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Dynamic Risk Management feedback received with regard to viability and operability Issues Paper

Objective

- 1 The objective of this session is to provide EFRAG TEG with a summary of the feedback received from European banks with regard to:
 - (a) Main challenges identified;
 - (b) Operational complexity; and
 - (c) Suggestions made for reconsideration and improvement;during the outreach on the IASB's Dynamic Risk Management: Core model.

Question to EFRAG TEG

- 2 Do EFRAG TEG members have questions about the feedback received?
- 3 Does EFRAG TEG envisage any further steps to be undertaken by EFRAG at this stage?
- 4 Do EFRAG TEG members have any specific questions for EFRAG FIWG about the Core Model and the outreach?

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Background about participants

- 5 In total, the EFRAG staff attended 17 meetings with European participants and received written answers from one participant. Two of these are public participants funded by issued debt whereas the rest are either largely or partly funded by deposits. Details about the geographical origin, size and deposit funding of participants are as follows:

Geographical split:

Number of participants	Country
5	Austria, Germany, Switzerland
4	France
2	Italy
3	Netherlands
2	Spain
2	Nordic countries
18	Total

- 6 The IASB indicated that they had 19 participants from Europe and 27 overall which means the EFRAG Secretariat was privy to approximately 60% of the total outreach.

Total assets

Number of participants	Total assets
6	Less than € 500bn
7	Between € 500bn and € 1,000bn
5	More than € 1,000bn

Total customer deposits/total assets

Number of participants	Total customer deposits/total assets
2	0%
6	0% > x < 40%
3	40% > x < 50%
7	50% > x < 70%

- 7 According to one participant, due to the low or even negative interest rate environment, the amount of demand deposits has increased significantly.
- 8 For any bank that would model demand deposits for behavioural aspects, regulatory requirements are applicable that setting limits on maximum tenors (e.g., five years), also the expected behaviour of core demand deposits needs to be validated on a regular basis.

Interest rate risk market environments encountered

- 9 Participants were either active in a floating rate environment or a fixed rate environment or in a combination of both. Although the occurrence of a particular

interest rate environment seems to be regionally bound, both environments are well represented in Europe.

Viability and operability of the DRM core model

- 10 The purpose of the outreach the purpose of the outreach was to assess the viability and operability of the core model and whether it will enable participants to better reflect their risk management strategies and activities (risk management view or dynamic risk management) in the financial statements.

Main challenges identified by participants

Volatility in OCI

- 11 Many participants noted that revaluation through OCI (and the volatility that it would bring) was their biggest issue. In contrast to a fair value hedge where any movement of the hedged item would be offset by an opposite movement of the derivative in the opposite direction in profit or loss, this would not be the case when using a cash flow hedge. Here the movement of the hedging derivative would be recorded in OCI with no offsetting of the hedged item. This would create volatility.
- 12 Two participants emphasized that an accounting mismatch existed between the book value of derivatives (fair value) and the book value of hedged items (amortized cost). This could be avoided using a fair value hedge mechanic but would not be avoided using a cash flow hedge mechanic.
- 13 The participants noted that the accounting of derivative's fair value in OCI, which is 'asymmetrical', would be a key challenge both in terms of financial communication towards the users of financial statements, and in terms of its potential impact on regulatory capital. Furthermore, the public disclosure requirement on deviation from a theoretical target profile would not provide valuable information. As the proposed DRM model is not aligned with actual risk management practices.
- 14 For one of the participants concerned the impact on OCI would be 10% of their OCI balance.¹
- 15 One participant suggested to record the change in fair value of the derivatives as a single line item in the balance sheet (asset or liability) instead of in equity. It was noted that the fair value amount would not have to be tracked down to individual financial instruments, it would work as 'fair value balance' on a higher level of aggregation [not specified]. While it was noted such 'a fair value balance' may not bring much information about the entity's hedging of a net open risk position (which may include off-balance sheet positions), the detailed mechanics of this approach were not explored in the interview (please refer to paragraph 41 for some examples of different components of fair value that may require follow up). This solution would also resolve the difference in accounting treatment between under-hedges and over-hedges. Information on the potential future impact of over-hedging or under-hedging on the net interest income could be provided in the disclosures.

Impact on prudential measures

- 16 Various participants mentioned the impact of the use of a cash flow hedge mechanism on Core Equity Tier 1 under CRR² and that a filter similar to that for cash flow hedges currently available would be required. It is noted that this does not imply a different risk management strategy (hedging the fair value versus hedging the

¹ The participant noted that a regulatory filter would imply a savings in own funds, otherwise the position would be weighed at 100%. Another participant was afraid that a prudential filter would not be satisfactory as it would disconnect the prudential vision from the accounting vision of the bank's equity.

² CRR: Capital Requirements Regulation

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cash flows) but rather the destination to where the fair value of the hedging instrument is booked, either in OCI (without revaluation of the hedged item) or in profit or loss (with revaluation of the hedged item).

- 17 Views were mixed as to the importance of the impact on equity even if such a filter has been obtained with some regarding the impact on equity as unacceptable and others not being that concerned.

Single target profile

- 18 Several participants noted that the single target profile does not reflect risk management nor the business model, instead a range should be used. The reason for this is that the interest rate management considers the risk limits and a variety of factors may impact hedging decisions, such as a trade-off between EVE, NII and other objectives and measures. Also, it was noted that performance (i.e. effectiveness) should be assessed on the basis of a range of acceptable target profiles.
- 19 One of these participants stated that relying on a single target profile would lead to artificial 'ineffectiveness' generating artificial profit or loss volatility and that it should rather be replaced by a range approach and/or the recognition of under hedging.
- 20 Another participant indicated that the applicable regulation requires ALM to be flexible to adapt models based on the evidence of events. Therefore, a frozen target profile without changing strategy for say, demand deposits would not be acceptable.
- 21 One participant mentioned that in a given scenario of the model, target (i.e. the desired net exposure composed of actual hedged items and benchmark derivatives) and asset model (represents the expected timing and amount of future cash flows arising from the financial instruments within the scope of the DRM activities) are always the same. However, they systematically chose to under-hedge in order to be sure that the hedges are effective, as there will be always enough risk in the actual assets to be covered by the actual designated derivatives.
- 22 One participant noted the target profile includes coupons as well as notionals. Also, part of the asset profile has a non-linear exposure mostly resulting from prepayment options in mortgages.
- 23 Concerns about the complexity of working with a single target profile were raised in relation to the tracking of the positions.

Homogenous positions

- 24 One participant noted the need to create homogenous positions (based upon the different prepayment profile) was expected to be burdensome. Assigning a volume of core deposits to an asset pool with a different customer base was expected to be burdensome as the behaviour in respect to changes in interest rates would differ.
- 25 It was noted that the DRM allowed for the creation of an aggregated profile for different products. For floating rates, the prepayment profile was considered to be less of an issue.
- 26 One participant noted the requirement to include only assets with similar characteristics does not align with how IRRBB³ is managed and it would lead to high complexity, lower natural offsets and an increase in the use of derivatives.
- 27 One participant noted that in its ALM activities, the volume of the core deposits could change quite frequently. Hence, it is not clear whether this would constitute a change in risk management strategy and hence lead to the ensuing accounting consequence.

³ IRRBB: Interest Rate Risk in the Banking Book

- 28 Several participants noted that they do not manage interest rate risk in portfolios (that share similar risk characteristics) but from an entire balance sheet perspective, including all interest rate exposures. One participant mentioned that mixing different tenors was done to stabilise the product margin over time via modelling over multiple rate paths.

Benchmark derivatives

- 29 One participant noted that as the target model should reflect the modelling of all products on the participant's balance sheet the determination of the benchmark derivative regularly could be operationally difficult. Several participants noted that calculating a benchmark derivative for each closing would be operationally difficult.
- 30 Another participant commented that construction of this derivative may be open for interpretation and there is also the potential impact of basis risk (e.g. 1 month, 3 month and 6 month Euribor). One participant queried what the fixed rate of those benchmark derivatives would be and noted that if it would be identical to the net position hedged it would lead to greater complexity and inefficiency.
- 31 One participant mentioned that under the carve-out the net swaps (not further specified) outstanding are qualified as a macro-fair value hedge of the fixed rate eligible liabilities as there is no over-hedging, i.e. they are not designated as trading derivatives. However, under the proposed DRM model, the net swaps outstanding cannot be qualified as a macro-hedging as the benchmark swaps should be a net fixed rate payer outstanding. For that reason, the risk of the proposed DRM model approach is that most of the swaps set up to hedge the interest rate risk won't be qualified as hedging instruments, leading to the recognition of trading instruments.
- 32 One participant considered this a difficult concept to reconcile with their management strategy. Another one noted that they do not use benchmark derivatives to measure their performance.

Transition and first-time application

- 33 Several participants noted transition would play an important role. In case legacy positions were excluded from the DRM model, there would not be much possibility to create net positions, increasing the volatility in OCI. However, when including legacy-positions the impact could remain – for one of those participants - limited to about 5% volatility or less.

Other comments

- 34 The most important challenge for one participant is managing the information content to users of financial statements. Unlike the hedge accounting models in IFRS 9 and IAS 39, the DRM Core Model has a different concept in that it aims to provide users with information on the targeted NII that an entity aims to obtain over a targeted period of time. For some entities that do not risk manage the interest rate risk in this manner, several concerns arise such as the ability to derive the required information and in the case that it can be derived, if that information given to users of financial statements would not faithfully represent what their ALM is actually doing.

Request for testing beforehand

- 35 Based on experience with IFRS 9 hedge accounting requirements several participants pointed out the risk of different interpretations by auditors of a future DRM model. This could lead to significant differences in the profit or loss account. Hence, they asked that the future requirements should be first tested - IASB to deliver a proof of concept - and be unequivocally free from interpretation.
- 36 Another participant saw interpretation risk from a different angle. If the IFRS approach differs too much from concepts widely used in the IRRBB approach, the

existence of a second set of rules for the same topic leads to interpretation risk and misalignment between the accounting and regulatory perspective.

Operational complexity

37 The following aspects around operational complexity were mentioned:

Tracking

- 38 Several participants were concerned about having to track positions. For example, in order to follow whether prepayments affect the bottom layer or not, or to follow when there are over-hedges and hence which interest accruals can be included in the DRM or not. Also changes in risk management would require tracking of legacy hedges created under the previous risk management approach.
- 39 They noted that amortisation below the line item required a lot of tracking. DRM is a net open position, the continuous change to a new net position, would be neutralized with overlay hedges.
- 40 One participant was unsure whether the DRM model would be more onerous than applying the portfolio fair value hedge [under IAS 39]. They currently identify treasury positions and note that the use of a bottom layer approach already requires extra work in identifying positions. They expect this workload to be higher for the DRM model as the hedged portfolio would be bigger but noted that a lot would depend on the requirements of the auditors. Regular bottom layer checks that are currently already done are whether the loans remain in stage 1 or 2 for expected credit losses (when in stage 3 affected loans are removed). Also, regular checks between the hedged items and the hedging instruments are being performed.
- 41 One participant noted that separation and tracking of the different fair value changes of hedging derivatives would be a major challenge (hedged risk, the accrual, the pull to par, basis risks and the ineffective portion).
- 42 One participant noted that the requirements to define and track hypothetical benchmark derivatives over time are impractical and do not reflect actual risk management.
- 43 They also noted that identification of the portion of DRM hedging derivatives' values to recycle through profit or loss would not be consistent with risk management or make economic sense. While agreeing that over hedging exposure wise (i.e. notional wise) should lead to recycling a portion of the derivatives' values to deal with mismatch accounting, the comparison to the hypothetical benchmark derivatives' values is not consistent as the identification of the over hedging should be.
- 44 Further, the tracking of highly probable transactions is a source of concern as it may lead to impractical requirements.
- 45 One participant mentioned that the aligned/misaligned determination still requires substantive tracking as existing hedge accounting models are built on the concept of hedged items and hypothetical derivatives and existing risk management models 'track' the interest rate risk exposure for all interest rate sensitive assets and liabilities and not only the exposure of the asset profile.
- 46 One participant noted that the DRM model seems to require demonstration of the reasons why the portfolios of assets and liabilities change over time (new operations, early repayments, ...). This is a very heavy approach from a computational point of view considering the high number of operations involved.

Demonstrating economic relationships

- 47 One participant commented that demonstrating a qualitative economic relationship between the asset profile and designated derivative is one of the main challenges

of the model. Another participant noted that this concept was not used when carrying out ALM activities.

Challenges around modelling cash flows

- 48 One participant indicated the expected cash flows would depend on the scenarios envisaged. They also commented that pure cash flow views are difficult to model for behaviour and need to be adjusted for changes in estimates.
- 49 One participant indicate that repayments are not distributed homogeneously during the year and are complicated to introduce. Any difference between forecasted repayment and actual ones would generate additional ineffectiveness.

Eligible hedged items

- 50 One participant noted that it was unclear whether the model allowed to include a portfolio of assets (only), a portfolio of liabilities (only) or an imbalanced portfolio.
- 51 Several participants noted that regulated savings accounts or participant savings accounts are partly sensitive to interest rate risk and hence would not be considered as a core demand deposit under the DRM approach. However, ALM models these financial liabilities as compound instruments. A part of the instrument is a fixed rate instrument that exposes the bank to interest rate risk. The re-fixing dates of this part are then assessed with a model. The other part of the instrument is a variable rate instrument. This part is assessed by the pass-through rate which is the proportion of the variable rate index (Euribor 3 months for example) that is passed through the rate of the instrument.
- 52 Also equity (see separate heading), tangible and intangible assets, sundry debtors and creditors were identified as items to be eligible as hedged items.

Emphasis on EVE⁴ vs NII⁵

- 53 Various participants commented that the materials of the IASB focuses on NII, but that they rather use EVE and that it is unclear whether EVE is intended to be covered by the core model. However, one participant considered that the management of EVE relies on FVH logic and stable own funds which it considers to be inconsistent with DRM which prioritises the NII approach.
- 54 The IASB staff clarified that the DRM model addresses both the NII and EVE approach but acknowledged more examples from an EVE perspective would be helpful to illustrate this.

Use of external derivatives

- 55 Several participants noted that the prohibition to use internal derivatives was a strong operational issue.

Disclosure

- 56 One participant indicated that disclosure of under-hedge and/or over-hedge is one of the main challenges of the model. Currently it results in asymmetric information in the accounting. Overhedging leads to ineffectiveness in profit or loss, underhedging does not. Yet in risk management both overhedging and underhedging are seen as similar.

⁴ EVE: Economic Value of Equity

⁵ NII : Net Interest Income

Compensation between portfolios

- 57 One participant referred to the need to designate portfolios under DRM whereas ALM is performed at an aggregated level. It also stated that it is unclear whether compensation between portfolios is permitted under the DRM model.

Elements in the DRM core model that require reconsideration

- 58 Several participants noted that regulatory requirements are already in place for interest rate risk management⁶. These requirements are already implemented, to some extent disclosed externally and audited. The concern of these participants was that a DRM model, subject to further IASB deliberations, could give rise to a second set of rules without either relying on models and mechanisms that are already in place or, when relying on existing models, could give rise to interpretation issues when the same set of inputs was used for different purposes.

Hedging net position or assets/liabilities separately

- 59 Several participants mentioned to hedge assets and liabilities on a net basis. These participants asked to consider all instruments on both sides of the balance sheet (for example to resolve issues where a big-ticket liability is used to fund a large number of smaller loans).
- 60 However, several participants noted to prefer to hedge assets and liabilities separately – and not as a net position - or to include a portfolio of assets (only), a portfolio of liabilities (only) or an imbalanced portfolio as eligible hedged item.

Elements that need improvement

Use and revision of targets

- 61 Several participants considered the requirements on targets as too rigid. They wanted to rely on a range of target profiles, not a single one. Several participants added that a target profile as presented in the model was currently not used by them, they noted it was uncertain if they could identify the information needed to define it and hence queried the usefulness of information that would be provided to users based on this. They clarified that their interest rate risk management was done on a present value basis and it was unclear to them how to translate that in a cash-based risk management. One of them asked to clarify whether the target profile should refer to cash flows or notionals.
- 62 One participant suggested to incorporate current IRBB regulations on replication of non-maturing positions into the target profile.
- 63 Several participants suggested the introduction of the bottom layer approach similar to the carve out. Another suggestion is to use the modelling approach to consider a portion of deposits as fixed-rate assets for those demand deposits where the interest rate is determined by the participant or the regulator on a discretionary basis.
- 64 Another participant also queried selection of a single point in the risk management strategy range as well as aspects around the construction of the benchmark derivative. E.g., at transition, how would 'existing' benchmark derivative be determined or start at zero? Secondly, how would benchmarks with different characteristics be aggregated, examples include interest rate basis, payment dates and maturity.
- 65 One participant noted the artificial ineffectiveness resulting from discrepancy between actual and theoretical one single target. The impact in profit or loss is not aligned with actual risk management and would actually be a disincentive to hedge.

⁶ The EBA guidelines on the management of interest rate risk arising from non-trading activities were published on 22 May 2015.

Hence, under hedging should be recognised as a management objective in order to avoid volatility in OCI. It was noted volatility in OCI related to the extent of the duration mismatch between assets and liabilities, the higher the mismatch, the higher the resulting volatility.

Asset profile

- 66 One participant asked to clarify whether risk free cash flows and risk-free discounting curves could be used to determine the asset profile. In general they preferred to use cash flows and curves in line with internal policies of the interest rate risk management function.

Change in risk management strategy

- 67 One participant noted that a change in risk management was seen as rare by the IASB. However, they preferred the flexibility to change based upon observation of the market situation. As the market changes, then the hedging objective also changes.
- 68 Another participant was concerned that the core model would result in ineffectiveness where a rate change impacts the behavioural aspects of the asset repayment profile. Under existing practices, this would not require a change in risk strategy or objective and under the regulatory regime, it may be acceptable as long as the new position is within the risk limits. If offsetting derivatives were used rather than cancelling the old position and locking into a new one, the participant does not believe this should generate profit or loss impact.

Performance management

- 69 While agreeing that performance assessment should be relatively to the risk management strategy, one participant noted that IRBB focused on monitoring a risk neutral position. Results are not “perfectly” aligned vs “imperfectly” aligned. They suggested to look at the cash flow hedge requirements under US GAAP where no ineffectiveness was recognised as long as the overall hedge is effective and advocated that the IFRS solution would be aligned to that.
- 70 In addition, several participants noted the target profile should be appreciated as being dynamic in nature.

Use of the fair value option

- 71 One participant asked that the fair value option could be used for defining floating rate liability positions in the DRM model as it was very difficult to hedge [identify] pure interest rate risk. For example, with positions in equity linked bonds, it was difficult to use derivatives to do so.

Equity as an eligible hedged item (through proxy hedges)

- 72 Some participants noted that also they use equity as part of their interest rate risk position. In particular the free capital and retained earnings, not the additional hybrid instruments.
- 73 They noted that equity was interest rate inelastic (so the effect on equity of balancing out an interest position is only an opportunity change, with no resulting change in profit or loss), it has a long duration as shareholders cannot ask their money back, they can only sell their shares. If equity would not qualify it would lead to a lot of volatility in profit or loss.
- 74 One participant included equity as an open risk position to reflect the interest rate risk of this position (where equity was considered to reflect the duration of net assets). This approach would also work in the DRM approach. The open position could be hedged to zero if that was the mandate. Another participant specified that equity is modelled in the same way as deposits (laddered), and the model’s tenor is comparable to the average interest rate asset tenor of the participant.

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- 75 Several banks noted that equity was replicated longer term (without specifying the duration).
- 76 One participant suggested that in the DRM model equity bucketing is to be based on the bank's internal risk management models.

Under-hedging

- 77 Several participants noted that under-hedging (based on notionals) should be recognised as a risk management objective. This is allowed by the carve-out using a bottom-layer approach.

Scope

- 78 Several participants asked to consider the use of financial instruments measured at FVOCI as well as synthetically created positions. One participant also suggested to include financial instruments measured at FVPL.
- 79 Several participants noted that remunerated deposits (regulated or non-regulated) and equity positions should be included in the scope of the project.⁷
- 80 Including convexity in the model such as negative target profiles (resulting from non-linear exposures) and the use of swaptions. One participant noted that practically any product with an optional component is convex (main products are mortgage loans and home saving accounts).
- 81 One participant suggested to use the modelling approach to consider a portion of deposits as a fixed rate asset and this on a discretionary basis (in particular for demand deposits for which the interest rate is determined by the participant itself or by the authorities).

Multi-currency approaches

- 82 Several participants asked to include multi-currency approaches into the model, as well as permitting the use of cross-currency swaps.
- 83 One participant noted cross-currency basis risk and tenor basis risk should be considered in the next phase.

Optimisation as management of the tail risk

- 84 One participant noted that optimisation as management of the tail risk was allowed under the IRBB approach and hence should also be allowed under the DRM model. It was noted that optimisation does not equal speculation.

Flexibility in case of over-hedging

- 85 One participant proposed to use a threshold of tolerance in case of over-hedging, in order to avoid a profit or loss impact. This would allow management time for taking corrective action.

Disclosures

- 86 One participant was cautious about the level of detail for required disclosures while considering the sensitivity of such information.
- 87 Several participants also queried the asymmetry of information required for under and over-hedge and one of them suggested that rather than recognising the impact of over-hedging in profit or loss, disclosure may be sufficient.

⁷ The EFRAG Secretariat understands that this may already be the case.

Voluntary application

- 88 One participant noted it was unclear whether the DRM model has to be applied to all dynamic portfolios or that the DRM model could be applied on selected portfolios only.
- 89 Also it was noted that hedging should remain at the discretion of the bank (late hedging, no hedging), in contrast to the proposed requirements that require to continue hedging once started.

Liquidity

- 90 Several participants noted that liquidity can play a role in hedging a particular bucket. Sometimes the actual time bucket is not being hedged but the neighbouring bucket because of higher liquidity. This could have an impact on the notional alignment requirement and the present value-based designations.

Alternatives suggested

Fair value hedge mechanics

- 91 Several participants noted that they would prefer a fair value hedge approach instead of using the cash flow hedge mechanics. They note that displaying volatility in equity does not faithfully represent an activity which purpose is to reduce the sensitivity of NII/EVE to interest rate risk.
- 92 Several participants asked why a model based a FVH mechanism with a valuation of the hedged risk on a net basis by analogy to IFRS 13.48 52 (see Appendix) has not been considered? Those participants also noted that to consider gains or losses representing the portion of the hedged risk of a portfolio do not meet the definition of an asset or a liability and therefore to reject fair value hedge mechanics is questionable.
- 93 This because the conceptual framework acknowledges the possibility to select one unit of account for recognition and a different unit of account for measurement (cf. Conceptual framework §4.49). Accordingly, IFRS 13.48-52 exemption allows for groups of financial assets and liabilities managed on a net basis to be measured based on their net position under certain criteria (1/ the valuation process is the result of a documented strategy, 2/ fair value information is disclosed to management on this basis, 3/ the use of the exception corresponds to an accounting policy choice), while presentation has to be made on a gross basis.

Officialise and improve the IAS 39 carve out (confirmation of bottom layer approach)

- 94 European banks have the option to use the carved-out version of IAS 39 to account for their dynamic risk management (many but not all participants used it). Three key elements characterise the carve-out:
- (a) the adoption of a FVH technique (hedged items are revalued in the balance sheet for the hedged risks, hedging derivatives are measured at FVTPL, revaluation of the hedged items offset FV changes of the derivatives in P&L);
 - (b) bottom layer approach, to deal with ineffectiveness: they typically designate a proportion of the existing eligible items, leaving a systematic under-hedged exposure. This allows to limit the occurrence of ineffectiveness to unexpected circumstances (such as an unexpectedly high level of prepayments for mortgages). IFRS 9 has introduced a similar concept for micro-hedge.
 - (c) eligibility of core deposits.
- 95 The DRM model would solve the issue of the eligibility of core deposits.

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- 96 Several participants asked to (improve the) IAS 39 carve out as an alternative model. Some participants suggested new disclosures to complement the IAS 39 carve out.
- 97 Several participants suggested to add the layer approach in the current IFRS 9 to the EU carve out, allowing to hedge core deposits as a way forward.
- 98 In addition to core demand deposits also equity is to be added (as an eligible hedged item) to the IAS 39 carve out.
- 99 It was noted that for banks using a tranches portfolio approach, designating a bottom layer in their hedge accounting is a simple way of achieving conformity between risk management and accounting. Under the bottom layer approach, a portfolio of loans with prepayment option is split in two portions or layers: a portion that is likely to be prepaid – the bottom layer - and a portion that will almost certainly not be prepaid – the top layer. Only the latter tranche would be considered a source of interest rate risk and consequently be hedged.

Appendix: IFRS 13 Fair value measurement, paragraphs 48 to 52

Application to financial assets and financial liabilities with offsetting positions in market risks or counterparty credit risk

48 An entity that holds a group of financial assets and financial liabilities is exposed to market risks (as defined in IFRS 7) and to the credit risk (as defined in IFRS 7) of each of the counterparties. If the entity manages that group of financial assets and financial liabilities on the basis of its net exposure to either market risks or credit risk, the entity is permitted to apply an exception to this IFRS for measuring fair value. That exception permits an entity to measure the fair value of a group of financial assets and financial liabilities on the basis of the price that would be received to sell a net long position (ie an asset) for a particular risk exposure or paid to transfer a net short position (ie a liability) for a particular risk exposure in an orderly transaction between market participants at the measurement date under current market conditions. Accordingly, an entity shall measure the fair value of the group of financial assets and financial liabilities consistently with how market participants would price the net risk exposure at the measurement date.

49 An entity is permitted to use the exception in paragraph 48 only if the entity does all the following:

- (a) manages the group of financial assets and financial liabilities on the basis of the entity's net exposure to a particular market risk (or risks) or to the credit risk of a particular counterparty in accordance with the entity's documented risk management or investment strategy;
- (b) provides information on that basis about the group of financial assets and financial liabilities to the entity's key management personnel, as defined in IAS 24 Related Party Disclosures; and
- (c) is required or has elected to measure those financial assets and financial liabilities at fair value in the statement of financial position at the end of each reporting period.

50 The exception in paragraph 48 does not pertain to financial statement presentation. In some cases the basis for the presentation of financial instruments in the statement of financial position differs from the basis for the measurement of financial instruments, for example, if an IFRS does not require or permit financial instruments to be presented on a net basis. In such cases an entity may need to allocate the portfolio-level adjustments (see paragraphs 53 –56) to the individual assets or liabilities that make up the group of financial assets and financial liabilities managed on the basis of the entity's net risk exposure. An entity shall perform such allocations on a reasonable and consistent basis using a methodology appropriate in the circumstances.

51 An entity shall make an accounting policy decision in accordance with IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors to use the exception in paragraph 48. An entity that uses the exception shall apply that accounting policy, including its policy for allocating bid-ask adjustments (see paragraphs 53–55) and credit adjustments (see paragraph 56), if applicable, consistently from period to period for a particular portfolio. The exception in paragraph 48 applies only to financial assets, financial liabilities and other contracts within the scope of IFRS 9 Financial Instruments (or IAS 39 Financial Instruments: Recognition and Measurement, if IFRS 9 has not yet been adopted). The references to financial assets and financial liabilities in paragraphs 48–51 and 53–56 should be read as applying to all contracts within the scope of, and accounted for in accordance with, IFRS 9 (or IAS 39, if IFRS 9 has not yet been adopted), regardless of whether they meet the definitions of financial assets or financial liabilities in IAS 32 Financial Instruments: Presentation.