



Risk Units (RUs) and Tokenized Risk Units (TRUs)

Accounting Treatment Proposal

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Alignment with Key IFRS Standards (IFRS 8, IFRS 9, IAS 37)

IFRS 8 (Operating Segments): Under IFRS 8, RUs can be integrated into segment reporting as a way to disclose non-financial risk exposures by business segment. Companies would attribute **inherent** and **residual RUs** to the specific operating segments that generate those risks (e.g. operational risks to a production unit, cyber risk to IT). Segment reports would then show each segment’s inherent risk (before mitigation) and residual risk (after mitigation) alongside the **Risk Mitigation Index (RMI)**, which quantifies mitigation effectiveness.

Critically, management could translate residual RUs into expected loss provisions per segment (monetary values) and disclose these as part of segment results. This aligns with IFRS 8’s goal of giving insight into how management internally monitors risk and performance.

By reporting RUs at segment level, firms achieve **granular transparency** on risk and mitigation efforts for stakeholders, aiding comparability of risk-adjusted performance across segments.

IFRS 9 (Financial Instruments): RUs can also be aligned with IFRS 9 principles by treating them akin to expected credit losses – effectively expected losses from non-financial risks.

IFRS 9 emphasizes a **forward-looking** approach to loss provisioning, so firms would use historical loss data, current risk conditions, and forward-looking factors (like projected effectiveness of controls) to estimate expected losses for each RU exposure. In practice, residual RUs (post-mitigation risk) are **monetized as expected losses** over a given time horizon. These expected loss values would be **recorded as provisions** in the financial statements, much like credit loss provisions, if the criteria for recognition are met.

One approach is to map RUs to a **three-stage model** similar to credit loss staging: minimal risk RUs in “Stage 1,” higher-risk RUs in “Stage 2,” and RUs with evidence of significant impending loss in “Stage 3,” with increasing levels of provision recognized for each. IFRS 9’s fair value and measurement guidance would also apply to any instruments arising from RUs (like TRUs), ensuring **fair value adjustments** are made using observable inputs where possible and reflecting forward-looking information.

This IFRS 9 alignment means RUs are incorporated into a firm’s financials as **risk-based provisions** on a timely basis, accompanied by disclosures of assumptions, valuation methods, and sensitivity analyses showing how changes in risk metrics (e.g. RMI or risk levels) would affect those provisions. The result is more **forward-looking, risk-sensitive financial reporting** that anticipates losses from operational and other non-financial risks.

IAS 37 (Provisions, Contingent Liabilities, Contingent Assets): Under IAS 37, residual RUs can form the basis for recognizing provisions if they represent a **present obligation** from a past event, with probable outflows that can be reliably estimated.

In risk accounting terms, once an organization has incurred activities giving rise to certain non-financial risks (past event) and expects it will likely incur losses (outflows) that can be estimated via RUs, it may recognize a provision for those **expected losses**.

The residual RUs (after mitigation) provide a measurable estimate of the loss amount, satisfying IAS 37’s “reliable estimate” criterion.

For example, if after all risk mitigations a company still carries an expected \$2 million operational loss exposure (based on RUs), it could record a provision of \$2 million under IAS 37.

These RU-based provisions are measured at the **best estimate** of the expenditure required – often using stochastic models on historical and current data to quantify the risk, and discounting to present value if the payout of losses is expected over future periods.

If certain risk exposures don't meet the "probable" threshold, they wouldn't be recognized as liabilities but could be disclosed as **contingent liabilities** (indicating the potential risk in the notes). IAS 37 alignment thus anchors RUs to traditional accounting for losses: **probable losses become balance sheet provisions, and less-certain risks are transparently disclosed**. Extensive note disclosures would accompany any RU-based provisions, detailing the nature of the risk, timing of potential outflows, and key assumptions (e.g. how RUs were derived via modeling).

Classification of RUs in Financial Statements

Depending on the approach above, RUs might appear in financial statements in different ways:

- **As Provisions/Liabilities:** If adopting an IAS 37 or IFRS 9 approach, residual RUs would be converted into a monetary **expected loss provision** on the balance sheet.

For instance, a pool of RUs might be shown as "Provision for operational risk losses" under non-current liabilities, representing the risk-adjusted expected cost of those risks.

These provisions directly impact profit (through a provision expense) when initially recognized or adjusted, thereby bringing non-financial risk costs into the income statement proactively rather than waiting for losses to occur.

- **As Risk-Adjusted Performance Metrics:** Under an IFRS 8 segment reporting lens, RUs might not create a separate line item on the face of financial statements but instead be included in segment disclosures and used in internal performance metrics.

Management could present **risk-adjusted profit** for each segment (segment profit minus expected risk cost in RUs) as a non-GAAP measure in MD&A or segment note.

While not an IFRS-mandated measure, this would illustrate how each segment's performance is viewed after accounting for its risk exposure. IFRS 8 allows inclusion of such internally used metrics; for example, a segment report might show Segment A's operating profit alongside the RU-based provision allocated to that segment, and perhaps a "risk-adjusted profit" number after deducting that provision.

- **As Contingent Risk Disclosures:** Where risks are identified but not accrued (perhaps because they're not deemed "probable" yet), RUs can still be disclosed in the notes similarly to contingent liabilities.

An entity might describe its major non-financial risk exposures in qualitative terms and add that it has quantified those exposures as, say, 500,000 RUs (equating to an estimated \$5 million potential loss) for a given segment or risk type, even if no provision is recorded.

This would enhance transparency by quantifying exposures that traditionally might only be described qualitatively.

Impact on Financial Reporting and Risk Disclosures

Implementing RUs in financial reporting frameworks greatly enhances **transparency and comparability** of risk information, but also requires careful management of disclosures:

- Under **IFRS 8**, incorporating RUs means financial reports will show how risk is distributed across the company's segments and how effective mitigation efforts are over time.

This can improve stakeholder understanding of where the company's risk hotspots are and how they trend (e.g. seeing residual RUs drop as a segment improves controls). It essentially adds a new dimension to segment reporting – not just revenues and profits by segment, but risk-adjusted context for those profits.

The impact is more robust MD&A and segment notes, with tables of inherent vs residual RUs and discussions of risk mitigation initiatives. Companies would also need to explain their **methodologies** (e.g. how RUs are calculated, what an RMI score means) to give investors confidence in these new metrics.

- With **IFRS 9/ECL-style provisioning**, the financial statements themselves begin to reflect non-financial risks through earlier recognition of expenses.

This can affect profit volatility – initially recording an expected loss provision will reduce current earnings, but possibly make future earnings less volatile by absorbing losses in advance. It also aligns with regulatory trends toward **forward-looking risk recognition** (similar to loan loss provisioning reforms).

Disclosures would need to include the basis for these provisions, changes in estimates, and sensitivity to risk assumptions, akin to credit risk disclosures.

Firms would likely include non-financial risk factors in their financial risk management notes (e.g. describing how operational risk provisions are set) to comply with risk disclosure requirements.

- Following **IAS 37**, the presence of RU-based provisions and contingent liabilities in the notes makes the financial statements more **risk-sensitive**.

Stakeholders will see not only realized losses but also management's best estimate of future losses from current operations. This improves completeness of the balance sheet (no large unrecognized exposures) and ensures compliance with the letter of IAS 37 in recognizing obligations that are probable and estimable.

Risk disclosures under IAS 37 alignment would detail each major provision for non-financial risk (similar to how companies disclose provisions for legal or environmental liabilities today), including uncertainties around those amounts.

This could overlap with Enterprise Risk Management reports, bringing some ERM information into the audited financials.

Overall, integrating RUs leads to more **comprehensive risk disclosure** in financial reporting. It bridges the gap between traditional financial

statements and risk management by quantifying exposures that were previously off-book.

The trade-off is that it introduces estimation uncertainty and judgment (models, assumptions about risk) into the financials, which accountants must govern carefully to ensure reliability.

Tokenized Risk Units (TRUs) in Financial Statements

Tokenized Risk Units (TRUs) are digital financial instruments representing residual RUs – essentially allowing portions of risk exposures to be **tokenized and traded**.

Accounting for TRUs involves multiple perspectives, as different parties (issuer, buyers, traders) will treat these instruments differently on their books.

A core feature of TRUs is that they are traded in a **controlled environment** with mechanisms to limit speculation (e.g. price bands and scheduled repurchase by the issuer), influencing their accounting treatment and valuation.

Issuer's Perspective (Accounting for TRU Issuance)

When an organization issues TRUs, it effectively **transfers some of its risk exposure to investors** in exchange for upfront funding. From the issuer's standpoint, TRUs create an obligation similar to a debt or provision:

- **Recognition as Liabilities/Provisions:** The issuer incurs a contractual duty to **repurchase or redeem** the TRUs in the future under specified conditions (often at preset dates and prices).

This obligation would be recorded as a liability on the issuer's balance sheet. Depending on interpretation, it could be treated as a financial liability under IFRS 9 or as a provision under IAS 37 – in practice, the issuer might classify it as a form of **deferred risk mitigation obligation**.

In alignment with IAS 37, one can view the issued TRUs as a present obligation to mitigate risk (the funds raised must eventually be repaid or used to cover losses), which warrants recognition of a provision for the expected repurchase amount.

In IFRS 9 terms, the TRU is a **financial instrument** the company has issued, so it could be initially recognized at fair value (the proceeds received) and subsequently measured at amortized cost or fair value through profit or loss, depending on the terms.

Notably, the **measurement is constrained** by the TRU's unique design – since the issuer will repurchase at a known price or within a narrow range, the liability's value will track that predetermined outcome rather than free-floating market prices.

- **Presentation and Segment Reporting:** Issuers would likely attribute TRU activity to the segments where the underlying risk resides. For example, if Segment A tokenizes \$3 million of residual risk into TRUs, the liability for TRU repurchase and the cash raised would be linked to Segment A in internal reporting.

IFRS 8 segment disclosures could highlight how much capital was raised via TRUs for each segment's risks and how those funds are allocated to risk mitigation projects. This enhances transparency by showing that the

segment not only has a certain risk exposure in RUs, but also how it's being funded or hedged via TRUs.

- **Use of Proceeds and Risk Mitigation:** From an accounting standpoint, the cash received from issuing TRUs increases the issuer's assets (cash) and is earmarked for investing in risk controls or insurance – which might be expensed or capitalized depending on the nature of those investments.

There is also an off-setting liability to repurchase the TRUs in the future. As time passes or as risk conditions change, the issuer might adjust the carrying value of the TRU liability.

If the TRUs were issued at, say, \$10 per unit and the issuer committed to repurchase at \$11 after a year, the liability could accrue that cost (similar to accruing interest or premium).

Any **fair value adjustments** due to trading (if, for instance, TRUs trade at a slight premium or discount in the interim within allowed limits) would also be reflected in the liability's carrying amount. In effect, the issuer's profit and loss may recognize financing costs on the TRUs (like the 5% premium paid to holders) as they accrue, and potentially minor gains or losses if the liability is revalued with changes in estimated repurchase cash flows or timing.

- **Disclosure:** Issuers will provide footnote disclosures explaining their **TRU programs** – including the total RUs tokenized, terms of the tokens (maturity, repurchase price or range, any conditions), and how the raised funds are utilized for risk reduction.

They would also disclose the effect on their risk profile (e.g. "By issuing TRUs, the company has transferred \$X of operational risk to external investors") and any contingent features (for instance, if repurchase is contingent on the risk outcome or always required). This informs readers about the interplay of risk management and finances.

Initial Buyer's Perspective (Investor who buys TRUs at issuance)

The initial buyer of a TRU is effectively providing capital to the issuer to cover a risk exposure, in return for a potential profit (a premium or interest) and return of principal via repurchase. For the buyer, a TRU is an **asset** – likely a financial asset akin to a bond or risk participation note:

- **Recognition as an Asset:** On purchase, the buyer would record the TRUs at cost (which presumably equals fair value at issuance, e.g. paying \$10 per TRU). The classification under IFRS 9 depends on the buyer's business model and the cash flow characteristics.

TRUs typically have contractual cash flows consisting of the eventual repurchase by the issuer (plus maybe periodic premiums or interest), which could qualify as *solely payments of principal and interest* in form.

If the buyer's intent is to hold the TRU to maturity (to collect the fixed premium and repurchase value), the asset could be classified at **amortized cost**, recognizing interest income over time.

In contrast, if the buyer might sell the TRU before maturity, they might classify it as **fair value through profit or loss (FVTPL)** or possibly fair value through OCI, meaning they will mark it to market each period. In either case, **valuation** will consider the controlled trading environment of TRUs – since prices can only fluctuate within a narrow band tied to residual risk, buyers

will rely on observable inputs like the nominal RU value and remaining time to repurchase to estimate fair value.

- **Subsequent Measurement & Income Recognition:** If held at amortized cost, the buyer would accrete the purchase price to the expected repurchase amount, recognizing the difference as interest income over the holding period.

For example, if a TRU was bought at \$10 and will be repurchased at \$10.50 in one year, the buyer records ~\$0.50 as interest income over the year (which is the profit incentive for taking on the risk exposure).

If instead the TRU is measured at fair value, and if any changes in fair value occur (say the TRU trades up to \$10.20 due to slightly reduced risk or time passage), the buyer would record an unrealized gain in profit or OCI, as appropriate.

Given the **limited volatility by design**, these fair value changes should be relatively small and mainly time-dependent (approaching the repurchase value as the date nears).

The buyer must also consider credit risk of the issuer – though TRUs are tied to risk outcomes, the buyer's ability to get repaid depends on the issuer's solvency, so expected credit loss provisioning may be needed if there's any doubt about the issuer honoring repurchase (this would be similar to holding a corporate bond and following IFRS 9 ECL requirements).

- **Valuation Considerations:** The initial buyer will note that TRUs have a **capped upside** (you cannot sell a TRU for far above its eventual repurchase value due to the trading rules) and a relatively predictable value path. Fair value at any time might be computed by discounting the guaranteed repurchase amount (plus any interim premiums) back to present using a market rate.

Any deviations (like trading a bit below that value if someone sells early at a discount) represent an opportunity or a minor loss. IFRS 13 fair value hierarchy likely places TRUs in Level 2 or 3 depending on the availability of market prices.

Since trading is in a specialized exchange, initial buyers might rely on the issuer's published pricing formula or recent trade data to mark their holdings.

IFRS 7/IFRS 9 disclosures for the buyer would include information on these risk transfer instruments as part of their financial assets, including sensitivity if the risk outcomes could affect the cash flows (if applicable).

Subsequent Buyers (Secondary Market Trading)

TRUs are transferable, so after issuance, they may trade among investors on authorized exchanges. **Subsequent buyers** (any party buying a TRU on the secondary market) will account for the TRU similarly to the initial buyer – it's a financial asset investment. However, there are a few points to note:

- **Trade Accounting:** When a TRU is sold from one holder to another, the seller will derecognize the asset and recognize any gain or loss (difference between carrying value and sale price).

The buyer will recognize the TRU at the purchase price (fair value on the trade date). Because TRUs trade within a controlled price range, these gains/losses are typically small unless the seller had initially carried the TRU at a significantly different value.

For instance, an investor who bought at \$10 and sells at \$10.30 before maturity would realize a \$0.30 gain (minus any accrued interest portion) in their profit.

The new buyer who pays \$10.30 will then earn the remaining premium up to the final repurchase (e.g. if repurchase is \$10.50, they'll earn \$0.20 over the remaining term).

- **Fair Value Updates:** Subsequent buyers might be more likely to classify TRUs as **FVTPL** if they intend to trade them again before maturity. In that case, at each reporting date, they mark the TRU to the current market price (or model price, given the constraints).

IFRS 9's fair value guidance would apply – for example, the TRU's fair value would factor in the issuer's promised repurchase price, time to maturity, and any updated information on the underlying risk (if risk has significantly decreased, perhaps the TRU might consistently trade at the upper end of the allowed range).

Notably, **trading dynamics are constrained** by design: algorithms and smart contracts enforce predefined **price ceilings and floors** tied to the underlying risk metrics.

This means secondary market prices largely move in a narrow corridor, simplifying fair value estimation. Any observed price will usually be within a few percentage points of the nominal value, reducing valuation uncertainty.

- **Accounting for Premium/Loss:** If a subsequent buyer purchases at a premium (above the original issue price) because perhaps the risk improved, that premium effectively reduces the yield they will get (since repurchase by issuer is fixed).

Conversely, buying at a discount could increase yield. These economics would be handled through the effective interest method if at amortized cost, or through recognition of fair value gain if the risk subsequently reverts.

Secondary transactions also indicate **market sentiment about risk** – if TRUs regularly trade at a discount, it might signal higher perceived risk or liquidity preference, which accountants might need to consider for impairment or disclosure.

Trader's Perspective (Frequent Trading and Market Making)

In the TRU ecosystem, "traders" or market participants (which could include dedicated market makers or even other issuers as arbitrageurs) might actively buy and sell TRUs to earn profits from short-term price differences. From an accounting perspective, a trader would treat TRUs as **trading inventory or financial assets held for trading**:

- **Inventory/Trading Asset:** A trader (e.g. a broker-dealer or a hedge fund) would likely classify TRUs as **financial assets at fair value through profit or loss**, meaning every change in price is immediately recognized in P&L. They would record TRU positions at purchase cost and revalue to market price each day.

Given the **controlled price range** of TRUs, the trader's potential profit comes from capturing small spreads or arbitraging slight price differences between buyers and sellers.

Even though price swings are limited, traders can still benefit from timing differences – for example, buying a TRU at the low end of its allowed range and selling at the high end could yield a quick, modest gain.

These gains are recognized in profit as trading income. The **liquidity** of the TRU market may be relatively low (since these are not freely floating instruments), so traders likely operate on thin margins.

- **Profit Recognition:** The profit incentive in trading TRUs is intentionally capped. The TRU platform might allow, say, a 5–15% maximum price appreciation over the issue price, aligned with the premium structure for holding to maturity.

Therefore, a trader's upside on any trade is constrained. For accounting, this means large fair value jumps are unlikely; instead, profits are incremental.

Traders will realize profits when they sell TRUs at a higher price than bought, or even via the automatic repurchase if they happen to hold some TRUs to a repurchase date.

All such results flow through the income statement. If traders also incur transaction costs or fees on the exchange, those would reduce their net trading income.

- **Risk Management on Books:** Interestingly, an **operating company could itself act as a TRU trader** for risk management purposes – for instance, Company A might buy TRUs issued by Company B if the price is attractive, instead of issuing its own TRUs, thus covering its risk exposure and possibly earning a small return.

In doing so, Company A would record an asset (TRUs of B) and could offset its own risk provision. This gets into advanced usage, but generally, any trader (whether a financial intermediary or a company) must track TRU holdings at fair value and disclose them appropriately.

They would also be mindful of the fact that TRU trading is not meant for pure speculative profit – the **market discipline mechanisms** (such as automatic issuer repurchase at predefined prices) mean that extreme gains or losses are improbable. Traders essentially earn the **time value of money, and a liquidity spread**, rather than speculation-driven windfalls.

Profit Incentive vs. Lack of Speculation in TRU Trading Models

The TRU framework is deliberately designed to **balance investor incentives with market stability**. Unlike typical financial instruments that might fluctuate significantly with supply and demand, TRUs have features to **prevent excessive speculation**:

- **Built-in Profit Incentive:** Investors in TRUs are enticed by a steady, bond-like return rather than speculative price jumps. For example, an issuer may offer a fixed premium (say 5% per annum) to TRU holders, paid via an assured increase in repurchase price each year. This gives a clear expected return for

holding the TRU to maturity (e.g. buy at \$10, get \$10 + interest back), creating a profit motive similar to interest income.

There's also some flexibility: an investor can choose to sell early on a secondary market to lock in a smaller gain if they don't want to wait the full term. The **trading platform's algorithms** might facilitate such early exits by allowing sales at a slight discount to the pro-rata repurchase value, so that the seller forgoes part of the premium to the buyer who takes over the position.

In all cases, the profits are relatively predictable and linked to the passage of time and persistence of the underlying risk.

- **Limited Speculation Incentive:** To avoid turning TRUs into a risky trading game, the model imposes **strict price range controls**. Smart contracts and exchange rules ensure that TRUs trade only within a narrow band around their nominal value, tied to the **remaining expected loss and time to maturity**.

For instance, if a TRU was issued at \$10 with an expected repurchase at \$11 after 3 years, the market might only allow it to trade between, say, \$10 and \$11 (or a slightly expanded range like \$10.5 to \$11.5 as seen in pilot examples). This cap means no matter how much investors might want to speculate; the price cannot skyrocket beyond the predefined margin.

The **highest possible price** is effectively the assured repurchase price by the issuer, which puts a ceiling on gains. Likewise, a floor is set by the intrinsic value of the expected loss coverage (investors wouldn't sell far below nominal value unless the issuer's credit is in question, and even then, mechanisms might prevent fire sales).

The absence of big price swings dissuades speculators who seek quick profits from volatility.

- **Stability Mechanisms:** The trading algorithms may automatically adjust prices based on updated risk data (e.g., if the underlying risk decreases thanks to successful mitigation, the system might nudge the TRU price upward within the allowed range).

They also enforce that any sale offers must be within a small percentage of the last price. This automation creates **predictable pricing** that mirrors the diminishing risk over time, rather than market hype. As a result, participants in the TRU market are motivated by the yield and risk-sharing benefits, not by flipping tokens in a volatile market.

The model thus **encourages long-term holding** (to earn the premiums) and **discourages pure speculation**, aligning the trading activity with the real economic goal of funding risk mitigation.

For accounting purposes, this means fewer surprises – fair values of TRUs for balance sheet reporting remain stable and closely tied to fundamental values, and profit recognition for traders/investors is more about steady accruals than volatile mark-to-market swings.

It also simplifies justifying valuations to auditors/regulators since the range of possible values is constrained by the design (reducing subjectivity in fair value estimates).

Challenges and Benefits of Different Accounting Treatments

Comparison of Approaches and Regulatory Implications

Various accounting treatments for RUs and TRUs each have pros and cons, and choosing among them can have regulatory and financial reporting implications:

- **IFRS 8 (Disclosure-Focused) Approach:** Here, RUs are primarily used in **segment disclosures** rather than as recognized amounts on the balance sheet. The benefit is clarity at a granular level – stakeholders see which units of the business carry more risk and how management addresses it.

It's also relatively easy to implement since it leverages internal risk reports without drastically changing recognition or measurement in primary financials. However, the limitation is that it **does not put the risk exposures on the face of financial statements**.

From a regulatory perspective, this approach might be seen as insufficient for prudential purposes: regulators could worry that merely disclosing RUs (without recognizing provisions) leaves a gap in the accounts (risks are identified but not reserved against).

IFRS 8 alignment alone might satisfy investors' demand for transparency but not go far enough for those who want to see a financial **buffer** for those risks.

It also relies on management's internal metrics – raising comparability issues across firms (one company's RU calculation might differ from another's).

- **IFRS 9 (Financial Instrument/Expected Loss) Approach:** This treatment effectively brings non-financial risks into the **realm of financial instrument accounting**, creating a more standardized recognition of expected losses.

The clear advantage is **proactive loss recognition** – much like credit losses are booked in advance, operational and other risks would have upfront provisions, which can lead to more **conservative and timely loss absorption**. This improves the alignment of risk management with accounting; a bank, for instance, could extend its well-understood credit risk models to operational risk.

A challenge, however, is the **complexity of modeling** and the need for robust risk quantification techniques (stochastic modeling, scenario analysis) to justify the provisions. Not all companies have the data or expertise to do this reliably, and there's a danger of over or under-estimation.

There's also a conceptual leap in applying IFRS 9 (which traditionally deals with financial assets/liabilities and credit risk) to things like operational risk – standard-setters and auditors would need to be convinced this is appropriate.

In terms of regulatory implications, if such provisions are recorded, regulators (like banking supervisors) might allow them to count towards risk buffers, which could be beneficial for compliance. Yet, there might be concern about **model risk** – if every firm uses its own models to book “expected operational losses,” consistency and comparability might suffer without a standard method (hence the interest in RASB standards).

- **IAS 37 (Provision/Contingency) Approach:** Aligning with IAS 37 keeps the accounting grounded in existing rules for provisions. The benefit is that it

ensures rigor – only recording liabilities when there’s a present obligation and probable outflows, which avoids overstatement of risk on the balance sheet. It also emphasizes detailed disclosures for any **contingent liabilities**, so nothing falls through the cracks; users will know what risks are not yet provided for and why.

This approach could be seen as more acceptable to auditors since it sticks closely to an existing IFRS framework (less radical than repurposing IFRS 9).

The challenge, however, is that many non-financial risks might not meet the “present obligation” criterion until a loss event actually occurs (e.g. the mere possibility of a cyber breach isn’t a present obligation in IAS 37 terms).

This could mean RUs fail to be recognized as liabilities in many cases, reverting to just disclosure – potentially undercutting the whole purpose of risk accounting.

Additionally, there’s interpretative flexibility: would issuing TRUs constitute a present obligation to repay (yes, contractually) and/or an obligation to mitigate risk? Likely yes, which is why TRUs can be seen as provisions for risk mitigation commitments.

But absent TRUs, just having an internal risk metric might not justify a provision until management actually commits resources to address it. Regulators might appreciate the **discipline** of IAS 37 (no booking of phantom liabilities), but could also worry that it **delays loss recognition** for smoldering risks.

- **Hybrid or New Framework:** In practice, companies might use a combination – disclose segment RUs (IFRS 8), and where appropriate, recognize provisions (IAS 37) or financial liabilities (IFRS 9) especially when they issue TRUs.

This combined approach could maximize transparency and accountability. However, until formal guidance is developed, there’s a risk of **inconsistent application**.

Regulators and standard-setters may need to issue interpretations or new standards (through something like the RASB or eventually the IASB) to codify how “risk units” should be handled so that all companies follow similar rules.

Regulatory implications revolve around how these approaches affect the **true and fair view** of financial statements and the adequacy of risk buffers. If RUs and TRUs become common, regulators would likely set expectations on methodology (to prevent firms from understating risk or creating misleadingly smooth earnings by tweaking risk models).

They might also see TRUs as a form of **risk transfer or financing** that should be treated carefully (for instance, ensuring that if a bank offloads risk via TRUs, it actually reduces required regulatory capital, but only if the risk truly is transferred to investors and not just circularly funded).

Additionally, because TRUs involve external investors, securities regulators would be interested in their proper disclosure as a new type of instrument and ensuring that trading remains within the intended non-speculative bounds (perhaps requiring exchange monitoring).

Valuation, Transparency, and Stability Challenges

- **Valuation Challenges:** RUs themselves are an invented unit based on models – determining the “monetary value” of an RU requires robust risk quantification. Firms face challenges in developing **stochastic models** that convincingly translate operational risk exposure into expected loss estimates.

The assumptions about frequency and severity of risk events, correlations, and effectiveness of controls (RMI) can vary widely and are often hard to verify until after losses occur. This introduces model risk and estimation uncertainty into financial reporting.

Auditors will challenge whether the RU valuation is “reliable” – especially for new risk types with little historical data. For TRUs, while their market price is constrained, **illiquidity** could be an issue: if few trades occur, determining fair value may rely on theoretical pricing (Level 3 inputs) or the issuer’s own pricing algorithm, which could be seen as biased.

Furthermore, if an issuer’s credit risk changes significantly (e.g., the company itself is in financial trouble), TRU values might fall outside the usual band (investors may discount the promised repurchase). This scenario complicates valuation because one must consider both the underlying risk unit and the issuer’s credit – essentially a hybrid risk.

- **Transparency and Disclosure Challenges:** Introducing RUs and TRUs requires comprehensive disclosures to avoid confusing users. There is a risk of **information overload** – detailed notes on risk methodologies, segment risk tables, reconciliations of RU movements, etc., could be hard for analysts to digest or compare.

Ensuring **clarity** in explaining what RUs represent (expected loss, worst-case loss, some percentile?) is essential so that investors interpret them correctly.

Also, companies might be hesitant to disclose certain risk exposures (for competitive or security reasons, e.g. detailing cyber risk metrics). Striking a balance between transparency and not giving away sensitive info is tricky.

From an audit/regulatory standpoint, transparency in the models and assumptions is crucial – black-box risk numbers could undermine confidence, so likely there will be pressure to standardize definitions and maybe have external validation of risk models (perhaps a role for the Risk Accounting Standards Board to set common standards).

- **Financial Stability Considerations:** In theory, widespread use of RUs and TRUs could enhance stability by ensuring companies **recognize and fund risk** before crises occur. For example, if every bank held provisions or issued TRUs for its major operational risks, unexpected losses (like a big fraud or systems failure) would be buffered by those provisions or covered by external capital from TRU investors, reducing the chance of insolvency.
- However, one challenge is **correlation** – if many firms face similar risks (say a regulatory change or a cyber threat), their RU models might all blow up at once, and if they all issued TRUs, the investors in those TRUs could suffer widespread losses or withdraw funding simultaneously.

This means that while each firm is safer, the system as a whole might concentrate risk with the TRU investors (who could be banks, funds, etc., potentially feeding back into systemic risk if not diversified). Additionally,

TRUs being a new financial instrument raises the question of who bears the ultimate risk – if a risk event happens, does the issuer use the TRU funds to cover it (and thus perhaps not repay investors fully)? Or does the issuer repay investors regardless, effectively meaning the firm still bears the risk?

The model presented suggests issuers *will* repurchase at fixed prices, so it's more like debt; in that case the firm still bears the underlying risk (investors just provided financing).

To truly transfer risk, one might design TRUs such that if losses occur, the payout to investors is reduced (like an insurance contract or catastrophe bond). If that element is introduced, accounting gets even more complex (and might invoke IFRS 17 for insurance contracts).

Therefore, defining whether TRUs are **risk transfer or just risk financing** is a key challenge. Regulators will want to ensure that if companies treat risk as “transferred,” the risk is genuinely taken on by someone else in economic terms.

Benefits of TRUs and Risk Accounting Innovations

Despite the challenges, adopting RUs and TRUs in accounting could yield significant benefits:

- **Improved Risk Transfer and Sharing:** TRUs create a mechanism for companies to **share risk with investors** outside the traditional insurance market.

This can be beneficial for risks that are hard to insure or quantify. Investors get a new asset class with modest, steady returns, and companies get to offload some risk pressure.

Over time, this could lead to a more diverse risk financing ecosystem, where operational and other non-financial risks are partly borne by capital market participants rather than solely by the firm or its insurers.

This spreading of risk can enhance overall economic stability, as losses (if they occur) are absorbed by a wider base.

- **Enhanced Funding for Risk Mitigation:** By tokenizing risk, firms raise dedicated funds to invest in safety, compliance, cybersecurity, etc. – essentially **turning risk reduction into a funded activity**. Instead of risk management being seen only as a cost center, it's paired with a financing strategy (the TRU proceeds).

This could encourage companies to proactively address risks (since they have earmarked funds from TRUs to do so) and provide stakeholders assurance that resources are allocated to keep residual risk in check.

In addition, smaller companies or entities with significant risk exposure could access financing specifically tied to their risk profile, potentially at lower cost than traditional debt if investors take comfort in the transparent risk metrics.

- **Greater Transparency and Market Discipline:** When risk is quantified and reported regularly, and when investors are literally invested in a company's risk management performance (via holding TRUs), there is an inherent discipline imposed on the company.

It must maintain and improve its **Risk Mitigation Index (RMI)** to reduce residual RUs, which in turn could improve its ability to issue TRUs at good prices or reduce the cost of repurchasing them.

This dynamic incentivizes continuous improvement in risk controls. For stakeholders, the company's financial reports become more **informative**, shedding light on areas like operational resilience and ESG risks in concrete terms.

Over time, if risk accounting is standardized, markets could start pricing companies (equity or debt) not just on earnings but also on risk exposure efficiency – e.g., two banks with the same profit, but one has far lower residual RUs, might be seen as the safer bet.

This could **reward prudent risk management** with a lower cost of capital.

- **Alignment with Regulatory Goals:** Regulators (especially in banking and finance) have been seeking ways to ensure non-financial risks are managed as rigorously as financial risks.

Approaches like RUs and TRUs provide tools to do exactly that – measure, report, and buffer these risks. If implemented well, firms could face fewer nasty surprises, leading to more **stable financial performance**.

The controlled nature of TRU trading also means we're not introducing a highly volatile element into markets; instead, it's a carefully calibrated instrument.

For the economy, broader adoption of such practices could mean fewer systemic shocks from operational risk events (since those would have been anticipated and provisioned).

- **Innovation and Competitive Advantage:** Early adopters of risk accounting and TRUs might enjoy a reputational boost as being innovative and transparent.

They could potentially attract investment from stakeholders who value sustainability and risk management (since these metrics could dovetail with ESG reporting, showing how a company quantifies and addresses things like environmental or social risks).

Moreover, the data gathered through RU frameworks can feed back into better management decisions, possibly reducing losses in the long run and improving efficiency.

In closing, the accounting treatment of RUs and TRUs sits at the frontier of integrating risk management with financial reporting. Professional accountants need to weigh these approaches, ensuring compliance with IFRS (IFRS 8 for reporting by segment, IFRS 9 for expected loss modeling, IAS 37 for prudent provision accounting) while also seizing the opportunity to enhance risk transparency.

A balanced, well-regulated implementation can strengthen both corporate reporting and actual risk management – giving investors and regulators a clearer window into the risks companies bear and how they plan to handle them.

The path is not without challenges in valuation and standardization, but the potential payoff is a more resilient enterprise and financial system, where risk is accounted for in every sense of the word.