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Date: 21 October 2026

Dear UKEB Secretariat

Call for Comments on the UKEB's Draft Comment Letter on the IASB's Exposure Draft *Risk Mitigation Accounting–Proposed amendments to IFRS 9 and IFRS 7*

We appreciate the opportunity to comment on the Draft Comment Letter (DCL) on the IASB's Exposure Draft *Risk Mitigation Accounting–Proposed amendments to IFRS 9 and IFRS 7*.

In the UK, Forvis Mazars LLP has approximately 170 partners and over 3,250 employees, and is ranked one of the top 10 firms nationally. Forvis Mazars Group SC is an independent member of Forvis Mazars Global, a leading professional services network. Operating as an internationally integrated partnership in over 100 countries and territories, Forvis Mazars Group specialises in audit, tax and advisory services. The partnership draws on the expertise and cultural understanding of over 35,000 professionals across the globe to assist clients of all sizes at every stage in their development.

Forvis Mazars Group is preparing a separate response to the IASB on the proposals and the analysis is in progress. Consequently, the observations contained in this submission may not necessarily reflect the final views in our response to the IASB. We have provided the comments below to assist the UKEB in its deliberations. Where we have not responded to a specific question raised by the UKEB, we have no further observations to share.

Objective of risk mitigation accounting (Questions 1-4)

We concur with the objective of developing an accounting model that is rooted in, and reflects, the management of interest rate risk. Preparers, regulators and, in some cases, users of financial statements commonly assess the effectiveness of interest rate risk mitigation activities using metrics such as Net Interest Income Sensitivity (NII), Economic Value of Equity (EVE) and Present Value of One Basis Point (PV01). By contrast, the proposed Risk Mitigation Accounting model seeks to reflect in the financial statements the economic effects of managing repricing risk on a net basis. While the concepts are related, they are not identical. Risk management metrics are designed to assess the success of a risk management strategy, whereas the proposed accounting model seeks to reflect the economic consequences of that strategy. We recognise the challenge of the IASB to develop a model that provides an adequate link between risk management and financial reporting, while remaining operationally practicable and cost-effective to apply.

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Therefore, notwithstanding the concerns raised elsewhere in this response, we believe that, with targeted refinements, the proposed model has the potential to provide a more faithful representation of the economic effects of dynamic interest rate risk management activities than what is achievable under the current requirements of IAS 39. The proposed model provides a clearer link between interest rate risk mitigation activities and accounting outcome, which we consider to be a positive development.

Scope and Entities that issue insurance contracts as defined in IFRS 17 Insurance *Contracts* (Questions 5 and 31)

The proposals have been developed primarily with the interest rate risk management activities of banks in mind and focus on the management of repricing risk arising within the banking book. We would recommend the IASB to explores whether the proposals can be adopted cost-effectively by smaller banks and building societies.

We also believe the model has the potential to be applied more broadly by entities that employ similar risk mitigation strategies to banks, even where their primary objective is not the management of net interest income. Insurers manage interest rate risk arising from insurance contract liabilities and the assets held to meet those liabilities. Their interest rate risk management activities are typically focused on financial assets held to support the capital an insurer is required to hold under the Solvency II (Solvency Capital Requirement). Insurers have, for some time, expressed concerns that neither the hedge accounting requirements in IAS 39 nor those in IFRS 9 provide satisfactory accounting models for reflecting their interest rate risk management activities in the financial statements. We are therefore supportive of the IASB's efforts to explore whether a solution based on the principles of the proposed Risk Mitigation Accounting model could provide a faithful representation of insurers' risk management activities.

Level of application and Designated derivatives (Questions 6, 11 and 12)

Under the proposals, risk mitigation accounting should be applied at the level at which the entity manages and mitigates repricing risk. We agree that in principle this should result in a faithful reflection of actual risk management activities. However, certain aspects of the proposed model, particularly the restriction on intragroup items, may limit the extent to which this objective can be achieved.

Proposed paragraph 7.3.4 prohibits the inclusion of internal derivatives as designated derivatives. Nevertheless, they can be an important element of interest rate risk management in groups, and their exclusion could limit the faithful representation of risk management practices. Where the effect of internal derivatives is combined at group level and their net effect externalised, it should be possible to include internal derivatives as designated derivatives at the level where the repricing risk is mitigated.

Underlying portfolios (Questions 7 to 9)

We support the objective that the accounting model should be aligned as closely as possible with an entity's risk management activities. On that basis, the model should be designed to facilitate close alignment between the composition of the underlying portfolios and the positions that are included in interest rate risk management. In particular, the model should allow for the inclusion of intragroup receivables and payables as mentioned above. In addition, we do not believe eligibility for inclusion in the underlying portfolios should be driven by the accounting designation or measurement basis of the individual instruments. To the extent that an item contributes to repricing risk that is actively managed, it should be considered for inclusion. We therefore support the inclusion of financial instruments measured at fair through other comprehensive income.

In the proposals the IASB has rejected equity as an eligible item for inclusion in the underlying portfolio. In our view this should not restrict entities that use equity modelling or structural hedges to include equity funding when determining the net repricing risk exposure (NRRE).

Determining the net repricing risk exposure (Question 10)

In our view the way the proposed model determines net repricing risk exposure (NRRE) is flexible enough and allows for common approaches to be used that measure exposure to interest rate repricing risk. Each of these approaches considers behavioural assumptions and repricing dates. Where the proposed model is possibly too restrictive is the allocation of a risk mitigation objective and benchmark derivatives to each time band.

Risk mitigation objective (Question 13)

The risk mitigation objective (RMO) is an accounting construct and not a feature of risk management practices. Any restrictions imposed through the RMO are therefore likely to create tensions between the accounting requirements and risk management. We highlighted above that imposing an RMO per time band could be too restrictive to reflect risk management practices.

In addition, we note that risk mitigation is performed within approved risk limits and if within these limits, hedging is considered to be effective from management's perspective. The RMO on the other hand is a specified risk mitigation target, which ultimately is the basis for determining how much of the fair value movements on the designated derivatives is deferred in the risk management adjustment (RMA). When over-hedging is acceptable within risk limits, there is a disconnect between risk management and accounting. The IASB could explore whether it is possible to introduce more flexibility whilst preserving accounting discipline and consistency of application in the model.

Benchmark derivatives (Question 14)

We principally agree with the proposals on the construction of the benchmark derivatives. We outlined above our reservation regarding the strict allocation of benchmark derivatives to repricing bands aligned with the RMO. In addition, clarification would be welcome when designated derivatives include non-linear derivatives such as options and the implications this has on the construction of benchmark derivatives. We suggest that the requirement for benchmark derivatives to have an initial zero fair value is refined for transition to avoid unintended consequences.

Risk mitigation adjustment (Questions 15 to 19)

The UKEB is seeking views regarding the effect on the risk adjustment (RMA), if financial instruments measured at fair value through other comprehensive income were permitted to be included in the underlying portfolio. We are supportive of financial instruments measured at fair value through other comprehensive income to be included in the underlying portfolio of financial instruments and for these instruments an adjustment to other comprehensive income instead of to the RMA would remove volatility in equity. However, it would need to be assessed whether a reasonable allocation method could be developed considering that the risk mitigation activities cover a portfolio of assets and liabilities.

The IASB proposes the excess test as a backstop mechanism intended to ensure that the risk mitigation adjustment (RMA) does not exceed an amount that is supportable by the future profit or loss effects of the repricing differences represented by the net repricing risk exposure. Whilst we acknowledge concerns regarding the potential for unintended consequences of the excess as designed by the IASB, the model provides limited alternative anchor points against which the supportability of the RMA can be assessed. If all unexpected changes could be fully reflected in benchmark derivatives, the excess test would become unnecessary. The introduction of the excess test implies that the IASB considers perfect alignment between benchmark derivatives and the risk mitigation objective (RMO) unlikely to be achievable in all circumstances. Although the RMO could be a potential alternative reference point for an excess test, given that it is based on the net repricing risk exposure (NRRE), it is not evident that an assessment based on the RMO would be less susceptible to the unintended consequences of an assessment based on the NRRE. Indeed, to the extent that the NRRE would be expected to be broader than the RMO, it is unlikely to be an alternative solution to address the concern. How the excess test could be refined is not immediately clear, but reliance on just the benchmark derivatives may not be a suitable alternative.

Withdrawal of IAS 39 (Questions 22 and 23)

We support the withdrawal of IAS 39 once the proposals have been finalised.

We suggest that the IASB considers transitional reliefs for entities that will adopt the hedge accounting requirements in IFRS 9 when IAS 39 is withdrawn.

We have the "Your Details" questionnaire attached in the Appendix to this letter. If you would find it helpful to discuss any of our observations further, please contact Catriona Lawrie under the contact details stated in this letter.

Yours faithfully,

Forvis Mazars LLP