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Interest Rate Benchmark Reform

International Accounting Standards Board
7 Westferry Circus, Canary Wharf
London E14 4HD
United Kingdom

[XX Month 2019]

Dear Mr Hoogervorst,

Re: IASB ED/2019/1 *Interest Rate Benchmark Reform* (Proposed amendments to IFRS 9 and IAS 39)

On behalf of the European Financial Reporting Advisory Group (EFRAG), I am writing to comment on the Exposure draft ED/2019/1 *Interest Rate Benchmark Reform* (Proposed amendments to IFRS 9 and IAS 39), issued by the IASB on 3 May 2019 (the 'Amendments').

This letter is intended to contribute to the IASB's due process and does not necessarily indicate the conclusions that would be reached by EFRAG in its capacity as advisor to the European Commission on endorsement of definitive IFRS Standards in the European Union and European Economic Area.

EFRAG considers the IASB proposals to be an appropriate solution in addressing the inability to meet specific forward-looking hedge accounting requirements due to uncertainty that exists around the transition of interbank offered rates (IBORs) in the periods before the transition. EFRAG supports the proposals for providing relief on hedge accounting requirements in these periods until the uncertainty ceases to exist regarding how the reform of IBOR rates will affect the cash flows of the hedged item and of hedging instrument because the details of the replacement of interest rate benchmarks are unknown.

EFRAG considers that this first phase is to a large extent appropriately handling the uncertainty with regards to specific accounting aspects prior to the IBOR transition (pre-replacement issues) and therefore focuses on those hedge accounting requirements only. EFRAG supports this approach and considers appropriate that accounting issues that arise subsequently to the IBOR transition are to be handled in the second phase (replacement issues).

EFRAG disagrees however with not providing a relief for the retrospective assessment under IAS 39 and the impossibility to retrospectively apply the reliefs to discontinued hedges in this first phase.

Hence, EFRAG recommends that the IASB consider the application of retrospective assessments in accordance with IAS 39 *Financial Instruments: Recognition and Measurement* in the first phase of the project. EFRAG considers that addressing retrospective assessments is necessary to determine how much of the value difference

between the hedged item and the hedging instrument is to be assigned to either other comprehensive income or profit or loss (both during the relief and when the relief ends).

Provided that the effects of any ineffectiveness are recognised in profit or loss according to the prevailing market conditions at the end of the relief, the effective share of the OCI reserve should follow the hedge accounting treatment under an assumption of continuity of the hedge. As a result, EFRAG suggests the IASB to extend the relief to the retrospective assessments of hedge ineffectiveness under IAS 39 resulting from the temporary failure to meet hedge effectiveness criteria as a result of interest rate benchmark reform.

Further, in EFRAG's view, retrospective reinstatement of previously discontinued hedges should be allowed if these hedges failed the hedging requirements only because the proposed reliefs were not (yet) available. We also note that the portfolio fair value hedge for interest rate risk represents a specific case of dealing with (de)designations. Continuous designations and de-designations are inherent in this approach. EFRAG suggests the IASB to clarify how the proposed reliefs can be applied in this case.

EFRAG finds the objective of the disclosures as currently proposed lacking explicit justification and proposes the IASB to clarify it. In the absence of such a clear objective EFRAG finds it difficult to justify why separate disclosures are required. As part of phase II, EFRAG further suggests the IASB to open a dialogue with users as soon as possible in order to define their information needs in relation to the impacts of the reform.

EFRAG is aware that the interest rate benchmark reform creates more accounting issues than the ones addressed in the Amendments. Considering the current speed of the regulatory developments and the corresponding moves in the markets to amend contracts in preparation for these changes, EFRAG is of the view that this second phase should be addressed as soon as possible and in parallel to the finalisation of the first phase, without hindering bringing relief for the issues already addressed in the first phase.

EFRAG notes that the transition paths of different IBORs are far from identical: while some rates are being replaced by alternative benchmarks, others are not replaced but undergo an evolution of underlying methodology. EFRAG is of the view that the IASB should consider the different patterns that the reform will have when assessing the replacement issues.

In this respect, EFRAG has summarised the transition patterns for the main benchmarks affecting jurisdictions in the European Economic Area, i.e. EURIBOR, EONIA and Sterling LIBOR in Appendix II of this letter as a working hypothesis.

In addition, to proactively assist the IASB in the preparation of next phase, EFRAG has identified in Appendix II a number of topics that could potentially be addressed in the second phase. In this regard, it is noted that several IFRS Standards refer to discount rates or interest rates being used. While not all of these interest rates are short-term IBOR rates, EFRAG proposes the IASB to address all potential impacts of the IBOR reform across the different standards during the second phase.

EFRAG's detailed comments and responses to the questions in the ED are set out in Appendix I.

If you would like to discuss our comments further, please do not hesitate to contact Didier Andries, Galina Borisova or me.

Yours sincerely,

Jean-Paul Gauzès
President of the EFRAG Board

Appendix I - EFRAG's responses to the questions raised in the ED

Question 1 [paragraphs 6.8.4–6.8.6 of IFRS 9 and paragraphs 102D–102F of IAS 39]

Highly probable requirement and prospective assessments

- 1 For hedges of interest rate risk that are affected by interest rate benchmark reform, the IASB proposes amendments to IFRS 9 and IAS 39 as described below.
 - (a) For the reasons set out in paragraphs BC8–BC15, the IASB proposes exceptions for determining whether a forecast transaction is highly probable or whether it is no longer expected to occur. Specifically, the Exposure Draft proposes that an entity would apply those requirements assuming that the interest rate benchmark on which the hedged cash flows are based will not be altered as a result of interest rate benchmark reform.
 - (b) For the reasons set out in paragraphs BC16–BC23, the IASB proposes exceptions to the hedge accounting requirements in IFRS 9 and IAS 39 so that an entity would assume that the interest rate benchmark on which the hedged cash flows are based, and/or the interest rate benchmark on which the cash flows of the hedging instruments are based, will not be altered as a result of interest rate benchmark reform when the entity determines whether:
 - (i) there is an economic relationship between the hedged item and the hedging instrument applying IFRS 9; or
 - (ii) the hedge is expected to be highly effective in achieving offsetting applying IAS 39.
- 2 Do you agree with these proposals? Why or why not? If you agree with only parts of the proposals, please specify what you agree and disagree with. If you disagree with the proposals, please explain what you propose instead and why.

EFRAG's response

~~EFRAG agrees that the relief from the uncertainties arising from the interest rate benchmark reform should be provided for highly probable requirement and prospective assessments required by IFRS 9 and IAS 39.~~

EFRAG's response

EFRAG agrees that the relief from the uncertainties arising from the interest rate benchmark reform should be provided for highly probable requirement and prospective assessments required by IFRS 9 and IAS 39. Also, EFRAG proposes that the retrospective assessments are being treated as a pre-replacement issue. Further, the IASB is to clarify how the reliefs can be applied when being applied to the portfolio fair value hedge of interest rate risk.

- 3 EFRAG supports the overall approach as, without the proposed relief, significant failures in hedge accounting could occur. The resulting one-off impacts on the financial statements are likely to be ignored by analysts as not providing useful information.

Highly probable requirement

- 4 EFRAG considers that discontinuation of hedging relationships solely due to the uncertainties regarding the timing and the amount of cash flows arising from the reform of interest rate benchmarks will not provide useful information to the users of financial statements.
- 5 The relief from highly probable requirement will allow entities to continue hedge accounting, as it permits an entity to temporarily ignore the interest rate benchmark reform effects when assessing the probability of future cash flows.
- 6 In EFRAG's view this approach is needed in order to avoid discontinuation of hedging relationships that would otherwise meet the hedge accounting requirements. The IASB's proposal solely covers the uncertainty about timing and amount of cash flows due to the IBOR reform. EFRAG supports the IASB's proposal for temporary relief from the highly probable requirement.
- 7 EFRAG notes that the portfolio fair value hedge for interest rate risk represents a specific case. Continuous designations and de-designations are inherent in this approach. EFRAG suggests the IASB to clarify how the proposed reliefs can be applied in this particular situation.

Prospective assessments

- 78 As stated in paragraph 4, EFRAG considers that the discontinuation of existing hedging relationships solely due to the uncertainty about the impact of IBOR reform on cash flows of the hedged item and hedging instruments would not result in useful information. EFRAG acknowledges the importance of providing the relief from prospective assessments of the hedge effectiveness required by IFRS 9 and IAS 39 as it ensures the continuation of hedging relationships.
- 89 Therefore, EFRAG supports the relief from prospective assessments, as long as uncertainties from the interest rate benchmark reform exist, as proposed by the IASB.
- 910 EFRAG agrees with the reasoning of the IASB set forth in paragraph BC22 of the Amendments. The relief refers solely to the uncertainties arising from interest rate reform and the requirements of IFRS 9 and IAS 39 on prospective assessment should continue to apply, including the measurement of hedge effectiveness.
- 11 The IASB decided not to propose any exception for the effects of the IBOR reform on 'retrospective assessments' required by IAS 39 because these assessments are based on the actual results of the hedging relationship and hence there is no uncertainty relating to them. However, EFRAG is of the view that the retrospective assessments have to be considered for the following reason. In order to determine how much of the value difference between the hedged item and the hedging instrument is to be assigned to either other comprehensive income or profit or loss, there is a need to rely also on the retrospective assessment. This need does not only occur at the end of the relief but is continuous over the different reporting periods (knowing that the relief can last for several reporting periods) and will already be required at the 2019 year-end.
- 1012 Provided that the effects of any ineffectiveness are recognised in profit or loss according to the prevailing market conditions at the end of the relief, the effective share of the OCI reserve should follow the hedge accounting treatment under an assumption of continuity of the hedge (i.e. amounts will be reversed when the hedged transaction occurs in future periods).
- 13 As a result, EFRAG considers that the retrospective assessments are to be treated as a pre-replacement issue (phase 1).

Question 2 [paragraph 6.8.7 of IFRS 9 and paragraph 102G of IAS 39]

Designating a component of an item as the hedged item

[4414](#) For the reasons set out in paragraphs BC24-BC27, the IASB proposes amendments to the hedge accounting requirements in IFRS 9 and IAS 39 for hedges of the benchmark component of interest rate risk that is not contractually specified and that are affected by interest rate benchmark reform. Specifically, for such hedges, the Exposure Draft proposes that an entity applies the requirement – that the designated risk component or designated portion be separately identifiable – only at the inception of the hedging relationship.

[4215](#) Do you agree with this proposal? Why or why not? If you disagree with the proposals, please explain what you propose instead and why.

EFRAG's response

EFRAG agrees that the hedged risk component or risk portion should only be separately identifiable at inception of the hedging relationship.

[4316](#) EFRAG supports the overall aim of the Amendments, i.e. to avoid accounting consequences caused by the transition from existing IBORs to risk-free rates that would not result in useful information.

[4417](#) Until uncertainty regarding the timing and amount of future cash flows of the hedged items and the hedging instruments ceases to exist, such uncertainty should not create volatility in financial reporting due to the discontinuation of hedging relationships that would otherwise meet the hedge accounting requirements.

[4518](#) Therefore, it is important that entities are able to conclude that the interest rate benchmarks, if they are not contractually specified, are still separately identifiable and reliably measurable for the hedging purposes as it allows the entities to continue hedge accounting. Making this assessment only once, at the inception of the hedging relationship, will achieve this objective.

[4619](#) Hence, EFRAG agrees that paragraphs 81 and AG99F of IAS 39 shall apply at inception of the hedging relationship, for a hedge of a benchmark portion of interest rate risk that is affected by interest rate benchmark reform.

[4720](#) EFRAG recommends that the final Amendments clarify that, where relevant, the reliefs are applicable to new hedging relationships, without removing the exception in paragraph BC27 of the Amendments.

Question 3 [paragraphs 6.8.8 – 6.8.10 of IFRS 9 and paragraphs 102H – 102J of IAS 39]

Mandatory application and end of application

[4821](#) For the reasons set out in paragraphs BC28 – BC31, the IASB proposes that the exceptions are mandatory. As a result, entities would be required to apply the proposed exceptions to all hedging relationships that are affected by interest rate benchmark reform.

[4922](#) For the reasons set out in paragraphs BC32 – BC42, the IASB proposes that the exceptions would apply for a limited period. Specifically, an entity would prospectively cease to apply the proposed amendments at the earlier of:

- (a) When the uncertainty arising from interest rate benchmark reform is no longer present with respect to the timing and the amount of the interest rate benchmark-based cash flows; and

- (b) When the hedging relationship is discontinued, or if paragraph 6.8.9 of IFRS 9 or paragraph 102I of IAS 39 applies, when the entire amount accumulated in the cash flow hedge reserve with respect to that hedging relationship is reclassified to profit or loss.

[2023](#) For the reasons set out in paragraph BC43, the IASB is not proposing an end of application in relation to the separate identification requirement.

[2424](#) Do you agree with these proposals? Why or why not? If you agree with only parts of the proposals, please specify what you agree and disagree with. If you disagree with the proposals, please explain what you propose instead and why.

EFRAG's response

EFRAG agrees with mandatory application of the Amendments to all hedge accounting relationships as this avoids the potential for selective application of hedge accounting requirements. EFRAG also agrees with the temporary nature of the relief as the relief is not needed once the uncertainties about the reform have been lifted. Finally, EFRAG agrees with not proposing an end of application in relation to the separately identifiable requirement as this would be inconsistent with the aim of the relief provided.

[2225](#) EFRAG agrees with mandatory application of the Amendments to all existing hedge accounting relationships. This is because voluntary application may lead to earnings management by way of selective discontinuation of existing hedge accounted relationships and selective reclassification of existing OCI balances.

[2326](#) EFRAG also agrees with the temporary nature of the relief and the conditions set in determining the end of the relief. The temporary nature of the relief is in line with the overall aim of the Amendments, i.e. there will no longer be a need for relief once the uncertainty on how the reform will impact the amount and timing of the cash flows of the hedged item and hedging instrument has been removed or when the hedging relationship ends. EFRAG invites the IASB to specify that assessing when the relief exactly ends may require the exercise of judgement relying on all the available information applicable to each fact pattern.

[2427](#) Finally, EFRAG agrees with not proposing an end of application requirement with respect to the proposed exception for the separately identifiable requirement as this would negate the effects of the relief that is proposed.

Question 4 [paragraph 6.8.11 of IFRS 9 and paragraph 102K of IAS 39]

Disclosures

[2528](#) For the reasons set out in paragraph BC44, the IASB proposes that entities provide specific disclosures about the extent to which their hedging relationships are affected by the proposed amendments.

[2629](#) Do you agree with these proposed disclosures? Why or why not? If not, what disclosures would you propose instead and why?

EFRAG's response

EFRAG is of the view the disclosures are to be justified in a better way as their objective is not clear. EFRAG asks the IASB to engage in a debate with users during phase II of the project in order to determine their needs in relation to the IBOR transition.

- 30 EFRAG questions the benefits of the proposed disclosures to users. As currently proposed, the disclosures seek to provide information on hedges applying the regular hedge accounting conditions separately from hedges that are accounted for using the exceptions. It should be clarified whether the intent of this separation is to enable users to assess the impact on the financial statements should the reliefs cease and the hedging relationships are discontinued. Should this not be the intention of the IASB, then it is difficult to see a reason for the separate disclosures.
- 31 EFRAG notes that the Amendments are narrow mandatory exceptions from the hedge accounting requirements. As a result, the disclosures related to the amendments should therefore also be narrow and designed to explain the consequences of these exceptions. EFRAG notes the disclosures should address wider reporting needs relating to the benchmark rate reforms. To identify such needs, it is asked that the IASB do further work in collaboration with users as part of Phase II of this project. This workstream should start as soon as possible to address users' needs appropriately and timely.
- 32 The IASB may also consider hedging relationships where only the hedging instrument or hedged item qualify for the relief and the impact this may have on the proposed disclosures.

EFRAG's response

EFRAG agrees with the IASB's proposal to require specific disclosures about the extent to which the hedging relationships are affected by the proposed amendments.

- 27 In EFRAG's view, IFRS 7 represents a good basis for such disclosures. While agreeing to rely on IFRS 7 disclosures, EFRAG is of the view that the objective of providing these should be explained in the final Amendments. EFRAG does not expect that the proposed disclosures will require undue cost or effort to segregate hedging relationships to which the amendments are applied.
- 28 EFRAG considers that the proposed disclosures will provide users with useful information about how the entity is impacted by the interest rate benchmark reform.
- 29 Therefore, EFRAG supports the IASB's proposal for additional disclosure requirements as set out in this Exposure Draft.

Question 5 [paragraphs 7.1.9 and 7.2.26(d) of IFRS 9 and paragraph 108G of IAS 39]

Effective date and transition

3033 For the reasons set out in paragraphs BC45–BC47, the IASB proposes that the amendments would have an effective date of annual periods beginning on or after 1 January 2020. Earlier application would be permitted. The IASB proposes that the amendments would be applied retrospectively. No specific transition provisions are proposed.

3134 Do you agree with these proposals? Why or why not? If you disagree with the proposals, please explain what you propose instead and why.

EFRAG's response

EFRAG supports the IASB proposals on the date of application with earlier application permitted ~~and~~. EFRAG disagrees with not applying retrospectively the retrospective application of Amendments to hedges that were discontinued solely because the amendments proposed reliefs were not (yet) available.

~~3235~~ EFRAG acknowledges the need for the earliest effective date possible for the application of the amendments which in some jurisdictions might be appropriate even before 1 January 2020.

~~33~~ EFRAG ~~also agrees~~ disagrees with the IASB that the retrospective application of the Amendments ~~proposed by the IASB will enable continuation of previously designated hedge accounting relationships but will not allow either hindsight designations or reinstatements of previously~~ should always be prohibited for discontinued hedging relationships. However, EFRAG notes the possibility that an entity may not apply the Amendments until the effective date, resulting hedges in possible discontinuation of hedge accounting for 2019 and a prior period. In EFRAG's view, retrospective reinstatement of hedge accounting when the Amendments are applied retrospectively. EFRAG sees no practical way to avoid this possible outcome.

~~3436~~ Therefore, ~~EFRAG supports the IASB proposals on effective date and transition~~ previously discontinued hedges should be allowed if these hedges failed the hedging requirements only because the proposed reliefs were not (yet) available.

Appendix II: Preparation for phase II (replacement issues)

Introduction

- 1 This Appendix is intended to proactively contribute to the discussion of the replacement issues. It includes:
 - (a) description of the main IBOR transition patterns that will affect the European Economic Area; and
 - (b) a number of topics that may be worthy of consideration by the IASB when addressing the replacement issues.
- 2 EFRAG considers the IASB proposals relating to the pre-replacement issues as a solution in resolving the uncertainty that currently exists around the transition of interbank offered rates (IBORs) and supports the proposals relating to the pre-replacement issues for providing relief on hedge accounting requirements.
- 3 EFRAG is aware that the Interest Rate Benchmark reform creates more accounting issues than the ones addressed in the Amendments. EFRAG considers that this first phase is handling the uncertainty with regards to accounting aspects before the IBOR transition and therefore is limited to hedge accounting. EFRAG supports this approach and considers that accounting issues that arise subsequently to the IBOR transition (replacement issues) are to be handled in the second phase.
- 4 EFRAG is further of the view that this second phase should be addressed as soon as possible in parallel with the finalisation of the first phase, without hindering bringing relief for the issues already addressed in the first phase.

Description of possible fact patterns

- 5 EFRAG expects that the transition path of each IBOR will be different and hence may require different accounting solutions. Specific accounting solutions may therefore be needed when dealing with one IBOR transition but not with another. As European constituents are likely to deal with a range of IBOR transitions, EFRAG is taking a holistic look at these, whilst recognising that some accounting effects may not arise when dealing with a particular IBOR.
- 6 EFRAG summarises the transition patterns of the main benchmarks affecting the European Economic Area, i.e. EURIBOR, EONIA and LIBOR as general fact patterns. EFRAG relies on these fact patterns in analysing the potential accounting effects that may arise.

EURIBOR

Transition type and date

- 7 Starting from 01/01/2022, only benchmarks that are compliant with the Benchmark Regulation (BMR) may be used in the EU for new contracts (and, subject to the assessment of the regulator, for legacy contracts).
- 8 EURIBOR does not transition to a new benchmark index. The administrator of EURIBOR, the European Money Market Institute (EMMI), has defined some changes to its calculation methodology, from 'quote-based' to 'hybrid', to ensure the compliance of the index with the BMR.
- 9 The Belgian Financial Services and Markets Authority (FSMA), in its role of National Competent Authority of the administrator, has to assess the compliance of the hybrid EURIBOR methodology with BMR and authorise its administrator EMMI in order to continue the use of EURIBOR in EU.

- 10 The current working assumption is that EURIBOR's revised framework will be authorised however, this will be certain only after the administrator files for authorisation and once the FSMA has announced its assessment.
- 11 EMMI will file for authorisation to the Belgian FSMA by Q2 2019. Subsequently, EMMI will start transitioning Panel Banks from the current EURIBOR methodology to the hybrid methodology, with a view of finishing the process before the end of 2019.
- 12 Many consider that a change in the calculation methodology for EURIBOR is not a change in the benchmark and hence there would not be a transition to a different benchmark.

Difference between new and old contracts

- 13 The current version of EURIBOR can be used in existing contracts and new contracts as its underlying interest is considered to remain unchanged by the shift to the new hybrid methodology. EMMI undertook the EURIBOR reform in order to be compliant with the EU BMR. EMMI needs to adapt the current quote-based methodology to a methodology that is anchored in transactions to the extent possible, as is the case in the new hybrid methodology. EMMI is reforming the EURIBOR benchmark for two main reasons:
 - (a) because the Benchmark Regulation and the guidelines of international organisations on the administration of benchmarks require that benchmarks are based on arm's length transactions to the extent possible; and
 - (b) to adapt the methodology to the evolving circumstances in the market that EURIBOR seeks to measure.

EONIA

Transition type and date

- 14 After conducting an EONIA Review, EMMI concluded that under current market conditions and dynamics (the activity underpinning EONIA is very low and concentrated), EONIA's compliance with the EU Benchmarks Regulation by 1 January 2020 cannot be warranted, as long as its definition and calculation methodology remain in its current format. Therefore, there was a need to find a replacement rate. The working group on euro risk-free rates recommended in September 2018, following a public consultation, the €STR as the new euro risk-free rate and replacement of EONIA.
- 15 In order to ensure an orderly and smooth transition from EONIA to the new €STR, the working group on euro risk-free rates recommended to follow the so called "EONIA recalibration approach" from the first €STR publication date until the end of 2021. Under this approach there will be a transition period, starting from 2 October 2019, during which EONIA changes its calculation methodology, to become "€STR + fixed spread¹". This recalibrated EONIA will exist until the end of 2021, after which it will be discontinued.
- 16 €STR starts to be published on the 2 October 2019 and will exist in parallel with the recalibrated EONIA until the end of 2021.
- 17 In theory, there should be no value transfer as there is no transition and the continuity of EONIA is preserved. The change in calculation methodology, and

¹ In accordance with the ECB Press release of 31 May 2019, the spread between €STR and EONIA is calculated at 8.5 basis points.

specifically, the fixed spread embedded in the new EONIA methodology has been quantified so that the recalibrated EONIA would avoid a value transfer.

- 18 The spread value will be constant during the transition period.
- 19 The full move to the €STR at the end of 2021 is not expected to create a value transfer, under the assumption that the relevant parties have agreed on and follow a fair compensation mechanism and they have reviewed their contracts accordingly.

Difference between new and old contracts

- 20 The change in EONIA under the recalibration approach does not intend to affect the underlying interest of the rate, therefore existing contracts indexed to EONIA as of 2 October 2019, will not be discontinued. Between this date and the end of 2021 these contracts will have to transition to €STR, as the recalibrated EONIA will cease to exist. The transition to €STR is not foreseen to be granted by law to all the contracts. As such, the parties to the contracts will have to agree on the transition provisions that will be applicable to the contract.
- 21 During the transition period, the working group has recommended that parties to new contracts use €STR as interest rate benchmark; however, if they use EONIA, fallback provisions will have to be incorporated in the contracts. After the end of 2021 all the contracts should transition to €STR.

LIBOR

- 22 LIBOR (London Interbank Offered Rate) is to transition to SONIA (Sterling Overnight Indexed Average).

Transition type and date

- 23 The transition period starts in 2019 and ends in 2021, after 2021 the LIBOR production is no longer guaranteed. This implies that both LIBOR and SONIA will coexist during a particular timeframe (parallel run).

Difference between new and old contracts

- 24 SONIA will be used for new contracts, while old contracts will still reference to LIBOR until explicitly changed by the contract parties.

Topics that have been raised with EFRAG which may need to be considered when dealing with replacement issues

- 25 EFRAG has been informed about a number of topics that may potentially need to be addressed when dealing with the replacement issues. These topics are listed below with the sole aim of informing the IASB and EFRAG has not developed a view as to whether standard setting is needed.

Topic 1: Derecognition

- 26 The contractual terms of assets and liabilities will be amended to reflect the new risk-free rate. This modification will trigger accounting consequences, as entities will have to assess whether the change result in derecognition of the old financial instrument and recognition of a new one.

Subtopic 1.1: IFRS 9 – SPPI criterion

27 The transition from an existing IBOR to a risk-free rate raises a question as to whether a financial instrument still meets the SPPI criterion. It is understood that the SPPI test will only be performed in case the IBOR reform results in derecognition of financial instruments.

28 EFRAG notes that every transition is unique, but the following elements may prove useful in assessing whether the SPPI criterion is still met or not:

- (a) continuity in the contractual rates (i.e. where the new risk-free rate is seen as a successor of the current IBOR);
- (b) if the change in interest rates has only a de minimis effect on the contractual cash flows, it will not affect the classification of the financial instrument; and
- (c) IBORs are generally short-term rates. In determining long-term rates floating interest rates swap rates are used which are based on a spread on top of the IBORs. These spreads represent credit and liquidity risk but as most swap rates are collateralised the credit risk is very limited.

Subtopic 1.2: IFRS 9 – Business model

- 29 In case of modifications that lead to derecognition of an existing financial asset and recognition of a new financial asset, it is not clear whether the recognition of such financial asset can be considered to meet the business model test and be held for collection of cash flows.
- 30 IFRS 9 notes that in particular circumstances sales that are made for particular reasons can be consistent with a business model whose objective is to hold financial assets in order to collect contractual cash flows. However, it is unclear whether this can be extrapolated to the situation of derecognising financial assets as a result of the IBOR reform.

Subtopic 1.3: Hedge accounting discontinuation

- 31 If an instrument (whether a hedging instrument or hedged item) is derecognised as a result of, and only of, modifications due to the replacement of the benchmark following the IBOR reform, this derecognition may lead to a discontinuation of the hedge accounting relationship in accordance with IAS 39, paragraph 91 or IFRS 9, paragraph 6.5.6.

Topic 2: Modification

- 32 In case modification does not trigger derecognition, a modification gain or loss may arise from recognition in profit or loss of the difference between the carrying amount and the revised contractual cash flows, discounted using the original EIR.
- 33 It is expected that new-RFRs will be lower than the old IBORs. When IBOR-based financial instruments are modified to be based on the new RFR they may include a higher fixed spread. To the extent the present value of the increase in the spread is offset by lower forecast floating rate cash flows, at the date of the modification the relationship between the lender and borrower would be unchanged. Accordingly, to the extent the modification does not result in a gain or loss for either borrower or lender, both parties should be able to apply IAS 39, paragraph AG7 or IFRS 9, paragraph B5.4.5.

~~*Topic 3: Retrospective assessment: hedge accounting ineffectiveness*~~

- ~~34 As illustrated in paragraph BC23 of the ED, the IASB decided not to propose any exception for the effects of the IBOR reform on 'retrospective assessments' required by IAS 39. Ineffectiveness may arise, for example, from differences in the changes of cash flows of the hedged item and of the hedging instrument, including differences arising from different timing in the benchmark rate replacement between hedged item and hedging instrument. Insofar this topic cannot be addressed as a pre-replacement issue, it could be considered dealt with as replacement issue.~~

~~*Topic 4*~~ ~~*Topic 3: Hedge accounting discontinuation*~~

- ~~3534 If an instrument (whether a hedging instrument or hedged item) is derecognised as a result of, and only of, modifications due to the replacement of the benchmark following the IBOR reform, this derecognition may lead to a discontinuation of the~~

~~hedge accounting relationship in accordance with IAS 39, paragraph 91 or IFRS 9, paragraph 6.5.6.~~

Topic 5: Recalibration of hedging relationship

~~3635~~ In order to calculate the change in the value of the hedged item for the purpose of measuring hedge ineffectiveness, an entity may use a derivative that would have terms that match the critical terms of the hedged item (i.e. a hypothetical derivative) (IAS 39, IG paragraph F5.5 and IFRS 9, paragraph B6.5.5).

~~3736~~ It has been observed that, when a previously designated old-IBOR hedge relationship is recalibrated to the new RFR, this circumstance may not be considered a new hedge designation for the purposes of determining the hypothetical derivative for cash flow hedges. In other words, the hypothetical derivative for a non-optional derivative, at the date of re-designation, would not be reset to zero at that date, rather would be recalibrated to have a fair value of zero when the hedge accounting relationship was last previously designated.

~~3837~~ In case a relief is provided this would avoid all cash flow hedges being deemed immediately ineffective when the cause of such ineffectiveness is the replacement of old IBOR to new RFR.

Topic 64: Hedge documentation

~~3938~~ Hedge documentation should be updated to consider the IBOR transition (IAS 39, paragraph 88(a) or IFRS 9, paragraph 6.4.1 (b)). This process may be burdensome and time consuming and may not be completed in time considering when the relief ends. It has been questioned whether relief would be needed to the extent that discontinuation of a hedge accounting relationship is solely due to the need to update the documentation.

Topic 7: IAS 8 – Change in estimates

~~40~~ There may be a lack of clarity as to whether changes in fair value measurement arising from the introduction of new RFRs are a change in estimate or a change in accounting policy (IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors).

Topic 8: IFRS 9 – SPPI criterion

~~4139~~ The transition from an existing IBOR to a risk free rate raises a question as to whether a financial instrument still meets the SPPI criterion. It is understood that the SPPI test will only be performed in case the IBOR reform results in derecognition of financial instruments.

~~4240~~ EFRAG notes that every transition is unique, but the following elements may prove useful in assessing whether the SPPI criterion is still met or not:

- ~~(a)~~ continuity in the contractual rates (i.e. where the new risk free rate is seen as a successor of the current IBOR);
- ~~(b)~~ if the change in interest rates has only a de minimis effect on the contractual cash flows, it will not affect the classification of the financial instrument; and
- ~~(c)~~ IBORs are generally short term rates. In determining long term rates floating interest rates swap rates are used which are based on a spread on top of the IBORs. These spreads represent credit and liquidity risk but as most swap rates are collateralised the credit risk is very limited.

Topic 9: IFRS 9 – Business model

~~4341~~ In case of modifications that lead to derecognition of an existing financial asset and recognition of a new financial asset, it is not clear whether the recognition of such

~~financial asset can be considered to meet the business model test and be held for collection of cash flows.~~

~~4442 IFRS 9 notes that in particular circumstances sales that are made for particular reasons can be consistent with a business model whose objective is to hold financial assets in order to collect contractual cash flows. However, it is unclear whether this can be extrapolated to the situation of derecognising financial assets as a result of the IBOR reform.~~

~~Topic 105: IFRS 17 – Interest guarantees in insurance contracts.~~

~~4543 Interest guarantees in insurance contracts generally rely on references other than IBOR rates (for example, livret A in France). But these references themselves are calculated relying on IBOR rates, so the change to a risk-free rate may affect the calculation of the interest guarantees.~~

~~Topic 11: Accounting treatment of OCI balances at the end of relief~~

~~The IASB should clarify the treatment for the effective share of the accumulated OCI reserve for cash flow hedging relationships that is under the scope of application of this Amendment, once the relief ends. Topic 6: Cross-currency swaps~~

~~4644 When cross-currency swaps are being used in hedging the currency risk of a floating rate debt, the IBOR transition will affect the cash flows of both the debt instrument and the swap. Provided that the effects of any ineffectiveness are recognised in profit or loss according to the prevailing market conditions at the end of the relief, the effective share of the OCI reserve should follow the hedge accounting treatment under an assumption of continuity of the hedge (i.e. amounts will be reversed when the hedged transaction occurs in future periods).~~

~~Topic 12: Collateralised derivatives discounting using €STR.~~

~~47 Based upon the information on transition path of €STR, market participants currently anticipate:~~

- ~~(a) collateralised derivatives will be discounted using €STR flat yield curve;~~
- ~~(b) CSA (Credit Support Annex) will no longer be remunerated based on EONIA but on €STR flat even if EONIA is supposed to be priced at €STR + 9 bp according to the assumptions.~~

~~48 If an entity has classified its CSA at fair value through profit or loss according to IFRS 9, paragraph 2.3, then the fair value of the loan is considered not to be affected by the change to the remuneration of the CSA. This arises because the new remuneration – €STR flat – is now considered by the market participants as being the new market-based remuneration.~~

~~49 If an entity instead has classified and measured its CSA at amortised cost using the IFRS 9 loan commitment exception IFRS 9.2.1(g), then the question arises whether the entity should apply IFRS 9, paragraph 5.4.3 to the modification of the CSA agreement.~~

~~5045 In addition to the topics listed above, do you have any other matters that the IASB should consider when dealing with the replacement issues? Please describe.~~