Staff paper

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Introduction

1. At its June 2024 meeting, the IASB discussed the information needs of the users of financial statements in relation to the Dynamic Risk Management (DRM) model. The IASB was not asked to make any decisions, but it discussed an initial analysis of the potential disclosure requirements of the DRM model as summarised in paragraphs 50 to 71 of Agenda Paper 4C for that meeting.

2. In this paper, we further analyse how these potential disclosure requirements would help achieve a balance between the information users of financial statements need to understand an entity's interest rate risk management activities and preparers' concerns about the costs associated with providing the information and the commercial sensitivity regarding some items of information. For this purpose, we obtained further preliminary views through targeted discussions with a few preparers.

3. This paper is structured as follows:

   (a) staff recommendations and the question for the IASB;

   (b) summary of previous discussions; and

   (c) staff analysis.

Staff recommendations and the question for the IASB

4. Based on the staff analysis included in this paper and the discussion included in Agenda Paper 4C for the June 2024 IASB meeting, we recommend that an entity applying the DRM model is required to provide information that enables users of financial statements to understand:

   (a) an entity's interest rate risk management strategy and how it is applied dynamically to manage repricing risk;[1]

   (b) how an entity's dynamic interest rate risk management activities affect the amount, timing and uncertainty of its future cash flows; and

   (c) the effect the entity's dynamic interest rate risk management activities have on the statement of financial position and statement of profit or loss.

5. Consistent with paragraph 21B of IFRS 7 *Financial Instruments: Disclosures*, disclosure information is provided in a single note or in a separate section in the financial statements. An entity is also permitted to incorporate information by a cross-reference from the financial statements to another statement that is available to users of financial statements on the same terms as the financial statement and at the same time.

6. To meet the disclosure objectives in paragraph 4, an entity is required to apply the principles set out in paragraph 41 of IFRS 18 *Presentation and Disclosure in Financial Statements* when determining the appropriate level of aggregation or disaggregation of information in the financial statements, including in the notes.

7. An entity shall disclose information about its risk management strategy that enable users of financial statements to understand:

   (a) how the entity's exposure to repricing risk arises, including a description of the underlying financial assets and financial liabilities included for determining

[1] In the context of the DRM model, repricing risk refers to the risk that, when financial assets or financial liabilities reprice at different times, changes in interest rates result in variability in the net interest income or the fair value of underlying items in the current net open risk position.

the current net open risk position (CNOP) and the nature of the repricing risk (ie whether arising from fixed or floating rate exposures);

(b) the levels at which repricing risk is managed (for example at an entity-wide level or a lower level);

(c) how the entity identifies, aggregates, monitors and manages its repricing risk including the risk metrics the entity uses and the frequency with which the CNOP and risk mitigation intention is determined; and

(d) the managed rate, time horizon over which repricing risk is mitigated and if the entity is allocating its risk exposures to time buckets, an indication of the time buckets used.

8. If an entity carries out applicable risk management activities but chooses not to apply the DRM model, it is still required to provide a qualitative disclosure to explain how it manages the repricing risk. Such disclosures shall include:

(a) how the entity's exposure to repricing risk arise;

(b) how the entity identifies, aggregates, monitors and manages its repricing risk; and

(c) how such risk management activities are accounted for in the financial statements.

9. An entity shall disclose both qualitative and quantitative information to enable users of financial statements to evaluate the terms and conditions of designated derivatives and how they affect the amount, timing and uncertainty of future cash flows of the entity. To meet this disclosure requirement, an entity shall provide a breakdown that discloses:

(a) a profile of the timing of the nominal amount of these designated derivatives (for example nominal amount by maturity bucket); and

(b) the average fixed rate of these derivatives.

10. In addition, an entity shall also provide a sensitivity analysis at the reporting date, showing how the net interest income (NII) or fair value of its underlying items that are included for determining the CNOP would change as a result of movements in interest rates that were reasonably possible at that date.

11. An entity shall disclose, in a tabular format, the underlying items that are included for determining the CNOP, including:

    (a) the carrying amounts of the financial assets and financial liabilities that are recognised, or the notional amounts of future transactions yet to be recognised;

    (b) the line items in the statement of financial position in which the underlying items are included;

    (c) qualitative disclosures about the inputs, assumptions and estimation techniques used for determining the expected cash flows; and

    (d) information about any hedged exposures that are included.

12. An entity shall also disclose, in a tabular format, information about the designated derivatives to enable users of financial statements to evaluate their terms and conditions, including:

    (a) the carrying amount of the designated derivatives;

    (b) the line item in the statement of financial position that includes the designated derivatives;

    (c) the change in fair value of the designated derivatives used as the basis for measuring the DRM adjustment; and

    (d) the nominal amounts of the designated derivatives.

13. In addition, an entity is also required to provide information about the performance of the DRM model to enable users of financial statements to understand the potential effect of an entity’s dynamic risk management on variability in its future NII and economic value of equity. Such information shall include:

(a) gains or losses recognised as part of the DRM adjustment during the reporting period;

(b) how the entity reflects the effect of unexpected changes in the CNOP during the period;

(c) the amount of misalignment (both cumulative and the effect in the current reporting period) and the line items in which the misalignment is recognised in the statements of profit and loss;

(d) the expected profile (based on the designated derivatives and benchmark derivatives) for recognising the DRM adjustment in profit or loss (ie future 'protection' against NII variability); and

(e) the amount of any write-down of the DRM adjustment at the reporting date and its expected effect on recognising the DRM adjustment in profit or loss.

Question for the IASB
1. Do the IASB members agree with the staff's recommendations included in paragraphs 4 to 13 of this paper?

Summary of previous discussions

Summary of investors' information needs

14. As discussed in paragraphs 13–42 of Agenda paper 4C for the June 2024 meeting, the key aspects of investors' information needs with regard to an entity's dynamic risk management activities include:

(a) information about an entity's risk management strategy and how the entity would respond to a changing interest rate environment, including:

(i) how an entity identifies its interest rate risk exposure;

(ii) the sources of interest rate risk exposure; and

(iii) how an entity monitors and mitigates its interest rate risk exposures.

(b) information that is specific and directly relevant to the entity rather than generic or boiler plate information;

(c) information that distinguishes between the different components of net interest income, and the main drivers of volatility between reporting periods;

(d) information about the sensitivity of net interest income and economic value of equity based on pre-defined scenarios and non-parallel shifts in interest rates;

(e) information that distinguishes between an entity's 'organic' risk exposure—clearly identifying what positions are actively being risk mitigated—and the derivatives used to mitigate such risk exposure;

(f) information about the inputs and assumptions an entity has used to calculate the organic interest rate risk exposures, focusing on the outcome of applying the model rather than the detailed processes or assumptions used in achieving that outcome; and

(g) information on the amount and timing of recognising the DRM adjustment in profit or loss over the risk management time horizon.

Summary of preparers' preliminary views

15. Paragraphs 43–49 of Agenda paper 4C for the June 2024 meeting described the preliminary views shared by some preparers, which can be summarised as:

(a) acknowledgement of the importance of providing relevant information about how an entity have applied the DRM model in its financial statements;

(b) required information to be entity-specific and aligned with the entity's risk management strategy and objectives;

(c) being able to leverage from the information they already provide as much as possible, such as the Pilar 3 disclosures, and avoiding the need to duplicate information provided outside the financial statements;

(d) concerns about being required to disclose forward-looking risk-based information or information that could potentially be commercially sensitive in nature, for example detailed information about the residual exposure to interest rate risk; and

(e) concerns about potential disclosure overload and disclosing information that extends beyond the boundaries of the financial statements, as well as the costs of providing the proposed information.

Staff analysis

Proposed disclosure objectives

16. As discussed in paragraph 11 of Agenda Paper 4A for the May 2022 IASB meeting, the application of the DRM model should provide information that enable users of financial statements to understand:

 (a) an entity's interest rate risk management strategy and how it is applied dynamically to manage repricing risk;

 (b) how an entity's dynamic interest rate risk management activities affect the amount, timing and uncertainty of its future cash flows; and

 (c) the effect the entity's dynamic interest rate risk management activities have on the statement of financial position and statement of profit or loss.

17. These disclosure objectives are similar to the objectives of the disclosure requirements for risk exposures that an entity hedges, and for which hedge accounting is applied, as described in paragraph 21A of IFRS 7.

18. We continue to consider these disclosure objectives to be appropriate and are of the view that they would enhance transparency in the financial statements about how an entity manages its repricing risk and variability in economic value of equity or net interest income.

19. Based on the input from stakeholders and consistent with the current requirements in paragraph 21B of IFRS 7, we also continue to be of the view that:

    (a) the required disclosures are provided in a single note or in a separate section in the financial statements;

    (b) information could be incorporated by cross-reference from the financial statements to another statement that is available to users of financial statements on the same terms as the financial statement and at the same time, and the financial statements are incomplete without the information incorporated by cross-reference;

    (c) where applicable, the information provided in the notes to the financial statements should enable users of financial statements to identify (and reconcile to) the corresponding line item in the primary financial statements.

20. In our view, although users of financial statements may have different perspectives and focus areas when performing their analyses, information that meet these objectives would help with their analyses and supplement other relevant information provided by management in relation to the entity's expectations about future net interest income volatility and interest rate risk exposure provided elsewhere.

Level of aggregation for DRM disclosures

21. One of the ongoing concerns preparers have relates to the appropriate level of aggregation or disaggregation of any proposed disclosures. In general, the more disaggregated the information is required to be disclosed, the higher is the risk of disclosing commercially sensitive information.

22. We understand that users of financial statements may not always prefer granular information in relation to interest rate risk management. Instead, during outreach meetings, many of the investors said that they prefer the disclosed information not to be too technical or over-complicated. This is because analysing large volume of detailed disclosures that involve complex assumptions and methodologies might lead

to an information overload. In some cases, disaggregation of information may not be necessary for the purposes of their analysis because they often try to obtain a high-level overview of an entity's overall interest rate risk management activities and identify relevant trends about the extent of interest rate risk an entity mitigates.

23. With regard to hedge accounting disclosures, paragraph 21D of IFRS 7 requires an entity to determine how much detail to disclose, how much emphasis to place on different aspects of the disclosure requirements, the appropriate level of aggregation or disaggregation and whether users of financial statements need additional explanations to evaluate the quantitative information disclosed.

24. Furthermore, paragraph 41 of IFRS 18 sets out principles for aggregating and disaggregating information in the financial statements, including in the notes. Accordingly, to meet the objectives in paragraph 16, we recommend entities apply those requirements when determining the appropriate level of aggregation for the DRM disclosures.

Disclosure about risk management strategy

25. As noted in Agenda Paper 4C for the June 2024 IASB meeting, paragraph 22A of IFRS 7 requires an entity to disclose information about an entity's risk management strategy that enable users of financial statements to evaluate:

    (a) how each risk arises;

    (b) how the entity manages each risk (for example whether an entity hedges an item in its entirety for all risks or only a risk component of an item, and why?)

    (c) the extent of risk exposures that the entity manages.

26. We continue to think that to achieve the objective in paragraph 16(a) of this paper, a similar disclosure requirement with regard to the application of the DRM model would be appropriate. We therefore recommend that an entity is required to disclose information about its risk management strategy that enable users of financial statements to evaluate:

(a) how the entity's exposure to repricing risk arises, including a description of the underlying financial assets and financial liabilities included for determining the CNOP and the nature of the repricing risk (ie whether arising from fixed or floating rate exposures);

(b) the levels at which repricing risk is managed (for example at an entity-wide level or a lower level);

(c) how the entity identifies, aggregates, monitors and manages its repricing risk including the risk metrics the entity uses and the frequency with which the CNOP and risk mitigation intention is determined; and

(d) the managed rate, time horizon over which repricing risk is mitigated and if the entity is allocating its risk exposures to time buckets, an indication of the time buckets used.

27. These disclosures are mainly qualitative in nature and describe how the entity identifies, aggregates, monitors and manages the repricing risk. Since this information is essential to an entity's dynamic risk management process, in our view these disclosures would provide useful information without incurring significant additional costs to preparers.

Entities that chose not to apply DRM model

28. The IASB tentatively decided in its July 2024 meeting that an entity would only be able to apply the DRM model if it:

(a) has business activities that expose it to repricing risk arising from financial assets and financial liabilities;

(b) adopts a dynamic risk management strategy with a dual objective that aims to mitigate the variability of both the net interest income and the economic value of equity, based on an aggregated (combined or net) repricing risk over a predetermined period;

(c) uses a systematic process to determine the net repricing risk exposure based on a specified managed rate and frequently adjusts its risk mitigation activities; and

(d) has free access to a liquid market that enables it to raise funding or invest excess cash at the prevailing benchmark interest rate.

29. In addition, the IASB also tentatively decided in its July 2024 meeting that when an entity carries out these applicable risk management activities, the application of the DRM model is optional. An entity could therefore choose whether to apply the DRM model or not, despite carrying out applicable risk management activities. In such a case, the entity may choose:

(a) to apply the general hedge accounting requirements in accordance with Chapter 6 of IFRS 9 *Financial Instruments*;

(b) to designate the underlying exposures at fair value through profit or loss in accordance with paragraph 4.1.5 or paragraph 4.2.2 of IFRS 9 to reduce the accounting mismatch between the underlying items and derivatives; or

(c) to account for the underlying items and derivatives applying the general requirements in IFRS 9.

30. Similar to the disclosure requirements for hedge accounting in IFRS 7, there might be an expectation that an entity would only have to provide the DRM disclosure information when it applies the DRM model. However, users of financial statements said on multiple occasions previously that there is a lack of information about how entities manage risk when hedge accounting is not applied. This is because the entity might still carry out hedging activities even if such activities are not reflected in the financial statements by using hedge accounting. We think this is particularly true in the context of the dynamic risk management, when an entity could, but decide not to, apply the DRM model. Therefore, as stated in paragraph 27 of Agenda paper 4B for the July 2024 meeting, we explore whether the disclosure of any information in such a case would be required.

31. In our view, requiring the disclosure of detailed information when an entity decided not to apply the DRM model, would not be feasible. As explained in the Agenda paper 4B for the July 2024 IASB meeting, there could be various reasons why an entity might decide to not apply the DRM model even if it carries out the applicable activities described in paragraph 28 of this paper. Requiring entities to provide quantitative information on an 'as if' basis would not be appropriate. Furthermore, such an approach would extend beyond the effects of an entity's risk management activities on the financial statements and therefore are outside the boundaries of the financial statements.

32. However, we are of the view that information similar to that proposed in paragraph 26 of this paper, as well as how such activities are accounted for in financial statements, would enable users of financial statements to understand an entity's interest rate risk management strategy and how it is applied to manage repricing risk. Such disclosures may also help improve the understandability of financial statements regarding the risk management activities of entities with significant exposure to repricing risk.

Disclosure of the amount, timing and uncertainty of cash flows

33. As mentioned in paragraph 14 of this paper, users of financial statements generally want to understand:

    (a) the 'organic' repricing risk exposure arising from the underlying items;

    (b) the main drivers for variability in net interest income; and

    (c) how protected (or not) the entity's net interest margin is against the possible changes in interest rates.

    In their view, such information enables them to better predict the possible effects on an entity's net interest income when market interest rate changes.

34. However, as described in paragraph 15 of this paper, many preparers expressed concerns about being required to disclose information about an entity's residual risk exposures or risk limits. They are of the view that such information could be used to

the entity's detriment in future negotiations with counterparties or by the entity's competitors that could put the entity at a competitive disadvantage.

35. As stated in Agenda Paper 4C for the June 2024 IASB meeting, we acknowledge preparers' concerns in this regard as similar concerns were raised during the development of IFRS 9. At the time the IASB decided to change the focus from the hedged item to the hedging instrument as explained in paragraph BC35X of the Basis for Conclusions on IFRS 7.

36. In our view, the disclosure of the amount, timing and uncertainty of cash flows of the designated derivatives are less sensitive because it does not directly relate to the pricing or costing structure of an underlying item. However, such disclosures are still relevant for users of financial statements in understanding the extent of risk mitigation as part of an entity's risk management strategy.

37. A few preparers commented that despite the change in the focus of disclosure to designated derivatives, disclosing the amount, timing and uncertainty of cash flows from designated derivatives may still lead to disclosure of commercially sensitive information, because the cash flow breakdown of underlying items used for determining the CNOP could be inferred by the cash flows of the designated derivatives. We disagree with this view because:

   (a) in most cases the designated derivatives would only mitigate a portion of an entity's CNOP, and therefore, there is no direct link between the amount, timing and uncertainty of cash flows from designated derivatives compared with those from underlying items;

   (b) by their nature, such disclosures are likely to be provided on an aggregate basis and therefore may be less commercially sensitive; and

   (c) similar requirements about the amount, timing and uncertainty of cash flows of hedging instruments are already required in paragraphs 23A−23F of IFRS 7 and those disclosures do not lead to disclosure of commercially sensitive information.

38. We therefore recommend that, to meet the objective in paragraph 16(b) of this paper, entities are required to provide a breakdown that discloses:

    (a) a profile of the timing of the nominal amount of designated derivatives (for example nominal amount by maturity bucket); and

    (b) the average rate of the designated derivatives.

39. In addition, for the reason discussed in paragraph 37(a), we recommend that an entity is required to provide a sensitivity analysis showing how the entity's exposure to repricing risk would change as a result of movements in interest rates that were reasonably possible at the reporting date. In our view, such disclosure would enable users of financial statements to predict the effect of interest rate changes on its underlying items without the use of risk management activities.

40. A few preparers said that they do not differentiate whether their exposure to repricing risk arise from its underlying items or from the designated derivatives. In their view, isolating and providing sensitivity analysis only for the exposure to repricing risk arising from the underlying items would not be consistent with their risk management views.

41. We acknowledge the way these preparers monitor and manage their exposure to repricing risk, however, we also note that users of financial statements said it is important to their analysis to distinguish between an entity's 'organic risk' exposure and designated derivatives as discussed in paragraph 33. Therefore, we recommend the sensitivity analysis be based on the 'organic' exposure to repricing risk.

Disclosure of the effects of the DRM model on financial position and performance

42. Information an entity is required to disclose about the effects of hedge accounting on financial position and performance, is set out in paragraphs 24A–24F of IFRS 7. This includes disclosure of information in a tabular format about the hedging instruments and hedged items such as the carrying amounts, the line items in which these items are

included and the accumulated amount of the fair value hedge adjustment or cash flow hedge reserve.

43. We think that most of the information needs users of financial statements identified with regard to the effects of the DRM model on the financial performance and financial position of an entity, could be provided through similar requirements.

44. As discussed in Agenda Paper 4C for the June 2024 IASB meeting, with regard to the CNOP, we recommend that an entity is required to disclose, in a tabular format, information about the underlying items that are included for determining the CNOP, including:

    (a) the carrying amounts of the financial assets and financial liabilities that are recognised, or the notional amounts of future transactions yet to be recognised;

    (b) the line items in the statement of financial position in which the underlying items are included;

    (c) qualitative disclosures about the inputs, assumptions and estimation techniques used for determining the expected cash flows; and

    (d) information about any hedged exposures that are included.

45. Similar to paragraph 24B of IFRS 7, we recommend that with regard to the designated derivatives, an entity disclose, in a tabular format, information about the designated derivatives as follows:

    (a) the carrying amount of the designated derivatives;

    (b) the line item in the statement of financial position that includes the designated derivatives;

    (c) the change in fair value of the designated derivatives used as the basis for measuring the DRM adjustment; and

    (d) the nominal amounts of the designated derivatives.

46. As discussed in the June 2024 paper, the DRM adjustment represents the expected benefit/protection to variability in an entity’s future net interest income and economic value variability. We therefore continue to think that information about the DRM adjustment would be needed, in the notes to the financial statements, for users of financial statements to understand the potential effect on future NII and economic value variability. Such information shall include:

    (a) gains or losses recognised as part of the DRM adjustment during the reporting period;

    (b) how the entity reflects the effect of unexpected changes in the CNOP during the period;

    (c) the amount of misalignment (both cumulative and the effect in the current reporting period) and the line items in which the misalignment is recognised in the statements of profit and loss;

    (d) the expected profile (based on the designated derivatives and benchmark derivatives) for recognising the DRM adjustment in profit or loss (ie future ‘protection’ against NII variability); and

    (e) the amount of any write-down of the DRM adjustment at the reporting date and its expected effect on the recognising the DRM adjustment in profit or loss.

Potential disclosure of information that is commercially sensitive

47. Although many preparers are supportive of a set of disclosures that meet the information needs of users of financial statements, we understand that some of them are concerned about the possibility of being required to disclose information that is proprietary or commercially sensitive in nature. As reiterated by some preparers in their latest feedback, disclosing pricing information or modelling assumptions in granular detail (for example those relating to a particular saving product) could infringe on confidentiality and might provide information that could be exploited by competitors.

48. The proposed disclosure requirements discussed in paragraphs 25–46 are developed consistently with the current hedge accounting disclosure requirements of IFRS 7. In our view, this information is already available as part of the dynamic risk management processes, and therefore the disclosures would provide useful information without incurring significant additional costs to preparers or risk the disclosure of information that could be commercially sensitive.

49. In addition, these disclosure requirements also include specific information directly related to the performance of the DRM model, and its potential effect on an entity's statement of financial position and statement of profit or loss.

50. We are therefore of the view that the aggregate nature of the DRM model, and therefore the aggregate nature of such disclosures would help mitigate the risk of requiring the disclosure of commercially sensitive information.