ALMA & Building Societies Association Industry (BSA) Response to the IASB's Risk Mitigation Accounting (RMA) Consultation

1. Introduction

The members of the Asset & Liability Management Association (ALMA) and the Building Societies Association (BSA) welcome the opportunity to comment on the IASB's consultation proposing a new Risk Mitigation Accounting (RMA) model and support the IASB's high level objective of improving the alignment between accounting and risk management. Our members appreciate the opportunity to contribute to the discussion.

To gauge industry views on the proposed new RMA model, a survey of ALMA and BSA members was undertaken. 15 firms responded to the survey from a range of mid-tier to smaller institutions; including UK banks and building societies with >£20bn balance sheet, Small Domestic Deposit Takers (SDDTs), branches/subsidiaries of international banks and other Bank/Credit Institutions. The collective views of the respondents are represented in the response herein and reflects the views of both mid-tier and smaller banks and building societies, including those with simple balance sheets and more advanced ALM infrastructures.

By way of background, ALMA was formed in 1992 and is a trade association of asset & liability risk management practitioners in banks, building societies and other related companies, with over 120 member institutions in the UK, Ireland and internationally. ALMA's primary aims are to provide education and promote awareness and best practice in asset and liability risk management issues, through provision of courses, conferences, masterclasses and networking events.

The BSA represents all 42 UK building societies, including both mutual-owned banks, as well as 8 of the largest credit unions. Building societies and mutual-owned banks have total assets of almost £677 billion and together with their subsidiaries, hold residential mortgages of £493.4 billion, 29% of the total outstanding in the UK. They also hold £495.6 billion of retail deposits, accounting for 23% of all such deposits in the UK. Building societies and mutual-owned banks account for 47% of all cash ISA balances. With all of their headquarters outside London, building societies employ around 52,300 full and part-time staff. In addition to digital services, they operate through approximately 1,300 branches, holding a 35% share of branches across the UK.

Our detailed feedback follows, but in summary:

Survey respondents broadly welcome the IASB's intention to improve the alignment between accounting outcomes and interest rate risk management. However, while the conceptual direction is supported, respondents raise significant concerns about operational complexity, exclusion of equity, alignment with Economic Value of Equity (EVE)-based risk management, and the practicality of implementing cumulative "lower-of" testing and benchmark derivative adjustments.

Key themes from our survey of ALMA and BSA members include:

- **General support for the RMA objective**, but concerns that the model may not faithfully represent holistic ALM practices-particularly for institutions managing on a PV01/KRD basis.
- **Operational burden and system complexity**, especially around life-to-date benchmark derivatives and granular bucket-level testing.
- **Potential for artificial P&L volatility** driven by accounting mechanics rather than economic risk.
- **Strong reservations about withdrawing IAS 39**, with many respondents favouring a modernised IAS 39 macro-hedging model over the proposed RMA framework.
- **Need for flexibility**, including portfolio-level netting, recognition of equity in EVE-based management, and simplified interactions between micro and macro hedging.

Overall, respondents encourage the IASB to refine the RMA model to better reflect real-world ALM practices and to consider evolving IAS 39 rather than replacing it outright.

The survey of members undertaken focussed on a subset of the IASB consultation questions which are most pertinent from a Treasury and ALM perspective, with the relevant questions set out below in further detail. We hope that our response is helpful and we would be happy to engage further where additional information or input from our members would be helpful.

2. Overview of feedback on the Consultation Paper proposals

The key themes arising from the survey responses to selected questions from the Consultation are set out below.

Question 1: Objective and scope of risk mitigation accounting (Section 7.1).

The IASB proposes that:
(a) the objective of risk mitigation accounting be for financial statements to represent the economic effect of an entity's risk management activities if the entity manages repricing risk on a net basis.
(b) risk mitigation accounting be applied on a voluntary basis. However, an entity would be permitted to apply risk mitigation accounting if, and only if, the entity mitigates repricing risk on a net basis and the entity's business and risk management activities have the characteristics specified in paragraph 7.1.4.
(c) an entity be required to document formally how it will apply risk mitigation accounting.

Key themes from survey respondents:

While the majority of respondents (c. 85%) support the objective of aligning accounting with net repricing risk management, respondents noted the following;

- Concern that the model does **not faithfully represent EVE-based management**, particularly due to:
  - Exclusion of equity from eligible items.
  - NII-style bucket matching that does not reflect PV01/KRD-based risk management.
- Significant **operational complexity**, especially:
  - Continuous cumulative "lower-of" testing.
  - Requirement to "tweak" benchmark derivatives from inception.
- Some respondents believe **a modernised IAS 39** (e.g. allowing other financial instruments and exposures, including asset pipeline, equity instruments and free reserves to be included, along with improved NMD treatment) may achieve the same objectives with far less complexity, and significantly reduced cost burden of implementation and ongoing operation.

Question 2: Underlying portfolios (paragraphs 7.2.1–7.2.4)

The IASB proposes that risk mitigation accounting be applied based on underlying portfolios—that is, portfolios of financial instruments that expose an entity to repricing risk. The IASB proposes that financial instruments be eligible for inclusion in underlying portfolios only if they are:
(a) financial assets classified as subsequently measured at amortised cost or fair value through other comprehensive income (in accordance with paragraphs 4.1.2 or 4.1.2A of IFRS 9 Financial Instruments);
(b) financial liabilities classified as subsequently measured at amortised cost (in accordance with paragraph 4.2.1 of IFRS 9); or
(c) future transactions that could result in the recognition or derecognition of financial instruments specified in (a) or (b).

The IASB is also proposing that an entity apply risk mitigation accounting only to its exposure to repricing

risk that is not otherwise mitigated. However, if a financial instrument is designated as a hedged item for a risk other than repricing risk, the hedged exposure would be eligible for inclusion in underlying portfolios.

Key themes from survey respondents:

The majority (c. 70%) of respondents support the eligibility criteria but believe the framework must better reflect EVE-based management and simplify interactions with micro hedging, with respondents noting;

- Eligibility criteria (Amortised Cost (AC)/Fair Value through Other Comprehensive Income (FVOCI) assets, AC liabilities, future transactions) are broadly supported.
- Respondents highlight a **bias toward NII-focused modelling**, whereas many institutions manage interest rate risk on an EVE basis.
- Concern that the framework does not fully accommodate **holistic PV01/KRD-based management**.
  - Operational complexity in maintaining boundaries between Micro fair value hedges and Macro RMA portfolios.
- Clarification is required on the interaction between RMA and existing IFRS 9 micro-hedging arrangements, particularly for FVOCI liquid assets that form part of an entity's overall net repricing risk position. Respondents consider micro hedging under IFRS 9 to be an effective accounting solution for risk management activities of such assets.
- Where free reserves, equity and capital instruments form part of an entity's risk management framework, the accounting model should provide an operationally workable means of faithfully reflecting their economic effect.

Question 3: Determining Net Repricing Risk Exposure (paragraphs 7.2.5-7.2.10)

The IASB proposes that an entity determine the net repricing risk exposure by aggregating the repricing risk arising from underlying portfolios by repricing time bands based on expected repricing dates. The expected repricing date is the earlier of the dates on which financial instruments in the underlying portfolios are expected to be settled or to reprice.

The IASB also proposes that the entity determine the net repricing risk exposure in a manner that is consistent with how it makes risk management decisions, including with regard to:
(a) the basis on which the entity aggregates the repricing risk arising from underlying portfolios and determines the repricing time bands (based on expected repricing dates); and
(b) the measure the entity uses to quantify the repricing risk exposure in each repricing time band.

Key themes from survey respondents

The use of expected repricing dates and repricing time bands is broadly consistent with existing ALM approaches and is conceptually familiar to many institutions. However, respondents expressed significant concerns about whether the detailed mechanics of the proposed model faithfully reflect how interest rate risk is managed in practice and whether the operational burden is proportionate.

Respondents believe the measurement mechanics require significant simplification to avoid artificial volatility and operational burden, noting the following;

- Many institutions manage interest rate risk using EVE, PV01 or KRD sensitivities, rather than target positions within individual repricing buckets, The proposed framework remains bucket-based and may not adequately accommodate these approaches.
- Strong concerns about the **granular bucket-level "lower-of" test**, which:
  - Prevents natural offsets across the yield curve from being recognised.
  - Creates asymmetrical profit and loss volatility despite the overall portfolio remaining within approved risk appetite.

  - Introduces a potential “shape risk” penalty that is not reflective of underlying economic risk as changes in the distribution of exposures across repricing buckets may result in accounting volatility despite no material change in overall interest rate position.
  - Conflicts with KRD-based and other sensitivity-based risk management approaches.
- Risk that institutions will be forced to aggregate buckets artificially to avoid volatility-undermining the representation of actual risk management. Where accounting-driven losses reduce retained earnings, they could affect capital headroom even where the underlying economic position remains appropriately hedged.
- Path dependency and complexity introduced by life-to-date benchmark derivative adjustments.
- Concerns regarding the construction, maintenance and recalibration of benchmark derivatives, particularly within dynamic open portfolios. Life-to-date benchmark derivative adjustments introduce path dependency and may result in accounting outcomes that appear difficult to reconcile with the underlying economics of the risk management strategy.
- Respondents request comprehensive worked examples, including examples based on PV01/KRD risk management, showing how the net repricing risk exposure, benchmark derivatives and cumulative lower-of assessment evolve as instruments are added to, removed from, or reprice within an open portfolio.

Respondents also highlighted the potential implementation burden associated with data, systems, controls and governance.

Suggested improvement:

Respondents have suggested an improvement to the proposal to allow portfolio-level "lower-of" testing to enable natural netting across time bands and avoid artificial volatility arising from offsetting positions across the yield curve. Respondents also encourage the IASB to provide additional flexibility and worked examples for institutions managing risk primarily through EVE, PV01 and KRD frameworks.

Question 4: Designated Derivatives (Section 7.3)

The IASB proposes that only interest rate derivatives with a party external to the reporting entity that are used to mitigate the entity’s repricing risk in accordance with its risk management strategy be eligible to be included as designated derivatives.

Paragraphs BC70–BC77 of the Basis for Conclusions explain the IASB’s rationale for these proposals.

Key themes from survey respondents:

The majority of respondents (>90%) support the proposal but emphasise the need for proportionate operational requirements, with respondents noting;

- Strong support for limiting designated derivatives to **external interest rate derivatives**, which promotes transparency, auditability and a clear distinction between internal risk transfers and externally executed economic hedges.
- Concern that the operational requirements associated with designation, redesignation and documentation should remain proportionate and practical, particularly for institutions that actively rebalance hedge positions within open portfolios. A desire to ensure that accounting requirements do not discourage proactive balance sheet management or create unnecessary administrative barriers to routine hedging activity.

Some respondents requested additional clarification regarding the treatment of intragroup derivatives; and the application of the requirements within group structures, including interactions between parent entities and subsidiaries.

Question 5: Effective date and withdrawal of IAS 39 (Section C1 of Appendix C to IFRS 9)

The IASB proposes that an entity be permitted to apply the requirements for risk mitigation accounting from the beginning of the annual reporting period starting on or after [the date the requirements are issued]. The IASB also proposes that an entity discontinue applying the hedge accounting requirements in IAS 39 Financial Instruments: Recognition and Measurement at the earlier of:
(a) the date on which the entity first applies the requirements for risk mitigation accounting; and
(b) annual reporting periods beginning on or after [the date on which IAS 39 is withdrawn].

Key themes from survey respondents:

Respondents urge caution over the proposed withdrawal of IAS 39 and do not support its withdrawal until the RMA model has been demonstrated to be operationally workable and capable of faithfully representing risk management across a range of business models, with the following themes emerging from the survey;

- Many respondents believe **withdrawal is premature**, given:
  - RMA's complexity.
  - Uncertainty about its ability to represent EVE-based management.
  - Risk of increased accounting-driven P&L volatility.

IAS 39 is regarded as a **stable and workable framework**, particularly for smaller institutions, with strong support from respondents for retaining IAS 39 as an **optional alternative.** Respondents from smaller institutions are concerned that withdrawal of IAS 39 could have unintended consequences for smaller institutions and FRS 102 reporters that continue to rely on IAS 39 requirements for impairment recognition and measurement. For these smaller firms, it is not clear what additional value RMA and the withdrawal of IAS 39 represents and whether the model is proportionate to the problem it seeks to solve. Much of the benefit could be achieved through a more targeted enhancement to IAS 39, specifically permitting hedge accounting for mortgage pipeline exposures and associated hedging instruments.

Additionally, clarity is requested on how such entities would be expected to account for impairment following withdrawal of IAS 39 and whether consequential amendments to FRS 102 would be required.

Additional Comments

ALMA and BSA members made the following additional comments in respect of the proposed new model;

- RMA may represent a **"sub-optimal middle ground"** compared with a modernised IAS 39.
- Exclusion of equity and granular lower-of testing undermine faithful representation of actual risk management practices and economic risk position.
- Life-to-date benchmark derivatives introduce **path dependency** and require costly system synchronisation.
- Respondents question whether RMA provides **incremental benefit** over simply enhancing IAS 39 to allow modern NMD modelling.
- Strong recommendation to issue worked examples showing how RMA would work in practice, including example calculations and journals for the following:
  - The identification of a hedging relationship.
  - Monthly management of a portfolio through changing rate environments.
  - Positions being de-recognised for RMA.
- Strong recommendation to:
  - Allow **total-portfolio offsets**.
  - Expand clarification of RMA applicability to **PV01/KRD-based measurement**.
  - Reconsider withdrawal of IAS 39.

- Respondents question whether the benefits of the proposed RMA framework are sufficient to justify the substantial investment required in systems, data, controls, governance and ongoing operational processes. As such, we urge the IASB to carefully consider the proportionality of the proposals, particularly for smaller firms, where a modernised IAS 39 would seem to provide a more proportionate option.
- A minimum of three years transition period is requested following publication of final rules to allow necessary system requirement assessments, development and implementation, as well as data and process changes, impact assessment, parallel running, audit engagement, internal governance and end-to-end testing. Smaller firms may require a longer period because of their reliance on third-party systems and vendors, more limited specialist resources, and competing regulatory change programmes.
- In addition, an optional two-year parallel run period following the implementation date is requested. The proposed model represents a fundamental change to hedge accounting and will require significant changes to systems, processes, controls, documentation and governance. A parallel run period would reduce implementation risk, allow firms to evidence that the new framework is operating as intended over a number of reporting cycles, and support more consistent application across the sector.

Conclusion

While survey respondents support the IASB's high level objective of improving the alignment between accounting and risk management; the current RMA proposals may not faithfully represent actual risk management practices and risk creating accounting-driven volatility, whilst introducing significant complexity and ongoing cost burden that do not outweigh the incremental benefits over existing IAS 39 requirements.

Respondents recommend that the IASB:

1. **Refine RMA to better reflect holistic, sensitivity-based risk management.**
2. **Simplify measurement mechanics**, particularly the cumulative lower-of test.
3. **Allow portfolio-level netting** across repricing buckets.
4. **Retain IAS 39** as an optional alternative, during an extended transition period.
5. **Consider evolving IAS 39** rather than replacing it outright.
6. Issue worked examples showing how Risk Mitigation Accounting would work in practice.
7. Provide a minimum three-year implementation period following publication of the final requirements.

ALMA and the BSA are supportive of further engagement should that be valuable to the IASB and can be contacted on liaison@ukalma.org.uk.