their financial statements, others might have applied the fair value option to their financial assets or financial liabilities instead.
- BC131 IAS 8 *Basis of Preparation of Financial Statements* states that retrospective application is the preferred approach to applying new requirements for the first time. However, in relation to the initial application of hedge accounting requirements, retrospective application—like retrospective designation—gives rise to concerns about the use of hindsight. In the IASB's view, prospective application of risk mitigation accounting would not only be consistent with the judgements and decisions an entity makes when applying risk mitigation accounting, but would also avoid an entity using hindsight in deciding whether and when to apply risk mitigation accounting. The IASB viewed this requirement as especially important because the application of risk mitigation accounting is optional. Therefore, like the initial application of the hedge

accounting requirements in Chapter 6 of IFRS 9, the IASB proposes that risk mitigation accounting be applied prospectively.

- BC132 The IASB noted that the initial application of risk mitigation accounting would require discontinuation of existing hedge accounting relationships (regardless of whether they are in accordance with IFRS 9 or IAS 39). Therefore, the Exposure Draft should include transition requirements covering both scenarios.

Entities that previously applied the hedge accounting requirements in IAS 39

- BC133 Entities that previously applied the hedge accounting requirements in IAS 39 include those that made the accounting policy choice to apply the portfolio fair value hedge requirements in accordance with paragraph 6.1.3 of IFRS 9. If feedback on the Exposure Draft indicates that the proposed risk mitigation accounting requirements would be an appropriate replacement for the remaining IAS 39 hedge accounting requirements, entities would be required to discontinue applying those requirements.
- BC134 The IASB noted that because the application of risk mitigation accounting is optional, some entities might 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 IFRS 9.
- BC135 However, if an entity decided to apply risk mitigation accounting, the prospective application of risk mitigation accounting would not directly affect the application of hedge accounting in the prior reporting periods. Therefore, fair value hedge adjustments and cash flow hedge reserves related to any discontinued hedging relationships would be unaffected because risk mitigation accounting would only capture value changes from that date onwards.
- BC136 One important consideration is the treatment of amounts recognised in the statement of financial position that relate to hedging relationships discontinued for the purpose of applying risk mitigation accounting. In the IASB's view, the most appropriate way to treat these amounts would be to require an entity to apply the discontinuation requirements in IAS 39. However, because IFRS 9 has substantially the same requirements as IAS 39, the IASB proposes that an entity apply the requirements in paragraphs 6.5.10 and 6.5.12 of IFRS 9 to such discontinued hedging relationships.

Entities that previously applied the hedge accounting requirements in IFRS 9

- BC137 Entities that previously applied the hedge accounting requirements in IFRS 9 would still be able to apply those requirements. However, if an entity decides to apply risk mitigation accounting, it might need to discontinue some hedging relationships in favour of applying risk mitigation accounting.

- BC138 The IASB noted that discontinuing such a hedging relationship be permitted only if the hedging relationship no longer met the qualifying criteria in paragraph 6.4.1 of IFRS 9. In most cases, the introduction of new accounting requirements would not automatically result in the qualifying criteria no longer being met.
- BC139 Without specific transition requirements, most entities would not be able to apply risk mitigation accounting until the IFRS 9 hedging relationships had expired. In the IASB's view, to achieve the objective of risk mitigation accounting, it is necessary to permit entities to discontinue some of their IFRS 9 hedging relationships to enable them to include some or all of the previously designated hedged items in the underlying portfolios.

Entities that do not apply hedge accounting requirements

- BC140 Some entities whose risk management activities have the characteristics specified in paragraph 7.1.4 of the Exposure Draft might not currently apply hedge accounting but could still decide to apply risk mitigation accounting. Such entities might include those that have decided:
- (a) to accept the accounting mismatches between the underlying portfolios and derivatives, and account for them applying the general requirements in IFRS 9; or
 - (b) to reduce the accounting mismatches between the underlying portfolios and derivatives by designating the underlying portfolios as measured at fair value through profit or loss in accordance with paragraph 4.1.5 or paragraph 4.2.2 of IFRS 9.
- BC141 The entities described in paragraph BC140(a) do not need transition requirements because such entities may choose to apply risk mitigation accounting prospectively from any date after the date of initial application.
- BC142 However, the IASB noted that for the entities described in paragraph BC140(b), the optional designation of financial assets or financial liabilities as measured at fair value through profit or loss is available only at initial recognition of the financial instruments and is irrevocable. Therefore, without a transition relief, such financial instruments would not be eligible for inclusion in underlying portfolios for the purpose of determining the net repricing risk exposure.
- BC143 In the IASB's view, risk mitigation accounting could provide such entities with a way to more faithfully reflect the effects of their repricing risk management activities. The IASB concluded that it would not be appropriate to prevent these financial assets or financial liabilities from being included in the underlying portfolios for the purpose of determining the net repricing risk exposure.
- BC144 Therefore, the IASB proposes to permit entities to revoke their previous designation of financial assets or financial liabilities as measured at fair value through profit or loss for the purpose of applying risk mitigation accounting.

- BC145 In the IASB's view, because risk mitigation accounting can only be applied prospectively, any such revocation should also be prospective. The fair value of a financial instrument on the date of initial application for an entity applying the transition requirements would become its new gross carrying amount and the basis for determining the instrument's effective interest rate. For the purpose of applying Section 5.5 of IFRS 9 to financial assets, the date of initial application of risk mitigation accounting is treated as the date of initial recognition of the financial asset.

Transition disclosures

- BC146 If the initial application of new requirements affects the current period or might affect future periods, an entity would ordinarily be required to provide the disclosures specified in paragraph 28 of IAS 8. However, in the IASB's view, this requirement would be inconsistent with the prospective application of risk mitigation accounting because it would be impracticable for an entity to apply two substantially different accounting methods at the same time.
- BC147 Furthermore, in the IASB's view, specific transition disclosures would be necessary to enable users of financial statements to understand the effects of the transition to risk mitigation accounting on an entity's financial statements. Such disclosures would be necessary to provide information about the IFRS 9 or IAS 39 hedge relationships that have been discontinued and about how the underlying portfolios and derivatives have been included in risk mitigation accounting. The IASB therefore decided to propose amendments to the transition disclosures included in IFRS 7 (see paragraph 44RR of the Exposure Draft).

Proposed amendments to IFRS 7 *Financial Instruments: Disclosures*

Statement of comprehensive income

- BC148 Over the course of the IASB's project to develop macro hedge accounting requirements, users of financial statements have said that to enable them to understand how entities manage their exposure to repricing risk, the financial statements should provide information that can be used to predict an entity's future financial performance. In particular, users need information that enables them:
- (a) to identify the effect of risk mitigation accounting separately from an entity's interest income or interest expense; and
 - (b) to understand how much an entity relies on using derivatives to stabilise and achieve its current net interest income.
- BC149 The IASB agreed that the distinction described in paragraph BC148(a) would improve transparency and would enable users of financial statements to better analyse and understand the effect of an entity's risk management activities on its current and future economic resources. Therefore, the IASB decided to propose that an entity present the effect of risk mitigation accounting in a separate line item in the statement of comprehensive income.

- BC150 The IASB noted that in accordance with paragraph 23 of IFRS 18, 'an entity needs not present separately a line item in a primary financial statement if doing so is not necessary for the statement to provide a useful structured summary. This is the case even if IFRS Accounting Standards contain a list of specific required line items or describe the line items as minimum requirements.'

Statement of financial position

- BC151 Following deliberation on the presentation of the risk mitigation adjustment in the statement of financial position, the IASB proposes that it be presented in a separate line item because:
- (a) it reflects the effects of an entity's risk management activities and it is specific to the entity's risk management strategy;
 - (b) its separate presentation in the statement of financial position would support comparability between entities that do or do not apply risk mitigation accounting;
 - (c) it does not meet the definition of an asset or liability set out in the *Conceptual Framework* and therefore differs from an entity's other assets or liabilities (see paragraphs BC90–BC92); and
 - (d) its measurement basis differs from that of an entity's other financial assets and financial liabilities.

- BC152 Therefore, in the IASB's view, it is necessary for an entity to present the risk mitigation adjustment in a separate line item in the statement of financial position. However, an entity only needs to present a line item separately in a primary financial statement if doing so is necessary for the statement to provide a useful structured summary (see paragraph BC150).

Disclosure objectives

- BC153 In the IASB's view, the disclosure objectives of risk mitigation accounting should be like those for hedge accounting (see paragraph 21A of IFRS 7). The disclosure objectives proposed in paragraph 30F of the Exposure Draft are intended to enhance the transparency of information an entity provides about its repricing risk management strategy and how it manages the effects of repricing risk on the cash flows from, or fair value of, the underlying portfolios.

Level of aggregation

- BC154 During the development of the proposals in the Exposure Draft, the IASB heard from stakeholders that one of their ongoing concerns relates to the appropriate level of aggregation or disaggregation of any proposed disclosure requirements. In general, the more disaggregated that information is required to be, the higher the risk of commercially sensitive information being disclosed. Similarly, many users of financial statements said that analysing large volumes of detailed disclosures that involve complex assumptions and methodologies might lead to provision of information that is not useful. Users

of financial statements often try to obtain an overview of an entity's overall interest rate risk management activities and identify trends in the extent of interest rate risk an entity mitigates. Therefore, information that is too detailed might obscure other material information or might not be material.

- BC155 Therefore, the IASB proposes not to specify the level of aggregation required for the disclosure of information relating to risk mitigation accounting. Paragraph 41 of IFRS 18 sets out principles for aggregating and disaggregating information in financial statements, including in the notes. Accordingly, to meet the disclosure objectives of risk mitigation accounting, an entity would be required to apply the requirements in IFRS 18 when determining the appropriate level of aggregation.

Disclosure of risk management strategy

- BC156 The proposed disclosures in paragraph 30I of the Exposure Draft are mainly qualitative in nature and describe how an entity identifies, aggregates, monitors and manages the repricing risk. In the IASB's view, because this information reflects the essential elements of an entity's risk management process, these disclosures would provide useful information to users of financial statements without requiring entities to incur significant additional costs to provide the information. Furthermore, the information that would be provided in accordance with the proposed requirements is not commercially sensitive because it is broadly similar to the information currently provided by entities that apply hedge accounting (see paragraph 22A of IFRS 7).

Disclosure of the amount, timing and uncertainty of future cash flows

- BC157 The IASB noted that an entity disclosing information about designated derivatives and their effect on the amount, timing and uncertainty of its cash flows would enable users of financial statements to understand the extent to which the entity had mitigated its repricing risk exposure. Such information would also enable users to understand how the risk mitigation adjustment would be recognised in the statement of profit or loss over the mitigated time horizon. The IASB therefore decided to propose an entity disclose the information specified in paragraph 30J of the Exposure Draft.
- BC158 The IASB also considered the potential commercial sensitivity of this information. It concluded that because the information relates to the cash flows of the designated derivatives and not directly to the pricing or costing structure of any financial instruments included in the underlying portfolios, it is unlikely to be commercially sensitive.
- BC159 The IASB responded to any residual risk of disclosure of commercially sensitive information by proposing that an entity be permitted to use the cash flows of the designated derivatives to infer the cash flow breakdown of underlying portfolios. The IASB concluded that the proposed disclosures would not result in the provision of commercially sensitive information because:

- (a) the designated derivatives would only mitigate a portion of an entity's net repricing risk exposure in most cases, so there is no direct link between the amount, timing and uncertainty of cash flows from designated derivatives and those from eligible underlying portfolios;
- (b) such disclosures could be provided on an aggregated basis; and
- (c) the current hedge accounting disclosure requirements in paragraphs 23A–23F of IFRS 7 require similar information and have not led to the disclosure of commercially sensitive information.

BC160 The IASB concluded that the proposed disclosures would enable users of financial statements to understand the extent of risk mitigation as part of an entity's risk management strategy. These disclosures would enhance the transparency of information provided about how an entity has mitigated the variability in cash flows and/or fair value.

BC161 During its deliberations on the disclosure of information about an entity's net repricing risk exposure, the IASB heard from users of financial statements that quantitative information about an entity's interest rate risk exposures and the mitigated rate would enable them to predict the future performance of the entity. However, most preparers commented that such disclosures could potentially result in the provision of forward-looking information that could put them in an unfair position compared with competitors that do not apply risk mitigation accounting or IFRS Accounting Standards.

BC162 When the IASB was developing the current hedge accounting disclosure requirements in IFRS 7, it acknowledged that disclosures focusing on the hedged risk would potentially provide competitors with insight into an entity's costing structure (see paragraphs BC35W–BC35X of the Basis for Conclusions on IFRS 7). It decided not to require information to be disclosed about the total risk exposure of the hedged items because of the potential forward-looking nature of this information. In line with this rationale, the IASB concluded that it would be inappropriate to require entities to disclose information about the net repricing risk exposure on a total or residual risk exposure basis.

BC163 Instead, the IASB proposes that an entity be required to provide a sensitivity analysis showing how its exposure to repricing risk might change depending on movements in market interest rates. The entity would use reasonable and supportable information available at the reporting date to determine changes in the mitigated rate that were reasonably possible at the end of the reporting period. In the IASB's view, disclosure of this information would enable users of financial statements to assess how interest rate changes would have affected the entity's underlying portfolios if the entity had not undertaken risk management activities.

BC164 The IASB acknowledged that some entities might not specify whether their exposure to repricing risk arose from underlying portfolios or from the designated derivatives. Isolating and providing sensitivity analysis for only the exposure to repricing risk arising from the underlying portfolios might not be consistent with such entities' risk management information. However, the

IASB proposes that the sensitivity analysis provided be based on the exposure to repricing risk arising from the underlying portfolios only, given the importance of this distinction to users of financial statements.

Disclosure of the effects on financial position and performance

- BC165 Paragraphs 24A–24F of IFRS 7 require an entity to disclose the effects of hedge accounting on its financial position and performance, which includes disclosure in a tabular format of information about:
- (a) the hedging instruments and hedged items, such as the carrying amounts;
 - (b) the line items in which these items are included; and
 - (c) the accumulated amount of the fair value hedge adjustment or cash flow hedge reserve.
- BC166 In the IASB's view, most of the information needs of users of financial statements could be met through similar requirements. Therefore, the IASB proposes that an entity provide the information set out in paragraph 30L of the Exposure Draft for the net repricing risk exposure and paragraph 30M of the Exposure Draft for the designated derivatives.
- BC167 The risk mitigation adjustment represents the extent to which an entity's risk management activities have provided benefit or protection in the form of reduced variability in the cash flows, or fair value of, the underlying portfolios during the mitigated time horizon. Therefore, the IASB proposes that an entity provide information about how the entity reflects:
- (a) the effect of unexpected changes in the net repricing risk exposure during the repricing risk assessment period;
 - (b) the gains or losses on the designated derivatives not included in the measurement of the risk mitigation adjustment, both for the period and cumulatively; and
 - (c) the expected profile for recognition of the risk mitigation adjustment in profit or loss based on the designated and benchmark derivatives and distinguishing between ongoing and discontinued risk mitigation accounting.
- BC168 The IASB also proposes that an entity provide a reconciliation from the opening to the closing balance of the risk mitigation adjustment in a tabular format in the notes (see paragraph 30O of the Exposure Draft). In the IASB's view, this reconciliation would help users of financial statements understand the potential effect of applying the model on the variability of cash flows or fair value—distinguishing between amounts related to ongoing and discontinued risk mitigation accounting.

Entities that do not apply risk mitigation accounting

- BC169 Feedback from users of financial statements suggested that if entities choose not to apply hedge accounting, their disclosures often lack information about how they manage repricing risk. In the IASB's view, the same would be true for entities that frequently change their risk management activities but have chosen not to apply risk mitigation accounting.
- BC170 In the IASB's view, it is not feasible to require an entity to disclose detailed information if it has chosen not to apply risk mitigation accounting. An entity might decide not to apply risk mitigation accounting for many reasons even if it carries out the applicable repricing risk management activities. The IASB also concluded that it would not be appropriate to require such entities to disclose quantitative information as if they were applying risk mitigation accounting. Furthermore, such an approach would extend beyond reflecting the effects of an entity's risk management activities on the financial statements and therefore falls outside the remit of this project.
- BC171 The IASB therefore proposes to require entities that meet the criteria set out in paragraph 7.1.4 of the Exposure Draft, but that choose not to apply risk mitigation accounting, to disclose qualitative information about how the exposure to repricing risk arises, the related risk management activities and how this is reported in their financial statements. This requirement would enable users of financial statements to understand such entities' interest rate risk management strategies and how they are applied to repricing risk management. In the IASB's view, such disclosures might also improve the clarity of risk-related information in the financial statements of entities with significant exposure to repricing risk.

Amendments to other IFRS Accounting Standards

Proposed amendments to IFRS 1 *First-time Adoption of International Financial Reporting Standards*

- BC172 IFRS 1 *First-time Adoption of International Financial Reporting Standards* currently does not permit retrospective application of hedge accounting to transactions entered into before the date of transition to IFRS Accounting Standards (see paragraphs B4–B6 of IFRS 1). The IASB has not identified any reason to change this requirement for risk mitigation accounting.
- BC173 At the date of transition to IFRS Accounting Standards, a first-time adopter would have to look at all its risk management activities to understand which activities would meet the qualifying criteria of risk mitigation accounting, and whether the effects of these activities would be better reflected by applying risk mitigation accounting.
- BC174 If first-time adopters were permitted to apply risk mitigation accounting retrospectively, they would be likely to face the same challenges associated with the use of hindsight as entities that already apply IFRS Accounting Standards. Furthermore, before beginning the preparations for adopting IFRS 9 and applying risk mitigation accounting, it is unlikely that an entity would have met all the qualifying criteria for applying risk mitigation

accounting, including documentation and collection of necessary data even if the entity already carries out the applicable risk management activities.

- BC175 Therefore, the IASB proposes to require the prospective application of risk mitigation accounting by a first-time adopter for the same reasons as discussed in paragraph BC131 in relation to entities that currently apply IFRS Accounting Standards.

Proposed amendments to IFRS 18 *Presentation and Disclosure in Financial Statements*

- BC176 Paragraphs B70–B74 of IFRS 18 *Presentation and Disclosure in Financial Statements* specify requirements for the classification of gains or losses on derivatives and designated hedging instruments. In accordance with these requirements, gains or losses on such derivatives are classified in the statement of profit or loss in the same category as the income and expenses affected by the risks the financial instrument is used to manage. In the IASB's view, for the purpose of risk mitigation accounting, the gains or losses on the designated derivatives are like those on the derivatives used as hedging instruments when applying hedge accounting. Therefore, the IASB decided to amend paragraphs B70–B72 and B74 of IFRS 18 to include references to designated derivatives.

Proposed amendments to IFRS 19 *Subsidiaries without Public Accountability: Disclosures*

- BC177 During its deliberations, the IASB concluded that most of the entities that carry out applicable risk management activities and qualify to apply risk mitigation accounting would not be eligible to apply the requirements in IFRS 19 *Subsidiaries without Public Accountability: Disclosures*. However, the IASB acknowledged that there might be situations in which some subsidiaries without public accountability carry out similar activities and qualify to apply risk mitigation accounting. The IASB considered whether it would be appropriate to add reduced disclosure requirements to IFRS 19 on risk mitigation based on the six principles set out in paragraph BC33 of the Basis for Conclusions on IFRS 19, and it decided not to do so.
- BC178 The IASB took this decision because the complexity of risk mitigation accounting means that adding such reduced requirements would significantly reduce the usefulness of the information provided by applying risk mitigation accounting. Furthermore, most of the information that an entity would be required to disclose would arise directly from the application of risk mitigation accounting and therefore would probably be available without undue cost. The IASB is also of the view that requiring all entities that apply risk mitigation accounting to provide the same complete list of disclosures would allow users of financial statements to become more familiar with risk mitigation accounting and its effects on an entity's financial statements.

Analysis of the effects of risk mitigation accounting

- BC179 For each aspect of the requirements proposed in the Exposure Draft, the IASB weighed up the likely costs and benefits for preparers and users of financial statements. For example, the IASB considered how best to balance the information needs of users of financial statements with preparers' concerns about the potential costs of implementation and the disclosure of commercially sensitive information.
- BC180 The IASB acknowledged that the challenges and complexities related to applying the hedge accounting requirements in IFRS 9 and IAS 39 make it difficult for entities to faithfully represent the economic effect of their risk management activities in their financial statements. One reason for the lack of transparency in financial statements about how an entity manages its repricing risk is the use of proxy designations for hedged items. This practice arises because of the restrictions imposed by the current hedge accounting requirements on which items are eligible for designation as hedged items.
- BC181 The IASB is of the view that by applying risk mitigation accounting instead, an entity would be able to provide a clearer link between information reported in its financial statements and its risk management activities. Risk mitigation accounting would benefit entities by:
- (a) enabling them to better communicate with investors by better reflecting in financial statements the effects of how repricing risk is managed (reducing the need for proxy hedging and including more financial instruments in the underlying portfolios, such as demand deposits and some pipeline transactions); and
 - (b) improving operational efficiency because of closer alignment between their risk management activities and financial reporting.
- BC182 Risk mitigation accounting supports better decision-making by users of financial statements by providing:
- (a) improved transparency regarding an entity's interest rate risk management strategy and how it systematically and dynamically responds to a changing interest rate environment and the effect of its strategy and responses; and
 - (b) more comprehensive information, including improved anchor points to information provided outside the financial statements and that will enable users of financial statements to ask relevant questions.
- BC183 The initial application of risk mitigation accounting would require entities to incur one-off costs, like those listed in paragraph BCE227 of the Basis for Conclusions on IFRS 9. Such costs would relate to:
- (a) development of new processes, systems and controls to integrate risk management information into their financial reporting processes (for example, design, set-up and governance of the assessment of whether the risk mitigation will be realised in full);

RISK MITIGATION ACCOUNTING

- (b) creation of financial reporting capabilities for some newly eligible accounting treatments, where needed—for example, construction and measurement of benchmark derivatives;
- (c) arrangement of required documentation upon implementation of the new risk mitigation accounting requirements;
- (d) education of financial reporting, treasury, risk management and other relevant staff to enable them to assess whether the information prepared for risk mitigation purposes complies with the risk mitigation accounting requirements; and
- (e) production of guidance material necessary to explain the effects of risk mitigation accounting to the users of financial statements.

BC184 The IASB also acknowledged that there would be ongoing costs associated with risk mitigation accounting (for example, costs related to the construction and valuation of the benchmark derivatives, and the calculation and monitoring of the risk mitigation adjustment). However, the IASB expects these costs would be lower than the current costs of applying hedge accounting requirements. For example, when applying risk mitigation accounting, entities would no longer have to repeatedly de-designate and re-designate hedging relationships to accommodate the frequent changes in their risk management activities.

BC185 In the IASB's view, the initial and ongoing costs of applying risk mitigation accounting will depend on each entity's individual circumstances. Many factors could be relevant, including the length of the mitigation time horizon, the frequency of changes to the risk mitigation objective, the number and type of designated derivatives, and the processes and systems the entity has used to implement risk mitigation accounting. Given the difficulty in estimating the likely costs for preparers of a new accounting model, the IASB expects to obtain information about likely costs during the consultation and fieldwork. Entities would need to evaluate whether the costs incurred are justified by the improved ability to reflect the effects of repricing risk management in their financial statements. The proposed withdrawal of IAS 39 would be another relevant factor. If an entity is no longer able to apply those requirements, it will inevitably incur costs associated with applying a new set of accounting requirements—whether those costs arise from applying risk mitigation accounting, applying hedge accounting in accordance with IFRS 9 or recognising all gains or losses on its derivatives in profit or loss.

BC186 Even entities with sophisticated risk management functions (including bespoke solutions) that produce reliable information to help manage repricing risk would be likely to incur some costs relating to the initial application of the new requirements. However, the IASB expects that the ongoing application costs would be lower because of the potential efficiencies gained from better aligning risk management with financial reporting. Furthermore, the IASB notes that entities applying risk mitigation accounting would benefit from closer alignment between financial reporting and risk management when communicating their performance.

- BC187 The IASB also expects that disclosing the proposed information about risk mitigation accounting in a single note would reduce costs for users of financial statements. Users would be able to access a set of information that is more transparent and relevant to their analysis of an entity's performance, and more closely linked to the entity's risk management decision-making. Furthermore, these requirements would also reduce the need for users of financial statements to rely on unaudited management information to understand the effects of an entity's risk management activities on its financial statements.
- BC188 Consequently, the IASB concluded that the long-term benefits of implementing risk mitigation accounting are likely to outweigh the associated costs for entities.



IFRS[®]

Foundation

Columbus Building
7 Westferry Circus
Canary Wharf
London E14 4HD, UK

Tel **+44 (0) 20 7246 6410**

Email **customerservices@ifrs.org**

ifrs.org

The IFRS Foundation has trade marks registered around the world, including 'FSA[®]', 'IASB[®]', 'IFRS[®]', 'International Financial Reporting Standards[®]', 'ISSB[®]', and 'SASB[®]'. For a full list of our registered trade marks, visit www.ifrs.org.