ISDA | Safe, Efficient Markets

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Basel Committee on Banking Supervision
Bank of International Settlements
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Basel
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Dear members of the Audit and Accounting Experts Group,

Prudential Regulatory Capital considerations with respect to the IFRS Accounting Exposure Draft, Risk Mitigation Accounting, Proposed amendments to IFRS 9 and IFRS 7

In December 2025 the IASB published the IFRS Accounting Exposure Draft, Risk Mitigation Accounting ("the RMA ED")[1]. The IASB also issued a Request for Fieldwork[2], in which respondents are asked to test the proposals in the RMA ED and provide feedback to the IASB on its effects. The International Swaps and Derivatives Association ("ISDA")[3], European and APAC RMA Accounting Working Groups are presently assessing the RMA ED and will provide their formal feedback in response to the IASB request before the comment period ends on 30 November 2026. Some of ISDA's members are also currently performing the fieldwork and will provide their feedback directly to the IASB. The purpose of this letter is to seek guidance from the BCBS on the likely prudential regulatory treatment of the elements proposed in the RMA ED and to share ISDA's members' preliminary views on the topic.

The IFRS Foundation has been copied on this letter in recognition that the principle of cooperation between the BCBS and the IFRS Foundation is well established. As the Risk Mitigation Accounting (RMA) proposals continue to develop, ISDA believes it is important that this cooperation continues.

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[1] Exposure Draft *Risk Mitigation Accounting—Proposed amendments to IFRS 9 and IFRS 7*

[2] Request for fieldwork on the proposed risk mitigation accounting model

[3] Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 1,000 member institutions from 79 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's website: www.isda.org. Follow us on LinkedIn and YouTube.

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ISDA's members, in considering the potential effects of the RMA ED, have identified the prudential regulatory capital implications as an area of importance. The application of the proposed model would result in the recognition on the statement of financial position, of the risk mitigation adjustment, as defined in paragraph 7.4.8 of the ED. This would be a single unit of account for each instance of the RMA model. Under the current prudential regulatory requirements as applied in many national jurisdictions, and under the existing guidance in IAS 39 and IFRS 9, when a fair value hedge ("FVH") designation is applied, if the equivalent of the risk mitigation adjustment (i.e. the FVH model adjustment on the hedge items) is an asset it would generally be subject to a regulatory capital charge by its inclusion in the calculation of Risk Weighted Assets ("RWAs"). Conversely, in the case of a cash flow hedge ("CFH") designation, no impact on Own Funds would arise, even though the hedging derivative is of the same nature. The risk mitigation adjustment is conceptually consistent with existing hedge accounting mechanisms and does not create additional prudential risk. From a prudential perspective, the risk mitigation adjustment should follow the prudential treatment of the underlying exposures as is the case today, for the two reasons set out below.

1. *The risk mitigation adjustment is neither an asset nor a liability under the IFRS Conceptual Framework for Financial Reporting (the "Conceptual Framework")*

The RMA ED describes that the recognition and measurement of the risk mitigation adjustment is based on the extent to which the gains or losses on the derivatives entered into by the entity to manage repricing risk, have been deferred to future periods[4]. The deferral is over the mitigated time horizon in which the repricing differences arising from the financial instruments in the entity's underlying portfolios, affect profit or loss. In the Basis for Conclusions of the RMA ED[5], the IASB explains that, with respect to the asset or liability that is recognized to represent the risk mitigation adjustment, no rights or obligations would be associated with it beyond the rights or obligations already accounted for through the underlying portfolios and the designated derivatives. As such, the IASB describes that recognition of the risk mitigation adjustment as a credit or debit on the statement of financial position is not consistent with the definition of an asset or a liability in the IFRS Conceptual Framework. The risk mitigation adjustment does not represent any new lending activity or deposit activity and does not represent any change in hedging activity. It does result in the recognition of some new elements of economic value that the IFRS framework would not otherwise permit, e.g., in relation to demand deposits and pipeline transactions. It is the deferral of unrealised income and cost from derivative contracts as they relate to underlying exposures, which are already subject to regulatory rules and guidance.

We note that the risk mitigation adjustment results from the comparison of the cumulative changes in fair value of the designated and benchmark derivatives, to quantify any ineffectiveness representing an unrealised adjustment to future NII. Any ineffectiveness (over hedge) or misalignment P&L arising from the operation of the RMA model is taken

[4] RMA ED, paragraph B7.4.15

[5] RMA ED, Basis for Conclusions, paragraph BC90.

immediately to P&L and therefore directly impacts CET1. Only the part which is considered an 'effective' hedge of repricing risk represents the future adjustment to NII attributable to risk mitigation activities. The purpose of the prudential framework as it relates to RWAs, is to ensure that banks hold enough capital to absorb unexpected losses to prevent insolvency and ensure financial stability. The balance sheet representation of the risk mitigation adjustment can be considered free of risk, similar to if there is no credit or default risk. Consistent with this, ISDA's members consider that the risk mitigation adjustment should have no incremental effect on current regulatory requirements, including the calculation of RWAs, leverage ratios, LCR or NSFR.

It should also be noted that the RMA model is specifically designed to reflect balance sheet risk management activities addressing banking book's interest rate risk. Such positions are already subject to the dedicated Interest Rate Risk in the Banking Book (IRRBB) supervisory framework and Pillar 2 assessment process and are not captured through specific Pillar 1 market risk requirements. Prudential treatment of the accounting adjustment should therefore remain consistent with the existing regulatory framework applicable to banking book's interest rate risk management activities.

Any incremental effect on RWAs from applying the RMA model would represent a second-order consequence of the accounting representation rather than a reflection of changes in the underlying economic risk profile. Depending on market conditions and portfolio composition, such effects could be positive or negative. Moreover, because the RMA model is designed to align the timing of recognition of gains and losses associated with economically hedged positions, the framework is expected to remain broadly neutral from a profit and loss perspective, apart from temporary accounting movements inherent in the mechanics of the RMA model. Consequently, additional prudential requirements are not necessary.

2. *A strong conceptual continuity with existing IAS 39 hedge accounting models*

It is the IASB's intention that once the proposals in the RMA ED are finalized and incorporated into IFRS 9 and IFRS 7, the remaining elements of IAS 39 *Financial Instruments: Recognition and Measurement*, which relate to hedge accounting shall be withdrawn.[6] As a result, entities that currently apply the IAS 39 macro CFH and / or the IAS 39 portfolio fair value hedge (FVH) model will need to transition to IFRS 9 and apply the macro CFH model under IFRS 9 or the RMA model as necessary.

At inception, the risk mitigation adjustment is conceptually very similar to the mechanics already embedded in existing IAS 39 hedge accounting models. In particular, the *building blocks* (benchmark derivatives and risk mitigation adjustment) of the RMA model perform a role that is economically comparable to the hypothetical derivatives used in CFH accounting, namely to defer gains and losses arising from risk mitigation activities and align their recognition with the periods in which the hedged repricing risk affects profit or loss. The principal difference to the RMA model is one of presentation. Under current CFH accounting, the cumulative effects of gains or losses from hedging derivatives, as reflected

[6] RMA ED, paragraph C1.17

in the macro CFH reserve, are filtered out of common equity tier one ("CET1") and therefore do not affect regulatory capital. The CFH reserve only impacts CET1 as its effects materialize on the statement of financial position and the income statement. CET1 represents the highest-quality capital and reflects funds that are available to absorb actual, realised losses as they arise. Temporary gains or losses arising from CFH activities do not indicate the bank's current loss-absorbing capacity so by filtering out the reserve from CET1, the temporary swings from the CFH that flow through OCI are neutralised. We suggest that a similar treatment should apply for the risk mitigation adjustment by allowing full recognition in P&L and therefore CET 1 of gains and losses arising from the risk mitigation adjustment. This has the effect of neutralising the effect on CET1 of gains and losses from the designated derivatives to the extent they mitigate repricing risk arising from the net repricing risk exposure.

We also note that if incremental RWAs were to apply to the risk mitigation adjustment, it would be a disincentive to apply the RMA model when other portfolio hedge accounting approaches, such as the macro CFH under IFRS 9 do not attract RWAs.

Suggestion to publish a frequently asked question and response

We recognize that ensuring appropriate prudential regulatory requirements for the risk mitigation adjustment is key as described above. We note that prior to IFRS 16, *Leases* taking effect, in April 2017 the BIS published a press release responding to frequently asked questions ("FAQs") on the changes to lease accounting.[7] The press release described how the Right of Use ("ROU") asset should not be deducted from regulatory capital, should be included in risk-based capital and leverage denominators and its risk weighting. This provided clarity to preparers and national regulators on the regulatory capital implications of the new accounting. We suggest that, once the RMA has been finalized (assuming is finalized as proposed for the aspects addressed in this paper), and prior to taking effect, the BIS should publish a similar FAQs document to provide guidance to preparers and national regulators. The question would be how the risk mitigation adjustment should be considered for the purpose of calculating an entity's RWAs and its effect on CET1 resources. We suggest that the risk mitigation adjustment should not be regarded as a new standalone asset or liability requiring separate prudential treatment. Instead, it constitutes an evolution under IFRS 9 of hedge accounting mechanisms already embedded in IAS 39, including CFH accounting and portfolio FVH accounting. Although the accounting representation differs, the underlying economic substance and risk profile remain unchanged, such that no additional prudential risk is created.

We recognize that it will only be possible to issue a FAQ once the RMA model has been published in final form and its effective date is set. However, whilst our members are assessing the model and it continues to develop, an indication of the regulator's likely position, perhaps through a draft FAQ or similar, would assist our members in assessing the potential impact of the RMA model.

[7] Bank for International Settlements, Press release: Frequently asked questions on changes to lease accounting, April 2017

We would be pleased to further support and share our members' insights with the Basel Committee on Banking Supervision as the work progresses to understand and develop the RMA model. If helpful, we would be happy to discuss in further detail the points raised above.

Should you have any questions or would like clarification on any of the matters raised in this letter please do not hesitate to contact the undersigned.

Yours sincerely,

Antonio Corbi
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International Swaps and Derivatives Association, Inc. (ISDA)