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Risk Mitigation Accounting (RMA):

An assessment of the IASB'S proposal.

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RISK MITIGATION ACCOUNTING (RMA): AN ASSESSMENT OF THE IASB'S PROPOSAL

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Executive Summary

Interest rate risk management is a key aspect of retail banking, as it directly affects the sustainability of the net interest margin. Specifically, repricing risk management is one of the main factors that can erode this margin over the short, medium and long term.

Through the **Risk Mitigation Accounting (RMA)** project, the IASB aims to provide an accounting framework that faithfully reflects how entities dynamically manage interest rate risk through open portfolios. Existing accounting requirements can create **accounting volatility** because they do not fully reflect the economic rationale of dynamic risk management.

However, there are areas for improvement in the proposed model:

- **Inherent complexity**: The search for a balance between representativeness and operational effectiveness carries the risk of oversimplification, which may misrepresent how interest rate risk is managed.
- **Entity-specific adaptation**: The idiosyncrasies of management models require exercising **professional judgement**, thus making standardisation difficult.
- **Exclusion of equity**: Although controversial, this decision has been justified by the structural mismatch in notional values between assets and liabilities. Equity modelling may only be used to exclude from the net exposure cash balances and highly liquid variable-rate assets financed by equity.
- **Behavioural models**: There is heterogeneity in the deposit behavioural models developed by banks, which introduces **subjectivity** and may lead to hedge ineffectiveness. Behavioural models should also be used to estimate mortgage prepayments.
- **Limitations**:
  - The balance-sheet items arising from the application of the model may not be consistent **with the definitions** of assets and liabilities set out in the Conceptual Framework.
  - The management of **non-linear risks** (options) has not yet been illustrated within the project.
- The application of the RMA to financial assets measured at fair value through other comprehensive income (OCI) does not resolve the asymmetry in other comprehensive income (OCI).

In conclusion, the RMA project constitutes a step towards a more accurate representation of banking risk management. However, its application poses significant **technical and operational challenges**, which will require further adjustments before its consistent implementation across the banking sector can be achieved.

1 Introduction

The retail banking business involves raising funds from customers via current accounts and fixed-term deposits, thus making them creditors of the bank, and channelling such funds to the borrowers to whom loans are granted. The difference between what these borrowers are charged and what is paid to creditors is the net interest margin. If all positions had similar terms, maturities and amounts, the entity would not be exposed to risk arising from changes in market interest rates; but the reality is very different, and credit institutions must manage the impacts of potential changes in interest rates (repricing risk).

Therefore, dynamic interest rate risk management **is a critical process in the retail banking business**. For over a decade, the IASB has been working to develop a response that offers a solution to align the fundamentals of risk management and financial reporting with the effects of such risk hedging practices.

RMA is a proposed accounting model designed to reflect how entities manage repricing risk on a dynamic net basis in line with the actual strategy for managing Interest Rate Risk in the Banking Book (or IRRBB). It therefore proposes a framework that includes the aspects taken into account by entities in their internal management of IRRBB. These are essentially as follows:

- **Interest rate risk arises from the repricing risk** of net assets and liabilities. The risk of repricing on a bank's banking book arises when there is **a mismatch between the repricing or interest rate review dates** for assets and liabilities.
- **The portfolios to be hedged are open**, as new transactions arise over time and maturities or early withdrawals occur on the Statement of financial position.
- Some hedged instruments will be items whose **repricing behaviour is primarily determined using internal models developed by the entities** to capture relevant behavioural assumptions. This is particularly the case for current accounts (Non-Maturity Deposits, or NMDs), as well as fixed-rate instruments subject to prepayment risk (fixed-rate mortgages) or early withdrawal risk (fixed-term deposits).

The combination of asset and liability instruments with matching repricing characteristics mitigates the impact of changes in interest rates. Accordingly, prudent management of this risk requires consideration of the net position arising from financial assets and liabilities with similar repricing profiles. Under no circumstances is the hedging approach based on individual financial instruments. Rather, **the risk arises from the combination of assets and liabilities with fixed-rate and variable-rate characteristics** (IASB, 2022. February Staff Paper 4A: para. 34).

Entities use derivative instruments as part of their risk management strategy **to hedge net exposures arising from open positions in financial assets and liabilities.** The current accounting framework permits the hedging of groups of items, including net positions, under specific conditions (IFRS 9.6.6.1); however, it does not provide a hedge accounting model for dynamic portfolios.

The risk mitigation objective relating to the net position of assets and liabilities on the Statement of financial position, as determined by entities, is not fully achieved by the two hedge accounting models provided for under IFRS 9. Under those models, entities may hedge only individual assets or liabilities through either fair value hedges, which are typically applied to fixed-rate instruments and effectively convert them into variable-rate instruments, or cash flow hedges, which are applied to variable-rate assets and liabilities and effectively convert them into fixed-rate instruments.

In practice, banks manage the risk of interest rate fluctuations on their balance sheets over different time horizons:

a) **Short-term horizon** (normally up to 1 or 2 years), in which entities monitor the sensitivity of the net interest income over the near term, thus limiting the potential risk arising from the reinvestment or refinancing of the net position of assets and liabilities whose interest rates are repriced within that short-term horizon (normally up to one year).

b) **Long-term horizon:** entities manage the repricing risk arising from the net position of all interest rate-sensitive assets and liabilities on the statement of financial position across their net repricing risk exposure. This risk is captured by the economic value (EV) sensitivity metric, which measures the impact of changes in interest rates on the economic value of the institution's statement of financial position. The economic value sensitivity metric also serves as the basis for deriving a proxy for the long-term sensitivity of net interest income. This proxy reflects the contribution of all balance-sheet positions and is therefore broader in scope than short-term interest income measures.

The model must therefore extend beyond the types of hedges set out in IFRS 9: fair value hedges and cash flows hedges (IASB, 2022. February Staff Paper 4A: para. 47). Fair value hedges are aimed at mitigating changes in the economic value of the statement of financial position, while cash flow hedges are intended to stabilise the institution's net interest margin (IASB, 2022. February Staff Paper 4A: para. 36). However, neither approach, considered in isolation, is capable of meeting both objectives simultaneously[1].

The proposed model has a twofold objective:

a) To provide relevant information to users, describing how the entity manages interest rate repricing risk.

b) The model seeks to improve the relevance of financial information by eliminating the accounting mismatches that arise when current hedge accounting requirements are applied to dynamic risk management practices. Under the existing accounting framework, gains and losses on derivatives used to mitigate the risk are recognised in profit or loss, whereas the net risk position being managed is not generally eligible for designation in a hedging relationship. Consequently, no corresponding adjustment is recognised in profit or loss, resulting in accounting mismatches and increased earnings volatility.

The repeatedly refers to the dual objectives of providing relevant information[2] and ensuring fair presentation[3]. However, information quality appears to receive considerably greater emphasis. This suggests a greater concern with the unintended effects that the existing accounting requirements may have on the primary financial statements than with the omission of information regarding the effects of the entity's risk management strategy. The new RMA approach would seek to **overcome the shortcomings of the current hedge accounting framework**, primarily the limitation on hedging a net open position of assets and liabilities . At the same time, the RMA seeks alignment with the entities' dual reflected in two metrics (short-term and long-term): short-term interest margin sensitivity and economic value sensitivity. The positions hedged under RMA change over time and are related to different objectives: minimising the impact on net interest margin in the short term and minimising the adverse impact on economic value.

This dual objective arises from the different impact that a change in market interest rates has, depending on the type of return offered by the financial instruments. Thus:

- **For fixed-rate instruments,** the relevant risk is the sensitivity of their economic value to changes in interest rates. As interest rates fluctuate, the fair value of these instruments changes accordingly;

1 Paragraphs BC21 and BC22 set out this dual objective and the time horizons for which each is typically used.

2 Amongst others, the following paragraphs from the Basis for Conclusions are worth noting: 11, 32, 37, 58, 59, 80, 92, 95, 167, 180.

3 They appear, amongst others, in the following paragraphs of the Basis for Conclusions: 12, 13, 39, 40, 46, 50, 92, 130 and 140

- For **variable-rate instruments**, the risk arises from changes in future cash flows when interest rates change, thereby affecting the institution's net interest income.

If all instruments had identical maturities, management of this repricing risk would involve entering into derivatives to mitigate the resulting exposure. In reality, however, instruments are originated with a range of maturities, while new transactions and other business activities continuously alter the net position. As a result, the item subject to hedging is the dynamic net position that exists in each period. The hedging objective is to protect the entity against both changes in economic value and adverse effects on future net interest income resulting from the associated cash flows.

In December 2025, the IASB issued an Exposure Draft setting out the principal elements of the proposed model. While the preparatory work had been guided by ambitious and well-founded objectives, feedback from stakeholders, especially financial institutions and supervisory authorities, suggested that the solution ultimately presented would depart in several respects from the approach developed during earlier stages of the project.

This paper seeks to provide a structured overview of the information available to us regarding the positions expressed before the publication of the proposed model and the solution subsequently set out in the Exposure Draft. The former includes the results of two surveys conducted among market participants: one commissioned by ISDA and carried out by EY, and another sponsored by EFRAG. The paper also considers the preliminary views expressed by the European Central Bank (ECB), ISDA, and audit firms such as EY and Deloitte. Its objective is to identify the key issues raised during the period leading up to the publication of the Exposure Draft and to assess how those issues have been addressed in the proposed solution.

The model proposed by the IASB would be incorporated into IFRS 9 as Chapter 7, and IAS 39 would no longer be applicable to micro- or macro-hedges. It is a voluntary model, however, if it is to be applied, it must be done so taking into account all requirements set out therein (Exposure Draft 7.1.6). This decision is consistent with the optional nature of hedge accounting, regulated in Chapter 6 of IFRS 9.

The Exposure Draft introduces a number of changes to the terms used in the preliminary phase, which are summarised in Appendix A.

The second section begins by examining the management of interest rate risk. It then analyses how the new accounting model incorporate these risk management strategies. Next, it presents the IASB's proposal to overcome the limitations of the existing model and introduces the Risk Mitigation Accounting (RMA) model.

The subsequent sections focus on several aspects of the proposed approach that have attracted particular attention. First, they identify the underlying portfolios comprising the net repricing risk exposure. They then consider how an entity manages risk within a specified risk limits. This requires defining the risk mitigation objective by identifying both the risks to be mitigated and the net repricing risk exposure to which the hedge relates, and subsequently constructing a benchmark derivative that reflects that risk mitigation objective.

The analysis then turns to the requirements applicable to derivatives designated as hedging instruments, as represented by the benchmark derivatives. It also examines the reasonableness test that must be satisfied for the full recognition of the risk mitigation adjustment in the statement of financial position.

Finally, the document summarises the principal findings and conclusions arising from the analysis.

2 How is interest rate risk managed?

Risk management activities are normally defined at the highest level of the institution's governance, within a delegated asset and liability management committee, and overseen by the Board of Directors. Given the critical nature of this activity, it is therefore subject to **oversight by prudential regulators** (IASB, 2021. April Staff paper 4B: 13).

In practice, there are **different strategies, processes and techniques** for dynamic interest rate risk management. Typically, the risk management strategy is set out in terms of risk limits, which are usually not changed very often. This heterogeneity poses a challenge for the accounting regulations that govern these hedges and should be addressed by formulating sound principles rather than rules of application (IASB, 2021. April Staff paper 4B: 9).

The key elements of risk management are as follows: the level of approval and changes to the risk strategy; the identification of the entity subject to risk management (the group or its subsidiaries); the assets and liabilities affected and the behavioural methodologies; net risk exposure and the metrics for assessing interest rate risk; the acceptable range for risk limits; and, finally, risk aggregation and the time horizon.

2.1. Governance and changes to the risk management strategy

Responsibility for decision-making rests with the highest governing body or a committee acting under its delegated authority. The risk management strategy is reviewed annually; however, it is generally regarded as a stable policy and is revised only in response to significant changes in market conditions or in the bank's business model.

The risk is communicated across the organisation through risk directives that are deployed throughout the various business and operational units. Risk exposures are monitored regularly; however, mitigating actions are not undertaken with the same frequency, since the position is allowed to vary within predefined risk limits (IASB, 2021, Staff Paper 4B, para. 17). As a result, hedging activities are carried out only when required to maintain the risk management objective.

The model requires departures from certain recognition and measurement requirements of IFRS 9 in order to reflect the entity's risk management strategy. Accordingly, paragraph 7.1.7 emphasises the need for caution when applying these requirements. The Exposure Draft requires an entity to document how it intends to apply risk mitigation accounting to each group of portfolios for which repricing risk is managed on a net basis. The documentation should focus on the methodologies and processes applied. In particular, the entity must explain, in its formal documentation, how it:

a) **Manages repricing risk** in accordance with its risk management strategy, including information about the mitigated rate, the mitigated time horizon; and the risk limits within which repricing risk is to be mitigated.

b) **Determines the repricing risk** to be mitigated, including information about the nature and characteristics of financial instruments included in the underlying portfolios, the measures used by the entity to quantify its net repricing risk exposure (hereinafter "net exposure"), the repricing time horizons, the frequency with which the entity assesses its net repricing risk exposure, and the approaches used to determine the repricing of the portfolios.

c) **Specifies the risk mitigation objective.**

d) **Identifies the designated derivatives used to mitigate repricing risk.**

e) **Captures the effects of unexpected changes in the net repricing risk exposure**, including information on how the entity identifies and adjusts the benchmark derivatives to reflect unexpected changes in its net repricing risk exposure, how the entity assesses whether any such changes have not been captured in the measurement of the risk mitigation adjustment, and how it measures the present value of the net exposure at the reporting date.

Risk management activities will change over time in response to changes in the entity's exposure. The entity is not required to plan such activities, but it is required to document the risks and processes that will lead to the implementation of these risk management activities (B7.1.9).

2.2. Determining the institutional level at which risk is managed

An issue related to risk management strategy is the organisational level at which it is managed (subsid-iary, group, etc.). Certain entities take a holistic approach, while others manage risk at the subsidiary level. In this case, group supervision involves verifying that each subsidiary complies with its set risk limits established for that subsidiary, and issuing specific instructions to individual subsidiaries when adjustments to the group's overall exposure are required.

The EFRAG survey reveals that **interest rate risk management is highly variable across entities.** Thus, in 35 per cent of all cases, interest rate risk management is undertaken at the group level, while in 26 per cent, it is mainly at the level of the subsidiary or business division. A further 35 per cent manage interest rate risk at both group and subsidiary levels (EFRAG, 2025: paragraph 23).

The ISDA (2025: 12) identifies the pooling of risks within a group as one of the operational challenges. EY (2023: 15) further notes that risk positions are occasionally managed by the trading desk, which, enters into contracts with third parties to obtain the positions required for risk management purposes. However, the trading desk's risk limits may differ from those established for the management of the Banking Book. In such situations, it will be difficult to demonstrate that the interest rate risk has been transferred to third parties Finally, it should be noted that **when risk management is performed at group level, consideration should be given to the implications for the individual financial statements of the various banking subsidiaries.**

Paragraphs B7.1.6 and B7.1.7 highlight that, although the risk management strategy is defined at the highest organisational level at which an entity manages repricing risk, risk mitigation accounting is applied at the level at which the entity determines its net exposure. The entity may manage several risk portfolios dynamically and independently, based on different benchmark interest rates corresponding to different currencies. In this case, while the risk strategy is set at the entity level, risk mitigation accounting is carried out on the basis of each mitigated rate (paragraph 7.2.8).

Since RMA may be applied differently across portfolios, and given the voluntary nature of the model's implementation, **the Exposure Draft does not address situations in which the model is applied to some portfolios but not to others. This may occur either because the entity does not treat certain portfolios on a net-risk basis, or because it elects not to apply risk mitigation accounting to those portfolios.**

Paragraphs BC.21 and BC.22 set out this dual objective and the time horizons for which each is typically used.

2.3. The assets and liabilities concerned: the underlying portfolios

The underlying portfolios comprise the financial assets and liabilities that are subject to interest rate hedging. These portfolios are subject to repricing risk on specific dates, resulting in a net exposure to repricing risk (hereinafter "net exposure"). The expected repricing dates are the earlier of the cancellation date or the repricing date. Given that this is an open position, the current model for hedge

accounting in Chapter 6 of IFRS 9 must be adapted because it does not adequately reflect this aspect of interest rate risk management.

2.3.1. Behavioural methodologies

Another major challenge in interest rate management is the assumptions used to model the behaviour of certain items on the bank's balance sheet: the most complex of these being the modelling of current accounts (NMDs or Non-Maturity Deposits) and fixed-term loans subject to early repayment risk. Of these, current accounts are the most significant, both due to their larger share of the balance sheet and because of their greater complexity. In its survey of institutions, the ECB (2025: 33) found that 87 per cent reported that these factors were significant or very significant. Modelling current accounts requires consideration of several elements:

a) The volume of balances that are considered not sensitive to interest rates (core NMDs).

b) The maturities of these core NMDs, and

c) The repricing speed of sensitive balances, which may also depend on the interest rate scenario.

Entities must use models to estimate the behaviour of these positions. As entities indicated to the IASB, the methodologies underpinning these models may change, although such changes are infrequent; however, the inputs are adjusted as market conditions evolve. This may mean that behaviour-based assumptions used at time t (when the hedges are designated) and based on specific inputs, may no longer be valid, and the position to be hedged may change. In the RMA model, this is referred to as an "unexpected change in the net repricing risk exposure", which is a highly significant issue that will result in hedging ineffectiveness, thereby affecting the profit or loss account.

With regard to behaviour-based assumptions, the ISDA (2025) identified the following challenges:

- **The modelling of NMD behaviour** is an issue thds beyond the requiremts of accounting standards, although it is already subject to supervisory review when assessing interest rate risk in the Banking Book (ISDA, 2025: 16).
- The model **does not clarify how future transactions will be incorporated into the Current Net Open Position (now underlying portfolios)**. Risk managers observe behavioural patterns and frequently use *bottom layers* to determine the volume of transactions to be included in the risk management framework. Another challenge concerns the definition of the "highly probable" criterion that must be met by future transactions to be incorporated will be defined (ISDA, 2025: 16). EY (2023: 9) emphasised that, for the reinvestment and refinancing of existing assets and liabilities at the prevailing market interest rate, **the criterion has been lowered from "highly probable" to "expected to occur".** If this change were not adopted, there would be an inconsistency between the criteria for these renewal transactions and the allocation of NMDs and prepayable assets, which are based on expected cash flows.
- The inclusion of **loan commitments** introduces non-linear risks and cannot be hedged with plain vanilla swaps (ISDA, 2025: 16).

2.3.2. The specific case of equity

Equity is one of the items financing the underlying portfolios. Equity, by definition, does not require a return and would therefore, in principle, fall outside the scope of interest rate risk management. However, some entities assign a target or minimum rate of return to equity when allocating funding costs, and its inclusion has been a matter of debate during the development of the model.

Illustratively, one might say that if an entity had fixed-rate financial assets financed by equity, this position would not give rise to reinvestment risk affecting net interest income. The only consideration would be the "opportunity cost" of having to hold a fixed-rate financial asset, which, in the event of a rise in interest rates, would not benefit from higher market rates and would face higher return

requirements from shareholders. The Economic Value sensitivity metric, excluding the equity that finances it, reflects this form of opportunity-cost risk; but if the entity wishes to manage long-term interest margin risk (considering the sensitivity of economic value as a proxy for the sensitivity of the long-term interest margin), and there are assets financed by equity, it would be necessary to include this equity when calculating the Economic Value sensitivity metric, as is the case in the internal risk management practices of many institutions when they wish to manage interest margin risk.

One possible explanation for the exclusion of equity from the hedged position under the RMA model in the hedged position is its alignment with the Basel Committee's regulatory Economic Value metric, under which equity used to finance interest-rate-sensitive assets cannot be included. The reason why the Basel Committee did not permit this is to avoid including further behaviour-based assumptions in the regulatory IRRBB metrics, since, once again, for this equity, behavioural assumptions regarding maturity must be made.

The survey conducted by EY (2024: 4) showed that 21.42% of the participating entities (6 out of 28) considered that the definition of the net open position and the target risk profiles were aligned with their risk management (in the current model, these are the underlying portfolios and risk limits). For their part, **67.85% (19 out of 28 organisations) indicated that the proposed model was partially aligned with their risk management practices** and only 10.71% (3 out of 28) stated that it was not aligned.

Excluding equity would deviate from the way in which a significant number of entities manage risk. Many entities include fixed-rate equity risk in their model, which is seen as a stable source of fixed-interest-rate funding. AT1s, which also pay investors an interest rate, are among the most hotly debated instruments (ISDA, 2025: 15).

//// **TABLE 1** **Inclusion of equity in the CNOP (now underlying portfolios)**

Valid responses	EY (2024) 28	EFRAG (2025) 24
Inclusion of equity in the net open position	12 (42.85%)	17 (71%)

↑ Source: EY (2024: 4) and ECB (2025: 32)

Deloitte (2023: 9) explained both positions on the inclusion of equity. From the perspective of the organisations advocating the inclusion of equity in the underlying portfolios, they argue that including equity in the underlying portfolio **better reflects interest rate risk management activities in the financial statements by capturing interest rate volatility more accurately** and avoids the need to use proxy hedging relationships. They also consider the inclusion of equity to be similar to that of NMDs, given that both are forms of interest-free financing.

During the drafting stage, the IASB opposed its inclusion. Its view was that, when equity serves as a source of funding, any interest rate sensitivity arises from the assets financed by that equity rather than from the equity itself. Consequently, equity does not directly affect either economic value sensitivity or net interest income. Furthermore, there is a difference between equity and NMDs, even though neither gives rise to contractual interest payments. This is due to the fact that the fair value of a portfolio of NMDs changes when the benchmark interest rate changes (if the depositor's behaviour is taken into account), a circumstance that does not occur for equity.

EY (2023: 7) adds an argument that would resolve some of the difficulties arising from the exclusion of equity. **If the model did not require the notional amounts of assets and liabilities to be aligned, it would no longer be necessary to allocate equity across the underlying portfolios.** Thus, if equity finances a net position in variable-rate assets, there would be no difference compared with a situation where a hedging derivative is designated as a "fixed-rate" equity hedge or a "variable-rate" asset hedge. Such an approach which do not require the alignment of notional values, would allow these excess variable-rate assets to be included in the RMA model. For example, this approach would allow an entity to enter into a receive-fixed, pay-variable interest rate swap with a notional amount of 10 in order to hedge a net variable-rate asset position of 10.

2.4. Net exposure to repricing risk and metrics for its mitigation

The aggregate exposure arising from portfolios of financial instruments subject to repricing risk determines the entity's overall exposure, which is measured using the metric employed to manage repricing risk. For example, the entity has an exposure of EUR 80 million in profit or loss terms as a result of a 20-basis-point increase or decrease in the benchmark interest rate on each interest rate review date (see BC. 65).

Net exposure to repricing risk is a concept that appears in the model set out in the Exposure Draft and is defined in the appendix of definitions. An entity could define separate portfolios in which different benchmark interest rates are managed; risk mitigation accounting would be applied separately to each portfolio. The measurements of this risk must specify the **benchmark rate against which the repricing risk is mitigated** (mitigated rate).

Repricing risk management may involve a variety of risk management activities and, as such, different metrics can be defined to monitor it. Entities typically manage both the economic value and the net interest income of the institution, in a manner consistent with the framework for Managing Interest Rate Risk in the Banking Book (IRRBB) defined by the Basel Committee. Entities therefore manage IRRBB across two time horizons:

- **Short-term:** sensitivity of the income over a one-year horizon.
- **Long-term:** sensitivity of economic value, whereby this metric is used to monitor the sensitivity of the margin over the entire time horizon.

The definition of the interest rate risk metric is aligned with the business model and is usually stable. As highlighted by the IASB's technical staff, in line with the Basel framework, these are the most common techniques (IASB, 2023. April Staff paper 4B: 25):

- The **present value of a one-basis-point change** in interest rates based on a spread analysis (PV01).
- The **absolute economic value of equity** (EVE) based on projected cash flows and measure under different interest rate shocks scenarios.
- The **Economic Value at Risk** (EVaR), which is similar to the previous approach except that it considers simulations of different shifts in the curve and calculates the impact of a decline in economic value at a given probability level.
- The **expected changes in net interest margin** over a short-term horizon due to movements in interest rates (Net Interest Income - NII or expressed as the *Net Interest Margin* - NIM).

Table 2 shows the risk management metrics used by the entities that responded to the survey conducted by EY (2024: 5). These results also indicate that, on average, entities use four metrics to measure interest rate risk.

//// **TABLE 2** **Inclusion of equity in the CNOP (now underlying portfolios)**

Interest rate risk metrics Sample (Responses to this question)	EY (2024) 41 (28)
PV01	19
Economic Value of Equity	19
Sensitivity of Net Interest Margin (NIM)	16
NIM stabilisation	8
Other (Earnings at risk; sensitivity of NII, including to rate shocks and ramps; sensitivity of economic value of equity; and interest rate gaps for future periods)	9

↑ Source: EY (2024)

2.5. The acceptable range within risk limits

Entities express their risk aversion through risk limits, which are defined as ranges. The model does not produce a single outcome but rather a range of acceptable exposures. Entities set these ranges based on their risk appetite, taking regulatory constraints into account. Thus, the EBA requires that it be notified when the economic value of the investment portfolio falls below 15 per cent of Tier 1 capital, under a standardised interest-rate shock scenario (both parallel and non-parallel shifts -of 200 basis points in the case of a parallel shift in the euro-); therefore, entities set their own limits before these regulatory thresholds are reached (IASB, 2023. April Staff paper 4B: 29).

Entities typically set limits based on the two metrics mentioned above: the sensitivity of the short-term net interest income to a defined magnitude of interest rate changes and, similarly, the sensitivity of the economic value.

Risk limits must be directly linked to the documented risk management strategy. **These risk limits may vary across different time buckets** (EY, 2023: 11; ISDA, 2025: 13). The RMA model assumes that the target risk limits are sufficiently granular, in line with what is expected under an effective interest rate risk management framework. A concern raised by several preparers is whether the model would work if the strategy were defined at an aggregate level rather than allocated by time bands, or if those time bands were very broad (EY, 2023: 12); that is to say, when interest rate risk limits are defined as a maximum permitted sensitivity of economic value or margin, resulting from taking into account the net exposures over the entire time horizon affecting these metrics; rather than defining limits on net exposure by time bands.

2.6. Risk aggregation and the time horizon

Entities use various techniques to aggregate risks. One of the most widely used techniques by the entities providing feedback to the IASB is a pricing mechanism based on reference to market interest rates, resulting in one of the following two alternatives:

- The equivalent of an internal derivative position.
- A net position (loan/deposit) between the business unit and the treasury department, replicating the interest rate risk of the underlying assets and liabilities (IASB, 2021. April Staff Paper 4B: 30-34).

Any margins arising from such positions with third parties would be recognised in the Statement of profit or loss of the unit generating them and would be disregarded for the purposes of the benchmark interest rates.

Adopting a different approach, some entities include the full interest coupon when determining their open position, by aggregating their assets and liabilities, as they consider this to be simpler than applying the benchmark interest rate.

Finally, the determination of the time horizon and the maturity buckets (time bands) are central to the risk management strategy. To this end, it is generally assumed that all cash flows within a given time bands have the same repricing date and may therefore be analysed as a whole. It is common practice to manage risk positions using contiguous buckets and to only execute hedges in the liquid part of the curve, thereby reducing hedging costs.

The ISDA (2025: 14) notes that entities that use standardised time buckets for risk management purposes may to exercise professional judgement when determining the time buckets that are consistent with their risk management strategy. They will therefore use one-month time buckets for short- and medium-term maturities and longer time buckets for instruments with long-term maturities.

When entities manage exposures in different currencies, they usually mitigate exchange rate risk and subsequently their exposures for the purposes of managing interest rate risk (paragraphs B7.2.6 to B7.2.8).

3 Limitations of current hedge accounting for dynamic interest rate risk management

The current accounting model for recognising dynamic risk hedges remains transitional in nature, as envisaged by IFRS 9. According to Morales-Díaz (2018), until a new macro-hedging model is approved, interest rate hedges may currently be recognised in one of three ways:

1.- Applying IFRS 9.

2.- Applying IFRS 9, except with regard to interest rate hedging, where IAS 39 would apply (IFRS 9.6.1.3). This, in turn, imposes fewer restrictions within the European context, as a result of the carve-out introduced when the standard was adopted, and following concerns from financial institutions on the difficulties caused by the new regulations.

3. Applying IAS 39 until a macro-hedging model is incorporated into IFRS 9. (IFRS 9.7.2.21).

IAS 39 was adopted in Europe with two carve-outs. One is related to the fair value option and the second to interest rate risk hedges. The first was removed following an amendment to IAS 39 in 2005. However, the second carve-out remains in place.

This carve-out contains amendments to interest rate hedging for challenging situations such as the aforementioned demand deposits, the treatment of financial assets subject to prepayment by the customer, and hedge ineffectiveness that would otherwise arise; as well as the problem caused by negative interest rates.

EFRAG (2022: para. 39)[4] has studied the application of the carve-out in Europe. The reasons put forward by the entities include the following:

- It is important for portfolios with fair value hedges where the notional value of the hedged instruments is not stable, such as portfolios of assets subject to early cancellation or demand deposits.
- It provides a more faithful representation of risk management activities in reported financial performance.
- It relaxes certain effectiveness requirements, thereby reducing the accounting ineffectiveness that would arise from a more rigid model in the designation and discontinuation process.
- For hedges on fixed-rate assets, particularly once prepayment rates increased significantly within the portfolio (this is understood in the context of significant reductions in market interest rates since 2012).

4 EFRAG (2022): https://www.efrag.org/system/files/sites/webpublishing/Meeting%20Documents/2107270958304630/03-03%20DRM%20Feedback%20around%20carve%20out%20perceptions%20and%20use%20-%20Issues%20paper.pdf

- The use of the carve-out has increased due to the structure of bank balance sheets, which comprise portfolios of fixed-rate mortgage loans funded by demand deposits.
- It facilitates the management of negative margins in micro-hedging relationships.
- It helps entities achieve lower operating costs and reasonable results from hedge accounting.

The carve-out is not applicable to current accounts and demand deposits due to the auditors' restrictive interpretation, which requires that, if the contractual interest rate on these deposits changes, they can no longer be regarded as fixed-rate and the hedges must be terminated (EFRAG, 2022: 41).

3.1. The hedging models set out in IAS 39 and IFRS 9

The current standards propose two hedge accounting models to hedge both the economic value of balance sheet items and cash flows and, consequently, earnings or profit or loss.

Entering into derivative contracts allows this repricing risk to be transferred. Derivative instruments give rise to rights and obligations to make or receive payments for the entities depending on changes in the underlying risk factors; it is this difference that forms the basis of the hedge. To ensure that this relevant information is not omitted, derivatives are measured at fair value, representing a right to receive payment or an obligation to make payment to the counterparty. The change in that position may be recognised in profit or loss or in equity, depending on the hedge type: fair value hedge (recognised in profit or loss), cash flow hedge (initially recognised in equity, and subsequently reclassified to profit or loss).

Hedge accounting models were developed to address accounting mismatches that arises when an entity engages in economic hedging activities which, if not treated separately, would result in unreliable financial information.

In the case of a fair value hedge, the carrying amount of the hedged item, the entity changes the measurement basis of the item, only to the extent of the hedged risk, to fair value through profit or loss, thereby offsetting the effect on the hedging derivative, which must be measured at fair value through profit or loss.

In the case of **cash flow hedges**, the change in value is recognised in equity. In this second type of hedge, the equity item recognised is the lower of the cumulative gain or loss on the hedging instrument and that arising on the hedged item (IFRS 9.6.5.1.1.a), with the remainder of the fair value of the hedging instrument recognised in profit or loss (IFRS 9.6.5.1.1.b). This hedge is used to hedge the cash flows of highly probable forecast transactions, as well as for instruments where the risk to be hedged is the cash flows rather than changes in their value, such as variable-rate instruments.

As noted by the IASB technical staff, the hedge accounting model that best suited the risk to be hedged using dynamic interest rate hedges was the cash flow hedge model. On one hand, when the objective is to hedge the interest margin, the objective is similar to that of these hedges; on the other hand, the dynamic nature of the hedges requires the inclusion of highly probable positions that are provided for under the cash flow hedge model. By contrast, the fair value hedge model would be more difficult to apply because the dynamic position does not necessarily consist of specifically identified assets or liabilities whose fair value changes can be separately measured. Moreover, the "lower of" requirement would prevent the excess cumulative change in the fair value of the designated derivatives from being recognised as effective hedging against the change in the fair value in the hedged position (IASB, 2022. February Staff Paper 4A: 9-12).

The proposed RMA model differs from the previous two models. The RMA model seeks to hedge exposure to both fixed-rate and variable-rate exposures and, accordingly, seeks to mitigate the effects of changes in both economic value and future cash flows. Under this approach, the entity determines the portion of its exposure that it intends to mitigate, and that decision defines its risk mitigation strategy.

3.2. The weaknesses of the current model

In 2010, the IASB noted that hedge accounting was not adequately aligned with the dynamic management of interest rate risks. In 2014, it published a proposal addressing this situation (*Discussion Paper. Accounting for Dynamic Risk Management: A Portfolio Revaluation Approach to Macro Hedging*). This document highlighted the importance of providing an appropriate accounting response to this approach to risk management, which is highly prevalent in the banking sector. Based on this feedback, between 2020 and 2021, the IASB has been developing the model in consultation with stakeholders. In May 2022, the IASB issued a statement on the continuation of the project and highlighted the following weaknesses in the current treatment of dynamically managed risk mitigation activities (IASB, 2022. May Staff Paper 4B: 18):

- **Open portfolios:** The current hedge accounting framework is not well suited to open portfolios because it effectively treats them as a succession of short-term closed portfolios. This approach gives rise to significant operational complexity, as entities must continuously monitor hedging relationships.
- **Net risk management:** IAS 39 acknowledges that interest rate risk is managed economically on a net basis (taking into account the interest rate risk arising from the mismatch in the repricing of the net balance of assets and liabilities), however, for hedge accounting purposes, the hedged item must generally consist of a gross position in assets or liabilities (rather than the net balance of these assets and liabilities). This process requires an "artificial" designation process, such as items to be hedged, and financial assets and liabilities on the bank's statement of financial position as an indirect means of addressing the underlying risk exposure being managed. This creates a disconnect between accounting requirements and actual risk management practices. As stated above, IFRS 9.6.6.1 permits net amount hedges subject to certain conditions.
- **Short- and long-term dimensions of repricing risk:** Entities simultaneously manage two interest rate risk metrics related to the net interest-bearing assets and liabilities on the banking balance sheet: the risk to the net interest income over a short-term horizon (normally up to 1–2 years) and risk to economic value, which is commonly used as a proxy for assessing long-term earnings sensitivity of the entire banking balance sheet. The current hedge accounting framework does not assess whether that accounting hedges on assets or liabilities (whether fair value hedges on fixed-rate instruments or cash flow hedges on variable-rate instruments) effectively reduce the institution's net exposure following risk mitigation activities and bringing the metrics for the short-term interest margin and economic value within the "acceptable" limits for interest rate risk defined by the entity for these two metrics.
- **Demand deposits and current accounts:** Demand deposits (especially from retail depositors) are a highly significant component of the liabilities side of bank balance sheets. Although these instruments can be withdrawn overnight by depositors, experience shows that a substantial proportion of these balances remains relatively stable over time and their remuneration exhibits limited sensitivity to changes in market interest rates (this is what is known as "core Non-Maturity Deposits (NMD)". In this regard, interest rate risk managers for the bank's balance sheet rely on behavioural models to estimate the stability and expected duration of these demand deposit accounts. However, as IAS 39 does not permit behavioural assumptions relating to demand deposit accounts to be directly designated in hedging relationships, the entities therefore resort to alternative approaches, such as identifying variable-rate assets so that they may be subject to cash flow hedges (converting their variable interest rate to a fixed rate, aligned with the "fixed" liability of the demand deposit accounts that finance them) and achieving similar results. However, this solution reduces the quality of the information and, furthermore, does not adequately reflect situations of over-hedging that arise when the volume of stable deposits ultimately proves to be lower than originally assumed when determining the volume of variable rate assets that must be converted to fixed rates through cash flow hedges[5]. In Europe, entities applying the carve-out under IAS 39 may apply fair value hedging to current accounts.

5 Consider a statement of financial position consisting entirely of variable-rate mortgages on the asset side and non-interest-bearing current accounts on the liability side. The entity applies a behavioural model to its current accounts and assumes that all balances are stable and insensitive to interest rate movements, meaning that they are classified as core non-maturity deposits (NMDs). Based on these assump-

Furthermore, the designation of a portfolio of financial assets subject to prepayment risk is based on a percentage of the portfolio rather than on a designated bottom layer of principal. Consequently, when the outstanding balance of the portfolio decreases as a result of prepayments, any hedge ineffectiveness is allocated to the designated percentage of the portfolio rather than to the undesignated portion.

tions, if the entity seeks to eliminate its exposure to interest rate risk entirely, it hedges all variable-rate assets through cash flow hedges, thereby converting their cash flows into fixed-rate cash flows. In theory, this strategy would eliminate interest rate risk entirely, since the hedged assets would effectively generate fixed-rate cash flows while being funded by current accounts assumed to behave as fixed-rate liabilities.

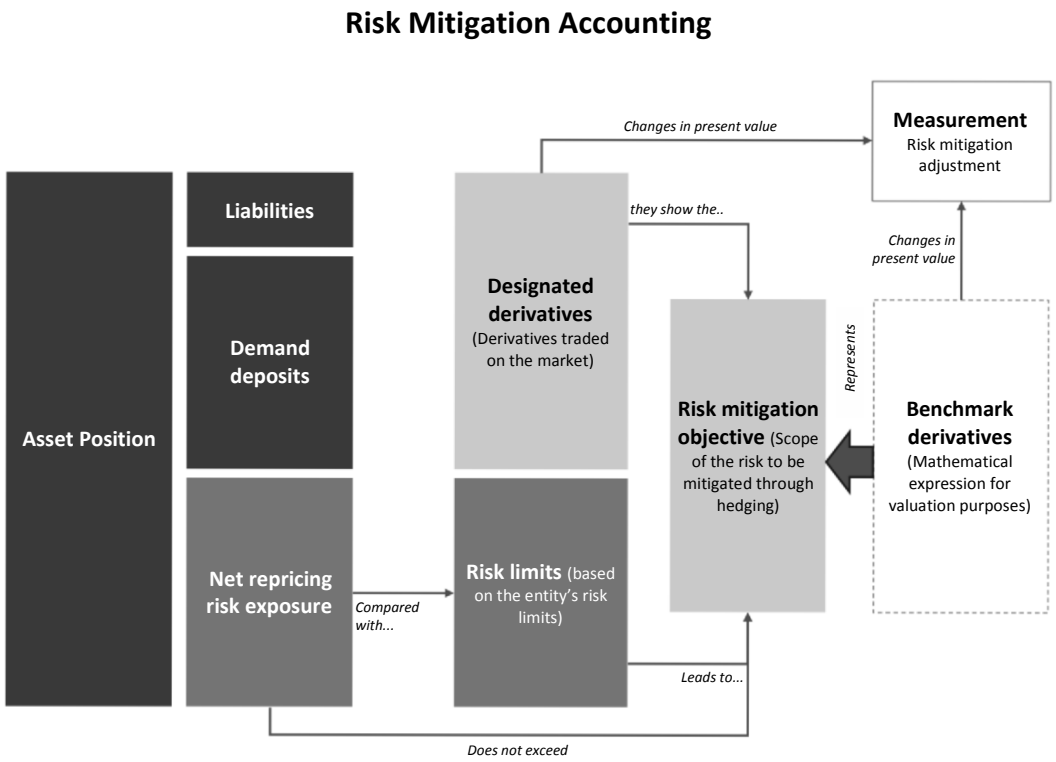
4 General outline of the proposed model

The proposed model aims to faithfully represent in the financial statements the effects of an entity's repricing risk management activities in this section, we begin by describing how the interest rate risk management strategy is developed and implemented under the model. Next, we set out the key items to be recognised in the main financial statements. We conclude with a third point describing the presentation and disclosure requirements in the notes to the financial statements.

4.1. Interest rate risk management model

Table 1 shows the logic of the RMA model, which is applied to the net repricing risk position. This is calculated as the difference between financial assets and liabilities subject to repricing risk, including funding provided by demand deposits (NMDs). The hedged position changes over time as the entity enters into new transactions and existing positions mature or reprice it will therefore be necessary to adjust the derivative positions used to hedge interest rate risk.

//// **TABLE 1** Overview of the RMA model



↑ Source: IASB (2025). Exposure Draft – Snapshot. Risk Mitigation Accounting. Amendments to IFRS 9 and IFRS 7. Available at: snapshot-iasb-2025-1-risk-mitigation-accounting-ifrs9-ifrs7.pdf

As part of their risk management strategy, entities normally establish risk limits based on economic value sensitivity metrics – including limits applicable to net exposures across the entire banking book time horizon and on the sensitivity metric of the short-term interest margin (up to 1–2 years). Entities are not required to allocate these limits to individual repricing time bands. For example, in an entity with a net Economic Value exposure of EUR 100 million to the risk arising from a 20 basis point change in the reference rate, if the acceptable risk limit is EUR 80 million, the entity should contract a hedge (designated derivatives) that would generate a favourable sensitivity effect of EUR 20 million in the event of a 20 basis point rise in interest rates and that would offset EUR 20 million of the adverse Economic Value sensitivity of EUR 100 million in the Economic Value metric in this interest rate change scenario. In this way, the risk mitigation objective (as evidenced by the designated derivatives contracted) would be EUR 20 million and would ensure that the interest rate risk arising from 20 basis point rises remains within the acceptable limit of EUR 80 million. This decision sets a risk mitigation objective, which is achieved by contracting derivative instruments with third parties. The risk mitigation objective is set in absolute terms and is therefore not a proportion of the underlying portfolios (paragraph B7.4.2). Paragraph BC.79 notes that the IASB requires the risk mitigation objective to be characterised by the following:

- It aims to reduce net exposure to a level consistent with the limits established by the entity's risk management strategy (paragraph 7.4.2). In the case discussed, the net repricing risk exposure of EUR 100 million is brought within the established limit of EUR 80 million by entering into derivatives that provide a risk-mitigating effect equivalent to EUR 20 million.
- **It is evidenced by the execution of derivative transactions** (paragraph 7.4.3).
- **It does not exceed the amount of the net repricing risk exposure** for each repricing time band (paragraphs 7.4.1. and B7.4.5). In other words, the net repricing risk exposure will not be less than EUR 80 million in any of the time bands. This prevents the creation of risk exposure through derivatives, rather than mitigating it (BC.80).

The frequency with which the entity sets its risk mitigation objective depends on the nature of the net repricing risk exposure and on its risk management activities (paragraph 7.4.4). This period need not coincide with the preparation of information for internal use or for third parties (paragraph B7.4.4). Furthermore, if risk limits were set at the repricing time-band level, this would be taken into account when determining the risk mitigation objective for each repricing time band (paragraph B7.4.6).

Interest rate swaps are normally entered into, although non-linear instruments such as interest rate options may be used, provided they do not result in a net short position (7.3.2.a). The portion of the net exposure that is not to be hedged must fall within the risk limits that the entity is prepared to assume (paragraph 7.4.2).

Entering into derivative contracts provides evidence of the entity's stated objective of risk mitigation (paragraph 7.4.3.). The position to be hedged, as expressed by the risk mitigation objective, is mathematically represented by benchmark derivatives (paragraph 7.4.5).

Through **the valuation of benchmark derivatives**, the entity would recognise the change in value of the hedged position which, unlike hedge accounting, will not change in value, as it is an aggregation of financial assets and liabilities. At initial designation, the fair value of the benchmark derivative must correspond to the fair value of the designated derivative (contracted on the market) and through which the risk mitigation objective is demonstrated (paragraphs 7.4.5 and B7.4.9).

This requirement forms part of the prospective assessment of the model. In the prospective assessment of the risk mitigation objective, the IASB requires the risk mitigation objective to not exceed the net repricing risk exposure in any repricing time band, as this would result in an artificial exposure to interest rate risk.

The effectiveness of dynamic hedging is measured at the end of the financial year (B7.4.18).

Unexpected changes in the underlying portfolios would affect the net repricing risk exposure; if net exposure in any repricing time band falls below the risk mitigation target, the benchmark derivatives must be adjusted so that they continue to reflect the risk mitigation objective (paragraphs 7.4.6 and B7.4.10). Unexpected changes could occur, for example, if early repayments on a mortgage portfolio were higher or lower than expected (paragraph B7.4.11).

4.2. Recognition and measurement in financial statements

At the end of the RMA reporting period, changes in the value of the benchmark derivatives and the designated derivatives[6] are measured. If the risk mitigation relationship has been effective, the changes in the value of the benchmark derivatives and designated derivatives are expected to offset each other. Any ineffectiveness would result in differences between the change in value of the hedged item (measured using the benchmark derivatives) and that of the designated derivatives.

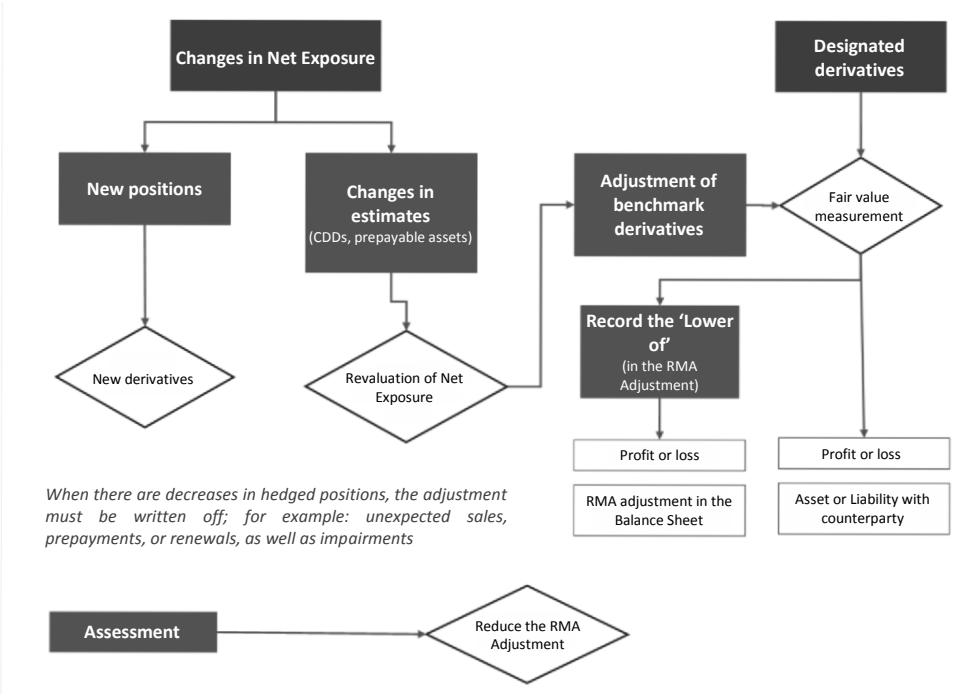
Table 2 illustrates the accounting treatment under the RMA model. In each RMA valuation period, the change in fair value is calculated for:

(a) the designated derivatives (entered into with market counterparties)

(b) the benchmark derivatives (which represent the risk mitigation objective)

The lower of requirement a) and b) represents the effective portion and gives rise to the Risk Mitigation Adjustment, which is a balance-sheet adjustment recognised in profit or loss. The "lower of" requirement is cumulative and requires any excess amount not supported by the benchmark derivatives to be recognised immediately in profit or loss (this prevents the deferral of gains or losses not justified by the net repricing risk exposure).

//// **TABLE 2** Accounting under the RMA model



↑ Source: Authors' own based adapted from a flowchart by EY (2023: 6).

In addition to the risk mitigation adjustment, designated derivatives are measured at fair value, with changes in fair value recognised in profit or loss and a corresponding asset or liability recognised in respect of the derivative counterparty. The resulting gain or loss recognised in profit or loss, if the hedge is effective, should be equal in amount and opposite in sign to that created by the risk mitigation adjustment. If the hedge is ineffective, the resulting ineffectiveness is recognised in profit or loss for the period. One of the issues to be determined in the model is which changes constitute hedge ineffectiveness and which are considered inherent features of dynamic risk management.

6 In the valuation process, variable-rate positions are assigned to the time band associated with their next repricing date, while fixed-rate positions are assigned to the bucket corresponding to their contractual maturity date.

For example, if the risk mitigation objective consists of fixed-rate assets funded by variable-rate liabilities (the benchmark derivative is an Interest Rate Swap (IRS) receive-fixed, pay-variable) and the designated derivative contracted on the market is an IRS receive-variable, pay-fixed. Assuming that market interest rates have risen during the RMA assessment period: the change in the fair value of the designated derivative is positive and the change in the fair value of the benchmark derivative is negative; when both changes are equal in magnitude and opposite in sign, the hedge is fully effective. In this case, the accounting entry is a debit to profit or loss and a credit to the risk mitigation adjustment. This credit to the risk mitigation adjustment represents the adverse change in the value of the hedged exposure, which is 100 per cent offset by the gain in the value of the designated derivative.

4.3. Presentation in the financial statements and disclosures in the notes

As a result of applying the model, the following effects would be recognised in the main financial statements and disclosed in the explanatory notes to the financial statements:

a) Statement of financial position:

Application of the model results in the recognition of an item referred to as the risk mitigation adjustment, which may give rise to either a debit or a credit balance, and which shall be presented in the statement of financial position as a separate line item in the statement of financial position. This line would represent an adjustment to the carrying amount, which will be either amortised cost or fair value through other comprehensive income (FVOCI), of the items that make up the net exposure. As the logic of the model encounters difficulties in tracing the Risk Mitigation Adjustment to specific items, this adjustment will be presented on a separate line in the Statement of financial position. The IASB (May 2022 Staff Paper) acknowledges the difficulty in classifying the risk mitigation adjustment as an asset or a liability and questions whether it meets the definition of an asset or a liability. The risk mitigation adjustment reflects the change in value of the underlying net repricing risk exposure. It may be considered as the valuation adjustment applied to a set of assets and liabilities (net exposure) that form a unit of account. One of the potential consequences of treating it as an asset or a liability is its impact on the regulatory capital requirements, which can lead to volatility in capital figures and financial instability.

b) Statement of profit or loss:

The effect of recognising the risk mitigation adjustment will be displayed in a separate line in the Statement of profit or loss. Any hedge ineffectiveness between the results of the designated derivatives and the risk mitigation adjustment shall also be presented. This misalignment, recognised in profit or loss, will be presented under the same heading as gains and losses recognised on other derivatives.

c) Notes to the Financial Statements:

Disclosures should enable users of financial statements to understand: (i) t**he risk mitigation strategy** and how it is implemented; (ii) **the effect of the RMA** on performance and the financial position; and (iii) **residual exposure** and risk management over time. For practical purposes, RMA disclosures could be structured into the following sections:

1) Mitigation strategy and scope

- Description of the repricing risk mitigation **strategy** (objective, nature of the risk, mitigation horizon and how it is determined).
- Identification of the **portfolios or positions** subject to RMA (e.g. fixed-rate assets, deposits with no contractual maturity, etc.) and the aggregation criteria.
- Explanation of how the **benchmark derivatives** is defined, and the link to the exposure managed.

2) Instruments used and designation

- Description of the **designated derivatives** (type of instrument, notional values, maturities, relevant interest rates or other pricing variables, and, where applicable, weighted average rates) and their impact on cash flows.

- Sensitivity analysis of net interest income or economic value due to changes in interest rates.
- Derivative **replacement** policy, where applicable, and how consistency with the strategy is maintained.
- The criteria used to maintain alignment between designated derivatives and benchmark derivatives.

3) Accounting effects of the RMA

- Amount of the **risk mitigation adjustment** recognised in the statement of financial position (separate asset/liability), indicating the line or note where it is presented.
- Amount recognised in the profit or loss for the period as a result of the RMA including the effect of applying the "lower of" requirement, where applicable.
- Identification of the line(s) in the Statement of profit or loss where the impacts are presented (e.g. profit or loss on financial instruments / profit or loss on derivatives).

4) Reconciliation of the risk mitigation adjustment

Present a reconciliation that includes:

- Opening balance of the risk mitigation adjustment.
- Change during the period attributable to the RMA implementation (including designations, changes to the benchmark and recalibrations).
- Amounts reclassified to profit or loss during the period.
- Closing balance of the risk mitigation adjustment.

5) Time profile and discontinuation

- Analysis of the **maturity/time horizon** of the Risk Mitigation Adjustment (when it is expected to affect profit or loss), preferably by time bands.
- Separation, where applicable, between Risk Mitigation Adjustments associated with **ongoing** relationships and **discontinued** relationships.
- When there is a discontinuation: reason (change in risk management), balance affected and criteria for subsequent allocation to profit or loss.

4.4. Recognition of the risk mitigation adjustment in profit or loss after discontinuation of risk mitigation accounting

The discontinuation of risk mitigation accounting (RMA) **is only appropriate** when there is a **demonstrable change in how the entity manages** its exposure to repricing risk (that is, when the described and documented mitigation strategy is no longer applied). Therefore, **it is not appropriate** to discontinue for normal operational reasons (e.g. routine portfolio adjustments, refinement of objectives or limits, replacement/renewal of derivatives or changes to position size) **if the underlying mitigation strategy remains in place**.

Discontinuation **is not a voluntary choice** made to achieve a specific accounting result; it must be based on a change in risk management.

Once RMA has been discontinued, the **cumulative risk mitigation adjustment** remains recognised as a separate item (asset or liability) and is **systematically reclassified to profit or loss** over the **mitigation horizon**, on a basis consistent with the pattern in which the mitigated risk would have affected profit or loss.

If, after discontinuation, the mitigated risk **ceases to affect** the entity (for example, due to the expiry of the exposure or the disappearance of the cash flows or positions to which the risk was linked), any **remaining balance** of the risk mitigation adjustment shall be recognised **immediately in profit or loss**.

5 Definition of underlying portfolios

This combination reflects the financial assets and liabilities for which the entity manages and monitors its net risk position in a holistic manner. This is known as the organic interest rate risk position, before entering into derivative contracts to mitigate its effects.

5.1. Key criteria

The criteria for including or excluding items serve a dual purpose (BC. 39):

- Items that are subject to interest rate risk are included.
- Items for which designated derivatives would otherwise give rise to an accounting mismatch are included.

The IASB has set two requirements for these instruments: a) the instruments must **be managed as a portfolio** and b) the **credit risk** must not significantly affect the contractual cash flows.

Some items included are the following:

- Financial assets **measured at amortised cost or fair value through other comprehensive income (FVOCI)**, because in both cases periodic interest is recognised using the effective interest rate. In the case of instruments measured at fair value through Other comprehensive income at reporting date, the fact that the financial instruments are measured at fair value does not prevent designated derivatives from creating an accounting mismatch in the recognition of gains and losses if they are not considered part of the hedged portfolios. Whether or not they are included in the underlying portfolios, this would lead to an asymmetry in "Other comprehensive income" (BC.46.b).
- **Future reinvestment or refinancing transactions** related to the initial positions that are expected to take place under existing conditions. Growth in positions would be recognised provided that such increases were highly probable (planned transactions or commitments by the entity). A dual probability approach is applied to (expected) reinvestments and refinancings, and to growth in those positions (highly probable). The former reflected by allocating the expected reinvestment or refinancing transaction to the period in which it is expected to occur (IASB, 2024, October Staff Paper 4: 12).
- **Items that are already designated in hedging relationships** are excluded from the model to avoid double counting. However, if the combination of the hedged item and its hedging instrument forms part of a repricing risk management strategy, it may be included in the model.
- **Financial instruments measured at amortised cost.** These are the instruments most commonly subject to repricing risk management.

A special case is that of **financial instruments with attributes that allow the counterparty to withdraw them** (demand deposits or current accounts, or financial assets with the option of early repayment by the customer). These instruments are valued at their face value because that is the amount due at any time (BC. 41). Additionally, they are generally a stable source of long-term funding, even if they pay little or no contractual interest. Entities model these balances using behavioural assumptions. (BC. 42). In such cases, it is necessary to model the customer behaviour with whom these positions are held. **Demand deposits** are positions, a substantial proportion of which is considered insensitive to interest rate movements and are therefore regarded as fixed-interest-rate positions. These positions represent a significant source of funding for retail banking institutions.

The objective of avoiding accounting mismatches influences the determination of the components that make up the underlying portfolios, as follows:

a) Financial instruments measured at fair value through profit or loss are not taken into account because changes in interest rates are already reflected in fair value, and there would be no asymmetric treatment under the accounting standards, as the effects of both the derivative and the hedged item are recognised in profit or loss in the same period.

b) Liability instruments with discretionary interest classified as equity: as they are recognised in equity, they give rise to an accounting mismatch in relation to changes in the value of the hedging derivative, which are recorded in profit or loss (BC.49 and BC.50). Finally, the model requires that only one type of benchmark may be used as the hedged risk, resulting in separate RMA applications for each benchmark rate. In practice, **risk management is performed using various benchmark indices, with specific timeframes, meaning that the model may not fully reflect entities' economic risk management practices.**

5.2. Demand deposits and fixed-rate financial assets subject to prepayment risk

Entities take various factors into account when assessing the behaviour of current accounts:

- The **portion that is stable and insensitive** to changes in interest rates is referred to as "**core" NMDs**. The **maturity of these core NMDs** would represent a fixed-rate liability shown over the term in accordance with the "NMD model maturity assumptions" for these core NMDs.
- The portion that is sensitive to interest rates: "Non-core" NMDs. These must also be represented in the net repricing risk exposure to the extent that the entity's internal model accounts for these non-core NMDs.

In retail banking, current accounts and other demand deposits that qualify as non-maturity deposits (NMDs) are a major source of funding, accounting for up to 60 per cent of total funding. These are positions that are not considered sensitive to changes in interest rates and are therefore regarded as fixed-rate positions. To be included, the model requires that they be on demand (with the option for the customer to cancel them) and that there be no obligation to change the return when market interest rates change. The difficulty with this type of funding is that behavioural models must be used to estimate the amount of funding that will be available.

On the other hand, certain assets, such as fixed-rate mortgages, are more likely to be subject to early repayment in a low-interest-rate environment, with borrowers taking advantage of this new situation; consequently, repricing buckets cannot be represented by the base-case interest rate scenario. For both demand deposits and fixed-rate mortgages, the allocation of exposures to repricing buckets cannot rely solely on the base-case interest rate scenario.

5.3. Equity financing

One of the issues under discussion is whether **equity should be included in the determination of net risk positions.** Shareholders generally require a higher return on equity than creditors require on debt financing. A significant proportion of the entities participating in the ISDA survey (2024) – specifically 12 out of 28 – indicated that the model should include equity in the net position. However, the IASB has provisionally decided that equity items should not be taken into account when determining the net position.

Institutions often manage equity-related exposures by reference to changes in benchmark interest rates; for example, internal funds transfer pricing rates.

The instruments included within this strategy are **those measured at effective interest rate** (amortised cost or fair value through other comprehensive income (FVOCI).

Under the RMA model, financial assets and liabilities are included in this net repricing risk exposure across different time bands, depending on the repricing dates or contractual terms.

In some cases, entities may consider that their cash positions or highly liquid variable-rate assets may not be exposed to repricing risk unless they are funded by equity. In such cases, entities may develop internal models to estimate the effect of equity funding through equity-modelling techniques (paragraph B7.2.17 and IE.184–191, Example 23).

5.4. Foreign currency positions

The entity may finance part of its activities with liabilities denominated in another currency. A similar approach may be adopted for asset portfolios. In such cases, derivatives are usually used to mitigate foreign exchange and interest rate risk. In principle, positions in different currencies are exposed to different economic environments that may give rise to different risk characteristics. These differences in economic conditions, combined with currency risk, has led the IASB to propose, on two occasions, that positions in different currencies should be accounted for through separate applications of the RMA model (IASB, 2018. February Staff Paper 4B: 44 and 48; IASB, 2023. July Staff Paper 4B: 45).

When the IASB discussed this issue in July 2023, it did so in the context of considering whether hedged positions should be included in the CNOP (now referred to as net repricing risk exposure). The technical team therefore emphasised that it is common to raise funds or generate assets in currencies other than the functional currency, thereby exposing the organisation to currency risk. In many cases, these exposures were hedged using cross-currency swaps and the interest rate risk was subsequently managed in the functional currency. The IASB also approved the technical staff's proposal to consider hedged positions within the CNOP (IASB, 2023. July Staff Paper 4B: 46).

5.5. Representation of non-linear features in underlying portfolios

Entities measure their net exposure on a non-linear basis as part of their internal risk management practices. Interest rate risk is typically measured through full revaluation techniques used to calculate economic value sensitivity measures and/or the sensitivity of one-year net interest income to changes in interest rates, by revaluing the cash flows of assets and liabilities, where the cash flows modelled differently under alternative interest rate scenarios (base, rising-rate, and declining-rate scenarios). In such cases, a risk mitigation objective relating to a net repricing risk exposure with non-linear features may require the use of interest rate options.

These non-linearities in the balance sheet positions that make up the net exposure resulting from the representation of repricing cash flows under a base-case scenario may not fully reflect the entity's actual risk exposure, as the repricing dates of the instruments differ depending on the interest rate scenario. This may represent a limitation of the RMA model.

6 Risk management strategy when applying the RMA model

Entities mitigate their net repricing risk exposure by entering into derivatives over the horizon specified in their risk management strategy. The first step is to define this net exposure and the acceptable interest rate risk limit. If the entity's risk limit were zero, the entity would have to hedge 100 per cent of the net repricing risk exposure. This amount to be hedged is called the risk mitigation objective. Consequently, the difference between the net exposure and the risk limits represents the risk mitigation objective, which displays the exposure to be mitigated through derivative transactions with third parties designated derivatives contracted on the market.

6.1. Net repricing risk exposure

The net repricing risk exposure *based on the relevant mitigated rate, arising from underlying portfolios for which an entity manages repricing risk on a net basis* (Appendix A).

Financial assets and liabilities included in the net exposure are allocated to time buckets based on when they are expected to be repriced or, in the case of fixed-rate instruments, based on their contractual maturities. From the outset, this introduces the use of behavioural models for both NMDs and fixed-rate loans subject to prepayment risk, and where actual behaviour differs from modelled behaviour gives rise to unexpected changes in net exposure and gives rise to hedge ineffectiveness under in the RMA model.

6.2. Risk limits and risk mitigation objective

This risk strategy defines **risk limits** which represent the level of risk an entity is prepared to accept. Risk limits define the level of risk that the entity is prepared to accept, while the risk mitigation objective sets out how much risk exposure it seeks to mitigate. The risk limit corresponds to the concept referred to in previous discussions as the "target profile", which is "*the range (risk limits) within which the current net open risk position can vary while still being consistent with the entity's risk management strategy*" (IASB, 2021. November Staff Paper 4A: 12). This is not an accounting concept, but is linked to the entity's risk management, which must be documented at the start of the hedging relationship. Changes to risk limits arising from adjustments to risk management activities do not constitute a change in risk management strategy and, therefore, do not result in the discontinuation of the risk mitigation accounting (B7.5.4).

The time buckets must be consistent with the entity's assessment of repricing risk (IASB, 2021. November Staff Paper 4A: 13). However, it is not standard practice to allocate risk limits by time buckets. In Spain and Europe, entities do not set their limits by time buckets, but rather as limits across all buckets (through limits on on economic value (EV) and one-year net interest income (NII) sensitivity). This comment appears in the survey conducted by ISDA (2024: 6). A similar point is made by EY (2023: 12), which states that: *some preparers have raised the concern whether the model will*

continue to work if an entity only has one overall risk limit that is not allocated into time buckets, or its risk buckets are very broad. This survey also identifies the lack of alignment between the implicit risk management model in the RMA and the approaches used by entities as a cause for concern (ISDA, 2024b: 13).

The target profile must be specified and documented when the risk mitigation objective is specified, even though a change to the profile does not lead to a change in the organisation's risk management strategy.

Hedging against repricing risk may seek to protect the net interest income or the economic value of the financial assets and liabilities for which the interest rate is managed. **The RMA model incorporates both objectives**, as hedging with a single objective could be achieved with the macro-hedges that are already in place under IFRS 9 (IASB, 2024. July Staff Paper 4A: 13). Why do entities combine these two objectives? Because, usually, the short-term objective is to stabilise the net interest income, while the long-term focus is usually on preserving the economic value that will enable future returns. The IASB has emphasised that this dual objective can be achieved by combining both objectives or by considering them jointly or through an integrated assessment (IASB, 2024. July Staff Paper 4A: 10.b).

The entity also defines the **risk mitigation objective** which represents the level of risk to be mitigated through the use of derivatives. It is represented by **benchmark derivatives** and implemented through designated derivatives.

The risk management strategy is evidenced by the execution of derivative transactions (designated derivatives).

6.3. Construction of benchmark derivatives

Benchmark derivatives represent the risk mitigation objective (RMO) and enable the effects of the RMA model to be measured. These derivatives must be consistent with the risk mitigation strategy, avoiding imbalances in risk exposure, and must be calibrated initial designation so that, with their fair value equal to zero. These derivatives are constructed to reflect the risk mitigation objective rather than the target profile, as they require measuring the extent to which risk is mitigated. Benchmark derivatives are based on the same criteria as the hypothetical derivatives set out in IFRS 9.

The technical staff set out the following principles for the construction of the benchmark derivative (IASB, 2023. April Staff Paper 4B: 35):

- The benchmark derivative **is constructed to be on-market** at designation so that it is calibrated to **a fair value of nil**. To this end, the floating leg is based on the managed risk, and the fixed leg is calibrated using the managed risk yield curve.
- The benchmark derivative **does not include features that exist only in the designated derivatives**. Thus, for example, valuation adjustments to a designated derivative for credit risk purposes should not be included.
- **The amount of risk and the tenor of the benchmark derivative are determined by the risk mitigation objective** and use the risk metric employed by the entity for the relevant repricing horizon. This may be either PV01 or the ΔNII. If the entity uses the latter method, the exposure is measured by multiplying the interest rate by the notional values of the designated derivatives in each repricing period.
- **The risk metric selected by the entity is determined by its risk management strategy**. This means that the entity cannot arbitrarily change its risk metric from one period to the next. This principle is consistent with a dual objective that seeks to stabilise the net interest margin in the short-term, and to preserve economic value in the long-term.

Benchmark derivatives are based on the derivatives contracted and designated for risk management purposes, but are not necessarily identical in terms of interest rates, maturity, tenor or notional amount.

One issue highlighted by the ISDA (2025: 20) is whether the benchmark derivative is based on market interest rates at the start of the period, as is the case with the IASB in the examples it provides, or at the time the designated derivative is entered into.

Changes in net exposure are addressed by constructing new benchmark derivatives which are added to the existing benchmark derivatives at the beginning of each repricing time band in order to represent the risk mitigation objective (EY, 2023: 14). Furthermore, these changes in net exposure and in the risk mitigation objective will require entering into new designated derivatives, whose maturity profiles and run-off patterns may lead to mismatches with the benchmark derivatives. These mismatches must be monitored (ISDA, 2025: 19).

ISDA (2025: 19) notes that further clarification is needed on the IASB's objective of **constructing market-consistent benchmark derivatives to minimise the differences between benchmark and designated derivatives**, especially when it is not possible to find such a market-consistent benchmark (time-bucket risk) where there is no traded derivative in that bucket that can be entered into and designated, or where the yield curve is illiquid for that maturity bucket.

7 Contracting designated derivatives

The risk management strategy involves entering into derivative transactions. Conceptually, the approach is to estimate the net exposure (the open risk prior to hedging with derivatives), which, when compared with the maximum acceptable risk limits, will determine the risk mitigation objective. The risk mitigation objective is represented by benchmark derivatives. To achieve this risk mitigation objective, certain derivatives (termed designated derivatives) must be entered into with third parties, whose risk profile is opposite to that of the benchmark derivatives.

To give a simple example: let us consider a bank whose Statement of financial position consists solely of 5-year fixed-rate assets, financed by a 1-year variable-rate funding, and whose interest rate risk limit is to hedge 100% of its interest rate risk (i.e. the RMO = net repricing risk exposure). In this case, the RMO would be represented by a benchmark derivative, namely a 5-year receive-fixed, pay-variable IRS. To close this RMO, it would be necessary to contract a designated derivative on the market that is the opposite of the RMO (i.e. a derivative with a 5-year pay-fixed, receive-variable IRS).

There are four important aspects related to the configuration of designated derivatives. The first is that these derivatives must be contracted with third parties. The second concerns the types of derivatives that can be entered into. The most common are derivatives that transfer risk on a linear basis (for example, interest rate swaps), but it would be possible to enter into derivatives that transfer risk on a non-linear basis (for example, an interest rate option) if this is consistent with the entity's risk management strategy (IASB, 2024, October Staff Paper 4: 29). The third is the option to designate derivatives already outstanding which do not initially have a fair value of nil. Finally, the fourth concerns the early termination of designated derivatives.

7.1. Designated derivatives with counterparties external to the reporting entity

Derivatives that hedge net exposure up to the acceptable risk limit must be entered into with third parties. Some entities have noted that open risk positions can be hedged by transferring the risk to the institution's trading desk via internal derivatives. For these entities, such internal derivatives could either be designated or considered as reflecting the RMO, without having to classify them as external derivatives, as the portfolio risk has been transferred to the trading desk (IASB, 2023. April Staff paper 4B: 18). Despite this approach, which is based on risk management, the IASB's technical team emphasises that risk may be transferred to a unit other than the one that originates the financial instruments (for example, a trading desk); however, only when the risk is ultimately transferred to a third party through an identifiable derivative transaction (IASB, 2023. April Staff paper 4B: 30).

Thus, as with hedge accounting under IFRS 9 and IAS 39, the IASB has ruled out the possibility of using internal derivatives between different units or entities within the group (IASB, 2023. April Staff paper 4B: 31).

If open positions in the business units are transferred to the trading desk (treasury department) through internal derivatives, and the trading desk then transfers them externally through derivatives with third parties, the resulting aggregation of positions may make it difficult to demonstrate the link between the net exposure and the contracted derivatives. The entity must select those designated

derivatives that are most closely aligned with the risk mitigation objective, while accepting a certain degree of hedge ineffectiveness (EY, 2022: 10).

7.2. Types of designated derivatives

A second issue that has been raised is the nature of these derivatives. Certain risks are not linear. This occurs when there is a cap or floor on interest rates for a variable-rate instrument, or when there are instruments with early repayment clauses, whose behaviour depends on the interest rate scenario. For example, a fixed-rate mortgage is expected to have more early repayments in low-interest-rate scenarios, while a fixed-term deposit will, on the other hand, have more early withdrawals in high-interest-rate scenarios. As regards caps and floors, the clearest example is the floors on variable-rate mortgages – if interest rates were to become negative, they would not reprice below the contractual floor.

Another example of non-linearity in the underlying portfolios is related to assumptions based on behavioural assumptions relating to current accounts: for example, the repricing speed of the interest-rate-sensitive portion (non-core NMDs) is expected to be higher in a high-interest-rate scenario than in a low-interest-rate one, and even in negative-interest-rate environments, this non-core part would not reprice since, at least in the case of retail deposits, entities do not pass on negative market rates to retail depositors.

These elements of non-linear repricing of balance sheet assets and liabilities mean that the actual interest rate risk (open interest rate risk position) cannot be represented simply by linear repricing flows in the base case scenario, as set out in the current RMA document (IASB, 2023. July Staff Paper 4c: 25). One alternative is to manage these exposures using interest rate options. When constructing benchmark derivatives that reflect the actual intended level of risk on the net exposure, it is important to avoid misrepresenting the risk. In this regard, the entity cannot consider either linearisation or the use of non-linear benchmark derivatives, as this would result in the double counting of non-linear effects (IASB, 2023, July Staff Paper 4c: 30).

These risk scenarios are not linear. Entities may manage them by estimating the expected cash flows arising from such clauses. The alternative is to manage them with options that enable the entity to manage these risks. When constructing its benchmark derivatives that reflect the intended level of risk on the net exposure, an entity cannot take into account both linearisation and the use of benchmark derivatives, as this would result in the non-linear effects being taken into account twice (IASB, 2023, July Staff Paper 4c: 30).

Normally, risk managers use linear derivatives, such as a plain vanilla interest rate swap as they are less complex and costly than non-linear derivatives (e.g., options). In such cases, entities aggregate the contractual cash flows of certain positions with the expected cash flows in the case of instruments with non-linear risk. In such cases, they choose to estimate the expected cash flows and and enter into derivatives accordingly.

However, some entities use non-linear derivatives, such as interest rate options, in situations where they wish to hedge non-linear risks. Thus, they avoid distortions arising from the linearisation of risks, which are based on expectations. This is the case for financial assets that pay a variable amount up to a cap, beyond which the payment becomes fixed, or where a fixed-rate financial asset allows for early repayment (IASB, 2023, July Staff Paper 4c: 12.b). The use of non-linear derivatives for speculative purposes would fall outside the scope of the RMA model.

A third approach would be to manage non-linear risks independently of the RMA model; in other words, to hedge those risks using derivatives according to the criteria set out in IFRS 9, and then to incorporate that hedged position into the RMA model, where it is recognised as part of the positions that are already hedged.

Like the general hedge accounting model, the RMA framework, does not restrict designated derivatives to one type or another, although the measurement of non-linear derivatives may be more complex (IASB, 2023, July Staff Paper 4c: 11).

7.3. Designation of existing derivatives

Derivatives already outstanding when the RMA model is implemented may be designated to hedge open interest rate positions. This is permitted under both IFRS 9 and IAS 39, provided that the eligibility requirements are met. The difficulty lies in how to treat the value of the derivative at the time of designation, which, in this case, is not zero. The conditions at the time the derivative was entered into may differ from those prevailing at the time the derivative was created.

For its part, the benchmark derivative is constructed on market terms at the time of initiation of the RMA model; its fair value is therefore zero. The difference between the value of the designated derivative and that of the benchmark could give rise to hedge ineffectiveness (IASB, 2023). July Staff Paper 4c: 47). The IASB technical staff consider that the off-market component recognised on initial recognition should not affect the risk mitigation adjustment. To this end, the entity must have appropriate procedures in place to monitor the differences between the designated derivative and prevailing market conditions at designation (IASB, 2023. July Staff Paper 4c: 58). For this reason, the IASB does not consider the designation of previously entered into derivatives to be common.

Derivatives designated at the time of contracting do not necessarily have to be on-market; this would be necessary if the interest rate on the hedged positions is not the current market rate at the time the decision to hedge is made. The IASB notes that designated derivatives may be contracted at off-market rates, but this is not the case for benchmark derivatives that represent the risk mitigation objective. One point of contention is that designated derivatives used to achieve the RMO must reflect the repricing characteristics of the underlying balance-sheet positions and do not have to match market rates: this will occur when hedging decisions are made after a delay. For example, a fixed-rate portfolio, originated when interest rates were low, where market rates subsequently rise and a hedge is put in place once rates have risen: the IRSs representing the hedged risk (the benchmark derivatives) carry fixed rates below prevailing market rates, and the designated derivatives (with a profile opposite to that of the benchmark derivatives) will also be off-market derivatives.

7.4. Early termination of designated derivatives

The entity may be required to terminate a designated derivative, either at the counterparty's request or because the entity decides to consolidate its derivatives positions, for example, by replacing multiple derivatives with a single contract. The termination of the derivative must be accompanied by the execution of a replacement derivative in order to meet the RMO. In such scenarios, the entity would leave the existing risk mitigation adjustment unchanged and recognise any resulting gains or losses in profit or loss. The replacement derivative would be entered into on market terms.

For example, an entity has entered into a swap under which it receives a variable rate and pays a fixed rate of 7 per cent; if this swap is subsequently terminated early and the prevailing fixed market rate is 5%, the entity would recognise the resulting loss immediately in the Statement of profit or loss. The derivative that would replace the previous one is contracted at a fixed rate of 5 per cent, so its fair value at initial recognition is zero (IASB, 2023, July Staff Paper 4c: 62-64).

8 Risk mitigation adjustment excess (reasonableness test)

The risk mitigation adjustment is a balance sheet item that must be assessed to see whether it will be realized in the future. This assessment requires demonstrating that the present value of the risk mitigation adjustment does not exceed the present value of the net exposure. As stated in paragraph 7.4.13, if the net exposure had been fully mitigated, the two amounts would match. The reason why a risk mitigation adjustment excess may arise is that unexpected changes occur in the underlying portfolios which have not been incorporated into the benchmark derivatives (paragraphs 7.4.11 and B7.4.19).

This reasonableness test, as referred to in paragraph BC.105, is conceptually similar to an impairment test for the risk mitigation adjustment item, as it assesses the recoverability of the risk mitigation adjustment (ISDA, 2025: 23). This line item represents the portion of the risk mitigation adjustment supported by the net exposure; that is, the extent to which the designated derivatives succeed in mitigating repricing risk in order to achieve the target profile. Any risk mitigation adjustment excess over the net exposure at the reporting date is recognised immediately in profit or loss.

The entity may use different approaches to measure the present value of the net exposure, provided that these are based on reasonable information that can be obtained without undue cost or effort (paragraph B7.4.21). The excess –recognised in profit or loss– of the present value of the risk mitigation adjustment over the present value of the net exposure will not be reversed in the future (paragraph 7.4.14). The IASB concludes that the reversal of an already recognised excess should not be permitted (due to the risk of earnings management and because it does not reflect the reinstatement of the original risk).

9 Conclusions

This document provides an overview of the objectives of the RMA model, the shortcomings within the current accounting framework that it aims to address, and the main observations arising at this stage of development of the proposal. In December 2025, the IASB issued the Exposure Draft, on which entities will conduct field tests to assess its performance. This document introduces the debate that has emerged around this project and prepares readers to undertake a critical analysis of the Exposure Draft.

The first point to be highlighted is that the accounting treatment of mitigating strategies for repricing risk in **net positions in the Banking Book cannot be addressed under the current hedge accounting provisions in the standards**. The main reason is that these are dynamic positions and therefore, it is not possible to enter into derivatives to hedge specific financial instruments. The strategy involves hedging a dynamic net exposure, which may vary over time, within defined risk limits.

For over a decade, the IASB has been working to address the management of this risk, which lies at the heart of retail banking operations. Developing an appropriate solution is challenging because the emergence of hedging inefficiencies can have a significant impact on the net interest income, on the Economic Value of Equity (EVE) and, consequently, on regulatory capital, which is subject to scrutiny by banking supervisors. The accounting treatment should be consistent with the economic rationale underpinning the hedging strategy and be acceptable to banking supervisors.

TThese challenges have led the IASB to make **the model optional** for entities, where entities wish to reflect the economic substance of their risk management activities.

The proposed model has a laudable objective; however, its current implementation must address the following challenges and issues:

- The **unit responsible for risk management** (entity or group) faces the following challenges, which must be addressed with an approach that takes into account the specific characteristics of each entity:
  - The risk limits for the trading desk may differ from those required for managing the Banking Book. In such situations, it may be difficult to demonstrate that interest rate risk has been effectively transferred to external counterparties.
  - When risk management is performed at the group level, the model must determine how this is reflected in the individual accounts of the various banking subsidiaries
- Entities typically set limits based on the following two metrics: the sensitivity of the short-term net interest margin to a defined magnitude of changes in interest rates for each currency and, similarly, the sensitivity of economic value.
- **Exclusion of equity**: the IASB has justified this decision on the grounds of a structural mismatch in notional values between assets and liabilities; however, as this item is widely incorporated into repricing risk management strategies, it remains a contentious issue.
- **Behavioural models**: these affect certain balance-sheet items the most complex issue being the modelling of current accounts (NMDs) and fixed-term loans subject to prepayment risk. There is heterogeneity in the deposit behavioural models developed by banks, which introduces **subjectivity** and may lead to hedge ineffectiveness.

- **Foreign currency exposure** has been addressed by permitting the inclusion of hedged positions within the underlying portfolios through instruments such as cross-currency swaps.
- The model stipulates that **only one benchmark rate may be designated as the hedged risk**, this means that there would be **as many RMA models as there are benchmark types**. In practice, risk management is performed using various benchmark indices, meaning that the model may not fully reflect entities' actual risk management practices.
- The treatment of **non-linear risks through options** has not yet been fully illustrated within the project. These non-linearities in the balance sheet positions that make up the net repricing risk exposure –through the representation of repricing flows in the base-case scenario– do not reflect the entity's actual risk exposure, as the repricing dates of the instruments differ depending on the interest rate scenario.
- One questionable aspect is that designated derivatives used to achieve the risk mitigation objective (RMO) must reflect the repricing characteristics of the underlying balance-sheet positions, without necessarily matching market rates. This may occur, for example, when the entity belatedly decides to hedge.
- **Reasonableness test**: Unexpected changes in net eexposure give rise to accounting outcomes that do not faithfully reflect the underlying economics, with unintended effects on regulatory capital levels.
- The treatment of the risk mitigation adjustment item as **an asset or liability is called into question as to whether it really is a right or an obligation**. It may be viewed as the valuation adjustment applied to a set of assets and liabilities that form a unit of account.
- The model should clarify how RMA operates when interest rate risk limits are not set by time bands but by overall limits on maximum economic value sensitivity and/or short-term net interest margin. In such cases, it would be useful to clarify how forward-looking analysis works, as well as explain the assessment of inefficiencies (over-hedging) when there is an unexpected change in the underlying positions being hedged.

Appendix A. Changes to terms

Previous term	**Term in the Exposure Draft**
Current Net Open Position	Net Repricing Risk Exposure
Dynamic Risk Management	Risk Mitigation Accounting
Risk Mitigation Intention	Risk Mitigation Objective
Target Profile	Risk Limits

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