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

Feedback to constituents – EFRAG Final Comment Letter

November 2019

This paper has been prepared by the EFRAG Secretariat for discussion at a public meeting of EFRAG TEG. The paper forms part of an early stage of the development of a potential EFRAG position. Consequently, the paper does not represent the official views of EFRAG or any individual member of the EFRAG Board or EFRAG TEG. The paper is made available to enable the public to follow the discussions in the meeting. Tentative decisions are made in public and reported in the EFRAG Update. EFRAG positions, as approved by the EFRAG Board, are published as comment letters, discussion or position papers, or in any other form considered appropriate in the circumstances.

Summary of contents

Introduction

Objective of this feedback statement

EFRAG published its final comment letter on the IASB ED/2019/1 *Interest Rate Benchmark Reform (Proposed amendments to IFRS 9 and IAS 39)* ('the ED') on 20 June 2019. This feedback statement summarises the main comments received by EFRAG on its draft comment letter and explains how those comments were considered by EFRAG during its technical discussions leading to the publication of EFRAG's final comment letter.

Background to the ED

Interest rate benchmarks (e.g. EURIBOR or LIBOR) play a key role in financial markets. These benchmarks index trillions of euros in a wide variety of financial products, from derivatives to residential mortgages. Recently such benchmarks are in the process of being replaced by alternative, nearly risk-free rates, which are based to a higher extent on transaction data.

The discontinuation of interest rate benchmarks could have a significant and widespread impact across financial markets, as well as in other areas where such benchmarks are used. In this context, stakeholders are considering what the effects of a discontinuation of these IBORs are on financial reporting.

The IASB has split its work on the Interest Rate Benchmark Reform in two phases. The first phase is addressing issues affecting financial reporting in the period before the replacement of an existing interest rate benchmark with an alternative interest rate and a second phase that deals with issues that might affect financial reporting when an existing interest rate benchmark is replaced with an alternative interest rate.

On 3 May 2019, the IASB issued the Exposure Draft ED/2019/1 *Interest Rate Benchmark Reform (proposed amendments to IFRS 9 and IAS 39)* (the 'ED') with a comment period of 45 days ending on 17 June 2019.

The ED covers the first phase of the Interest Rate Benchmark Reform and modifies hedge accounting requirements so that entities would apply them assuming that the interest rate benchmark on which the hedged cash flows and the cash flows from the hedging instrument are based will not be altered as a result of the reform. The proposals are not intended to provide relief from any other consequences arising from interest rate benchmark reform.

Further details are available on the IASB's website.

EFRAG's draft comment letter

EFRAG published a draft comment letter on the proposals on 13 May 2019. In the draft comment letter, EFRAG considered 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). EFRAG also noted that the IBOR reform creates more accounting issues than the ones addressed in the Amendments. EFRAG supported focussing during phase I on the pre-replacement issues only and listed in the Appendix II of the comment letter a number of topics that could potentially be addressed in the second phase (replacement issues).

Comments received from constituents

EFRAG has received seven comment letters from constituents that were received timely to be considered during the shortened comment period. These comment letters are available on the EFRAG website.

The comment letters received came from two national standard setters, three professional organisations and two listed companies.

Constituents supported the IASB initiative to provide limited relief for the financial instruments qualifying for hedge accounting as long as uncertainty due to IBOR reform exists.

Constituents overall agreed with the EFRAG draft comment letter and made the following comments:

a) They appreciated the IASB addressing the issues through the fast procedure and stressed the importance of swift endorsement of the Amendments in Europe as they need to be applied already in 2019;

b) They welcomed the EFRAG call to the IASB to address the issues in the second phase of the project as soon as possible and in parallel to the finalisation of the first phase;

c) They highlighted that the IASB should consider different fact patterns worldwide and not to focus only on LIBOR transition;

d) In addition, they would like the IASB to provide an assurance that the modification of a calculation methodology of a rate does not result in a modification of that rate and hence of the underlying instrument. This would ensure a continuity of existing contracts and accounting treatment and concerns EURIBOR transition path in particular;

e) They considered it necessary that the IASB provides relief for the retrospective assessment of hedge effectiveness under IAS 39 as soon as possible, considering even the phase one of the project.

EFRAG's final comment letter

EFRAG issued its final comment letter on 20 June 2019.

EFRAG supported the IASB approach to work in two phases, to deal during phase I with the pre-replacement issues and during phase II with the replacement issues. EFRAG urged the IASB to issue the amendments as soon as possible as entities needed to have clarity regarding the content and application of the amendments.

EFRAG considered the IASB proposals as a step in the right direction but noted that additional changes were necessary. In particular relief from including the uncertainties of IBOR reform in the retrospective assessment was needed.

Further, EFRAG disagreed with not applying the proposed amendments retrospectively to hedges that were discontinued because entities were unable to apply the proposed reliefs and suggested to assess whether structuring opportunities would not arise as a result of the ED not allowing reinstatement of such hedges.

EFRAG also noted that the IASB should clarify the application of the Amendments to the portfolio fair value hedge of interest rate risk and the use of cross-currency swaps.

EFRAG was not convinced that the proposed disclosures strike an appropriate balance from a cost-benefit perspective and was of the view that during the first phase qualitative disclosures were sufficient. For the second phase EFRAG asked the IASB to open a dialogue with users to identify their information needs in relation to the IASB proposals.

EFRAG noted that the interest benchmark reform created more accounting issues than the ones addressed in the Amendments. EFRAG was of the view that the second phase should be addressed as soon as possible and in parallel to the finalisation of the first phase.

EFRAG also noted that the IBOR transition paths differ one from each-other and invited the IASB to consider the different types of transition paths. In addition, to proactively assist the IASB, EFRAG listed a number of topics in its letter that could potentially be addressed by the IASB in the second phase. Finally, EFRAG asked the IASB to address all potential impacts of the IBOR reform across the different IFRSs during the second phase.

Detailed analysis of issues, comments received and changes made to EFRAG's final comment letter

EFRAG's tentative views expressed in the draft comment letter and constituents' comments

General comments and Cover Letter

EFRAG's tentative position

EFRAG considered 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 considered that the first phase was appropriately handling the uncertainty with regards to specific accounting aspects prior to the IBOR transition (pre-replacement issues) and therefore focused on hedge accounting requirements only. EFRAG supported this approach and considered appropriate that accounting issues that arise subsequently to the IBOR transition are to be handled in the second phase (replacement issues).

EFRAG noted that the interest rate benchmark reform created more accounting issues than the ones addressed in the Amendments. EFRAG added 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 noted that the transition paths of different IBORs were far from identical: while some rates are being replaced by alternative benchmarks, others are not replaced but undergo an evolution of underlying methodology.

EFRAG's response to constituents' comments

EFRAG final position

The comment letters received confirmed EFRAG's initial view. Based on the comments received, the following additional remarks were made:

- EFRAG disagreed with not providing a relief for the uncertainty in the retrospective assessment under IAS 39 and the impossibility to retrospectively apply the reliefs to discontinued hedges in the first phase.
- EFRAG urged the IASB to issue the amendments as soon as possible as entities needed to have clarity regarding their content and application.
- Also, EFRAG noted that 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. EFRAG suggested the IASB to assess whether structuring opportunities would not arise as a consequence of applying the amendments retrospectively
- EFRAG noted that objective of the disclosures as proposed did lack explicit justification and asked the IASB to clarify it. In the absence of a clear objective, EFRAG noted it would be hard to justify why separate disclosures were required. As part of phase

EFRAG's tentative views expressed in the draft comment letter and constituents' comments	**EFRAG's response to constituents' comments**
In this respect, EFRAG summarised the transition patterns for the main benchmarks affecting jurisdictions in the European Economic Area, i.e. EURIBOR, EONIA and Sterling LIBOR as a working hypothesis. In addition, to proactively assist the IASB, EFRAG identified a number of topics that could potentially be addressed in the second phase. *Constituents' comments* Please refer to the summary on page 3.	II, EFRAG suggested the IASB to open a dialogue with users in order to define their information needs in relation to the IBOR reform. • Finally, EFRAG noted that several IFRS Standards referred to discount rates or interest rates but not all of these rates were short-term IBOR rates. As part of phase II, EFRAG suggested the IASB to address all potential impact of the IBOR reform across the different standards.

EFRAG's tentative views expressed in the draft comment letter and constituents' comments

Highly probable requirement and prospective assessment

Proposals in the ED

Highly probable requirement

The IASB noted that if the effects of the interest rate benchmark reform were such that the hedged cash flows were no longer highly probable, then hedge accounting would be discontinued. In the IASB's view, this would not provide useful information to users of financial statements.

Therefore, the IASB decided to propose amendments to IFRS 9 and IAS 39 to provide an exception to the highly probable requirement that would provide relief during this period of uncertainty.

Prospective assessments

IFRS 9 and IAS 39 require entities to discontinue hedge accounting if the prospective assessment is not met. Once hedge accounting is discontinued, the entity is required to recognise in profit or loss the changes in the fair value of the derivatives (i.e. the hedging instruments before discontinuation), in the same way as trading derivatives.

The IASB considered the usefulness of the resulting information and decided to provide relief from the 'prospective assessments' requirements in IFRS 9 and IAS 39.

Retrospective assessments

In accordance with IAS 39, a hedge is regarded as highly effective only if both the requirements relating to retrospective and prospective assessments are met. If an entity fails to meet one of these assessments,

EFRAG's response to constituents' comments

EFRAG final position

Based on the comments received to Appendix II of the draft comment letter, EFRAG added retrospective assessments as a pre-replacement issue. Also, the application of the relief to the portfolio fair value hedge of interest rate risk was added as a pre-replacement issue.

EFRAG's tentative views expressed in the draft comment letter and constituents' comments	**EFRAG's response to constituents' comments**
hedge accounting has to be discontinued. IFRS 9 does not require a retrospective assessment. The IASB did not amend the requirements related to retrospective assessment, as it would undermine the fundamental principle in hedge accounting of offset between gains and losses on the hedging instrument and the hedged item. *EFRAG's tentative position* EFRAG supported the overall approach to the Amendments as, without the proposed relief, significant failures in hedge accounting could occur. EFRAG observed that resulting one-off impacts on the financial statements were likely to be ignored by analysts as not providing useful information. *Highly probable requirement* EFRAG supported the IASB's proposal for temporary relief from the highly probable requirement as 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 would not provide useful information to the users of financial statements. *Prospective assessments* EFRAG supported the relief from prospective assessments, as long as uncertainties from the interest rate benchmark reform would exist. *Constituents' comments* Constituents did not provide any comments on this question and agreed overall with the reliefs provided by the IASB.	

EFRAG's tentative views expressed in the draft comment letter and constituents' comments	**EFRAG's response to constituents' comments**
Designating a component of an item as the hedged item	
Proposals in the ED Both IFRS 9 and IAS 39 require the risk component to be separately identifiable and reliably measurable in order to be eligible for hedge accounting. The IASB decided to propose amendments to IFRS 9 and IAS 39 so that entities do not discontinue hedge accounting solely because the hedged item is no longer separately identifiable as interest rate benchmark reform progresses. The separate identification requirement for hedges of the benchmark component of interest rate risk is only applied at the inception of those hedging relationships. *EFRAG's tentative position* EFRAG supported 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. EFRAG agreed that paragraphs 81 and AG99F of IAS 39 should apply at inception of the hedging relationship, for a hedge of a benchmark portion of interest rate risk that was affected by interest rate benchmark reform. EFRAG recommended that the final Amendments clarify that, where relevant, the reliefs were applicable to new hedging relationships, without removing the exception in paragraph BC27 of the Amendments. *Constituents' comments* One constituent expressed concern that when IBORs become less liquid, it might no longer fulfil the "reliably measurable" criterion. The constituent asked that the Basis for Conclusions should address this situation. In	*EFRAG final position* EFRAG noted that the Amendments require to consider a change in liquidity in the yield curve and agreed with this. EFRAG agreed with the application of the Amendments to non-contractually specified risk components.

EFRAG's tentative views expressed in the draft comment letter and constituents' comments	**EFRAG's response to constituents' comments**
EFRAG's Financial Working Group the comment was raised that the Amendments should also apply to non-contractually specified risk components.	

EFRAG's tentative views expressed in the draft comment letter and constituents' comments

Mandatory application and end of application

Proposals in the ED

The IASB proposed that entities must apply the exceptions in the ED to all hedging relationships to which the exceptions are applicable. Voluntary application is not allowed as it could give rise to selective discontinuation of hedge accounting and selective reclassification of the amounts recorded in other comprehensive income related to previously discontinued hedging relationships.

The IASB also proposed that an entity ceases applying the proposed exceptions at the earlier of (a) when the uncertainty regarding the timing and the amount of interest rate benchmark-based cash flows is no longer present and (b) the discontinuation of the hedging relationship.

The IASB observed that there could be circumstances in which the exceptions in this ED are not applicable for example if a particular interest rate benchmark is not subject to a replacement with an alternative interest rate. Also, there could be circumstances where the exceptions are only partly applicable.

EFRAG's tentative position

EFRAG agreed with the mandatory application of the Amendments to all existing hedge accounting relationships. EFRAG also agreed with the temporary nature of the relief and the conditions set in determining the end of the relief. Finally, EFRAG agreed with not proposing an end of application requirement with respect to the proposed exception for the separately identifiable requirement.

Constituents' comments

EFRAG's response to constituents' comments

EFRAG final position

EFRAG agreed that assessing the relief depends on facts and circumstances and added a request to the IASB asking 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.

EFRAG's tentative views expressed in the draft comment letter and constituents' comments	**EFRAG's response to constituents' comments**
Constituents agreed that the proposed reliefs were to be applied mandatorily as permitting a voluntary application might lead to a selective discontinuation of hedging relationships. **Questions to constituents** *The Amendments require entities to cease applying the relief when the uncertainty arising from interest rate benchmark reform is no longer present with respect to the timing and amount of the interest rate benchmark-based cash flows. The assessment of when uncertainty ceases to exist requires the exercise of judgement.* *Do constituents believe that the level of judgement involved in this assessment would deserve additional discipline? For example, should the IASB add a clarification that this assessment has to be done by management using all the available information applicable to the specific facts and circumstances?* Two constituents noted the IASB ought to clarify that assessing when to cease applying the relief is to be done using all the available information applicable to the specific fact patterns. This because different scenarios can apply to different entities resulting in different outcomes. The examples provided in the BC to the Amendments were considered helpful but cannot reflect all possible scenarios.	

EFRAG's tentative views expressed in the draft comment letter and constituents' comments	**EFRAG's response to constituents' comments**
Disclosures	
Proposals in the ED The IASB proposed that entities applying the reliefs provide disclosure about the magnitude of the hedging relationships to which the reliefs apply. The IASB noted that IFRS 7 *Financial Instruments: Disclosures* already requires specific disclosures about hedge accounting and, for some specifically identified disclosures, information provided separately for hedging relationships to which the proposed exceptions apply, would provide useful information to users of financial statements. The IASB expected that the cost of this disclosure proposal would not be onerous because it only requires disaggregating information that is already required to be disclosed by IFRS 7. *EFRAG's tentative position* EFRAG agreed with IASB proposals to require specific disclosures about the extent to which the hedging relationships are affected by the proposed amendments. While agreeing to rely on IFRS 7 Disclosures to provide these, EFRAG asked that the objective of providing these disclosures should be explained in the final amendments. EFRAG did not expect the disclosures to generate undue cost or effort. *Constituents' comments* Several constituents noted that the proposed disclosures were burdensome and would generate undue costs. These costs would be generated by the disaggregation of carrying amounts and gains and losses arising from IBOR hedges that are not naturally disaggregated.	*EFRAG final position* EFRAG acknowledged the undue cost related to the proposed disclosures as put forward by different constituents. As a result, EFRAG changed its position and suggested the IASB that during the first phase, qualitative disclosures would be more appropriate. Further, EFRAG asked the IASB to seek the views of users during the second phase of the project in order to determine their needs in relation to the IBOR transition.

EFRAG's tentative views expressed in the draft comment letter and constituents' comments	**EFRAG's response to constituents' comments**
In addition, those constituents questioned the usefulness of the disclosures to users of financial information. Some of these constituents referred to the fact that the IASB did not require new disclosures when issuing IAS 39 amendments "*Novation of derivatives and continuation of hedge accounting*" in 2013.	

EFRAG's tentative views expressed in the draft comment letter and constituents' comments	EFRAG's response to constituents' comments
Effective date and transition	
Proposals in the ED The IASB proposed that the effective date of the amendments is annual periods beginning on or after 1 January 2020, with earlier application permitted. In addition, the IASB proposed the amendments would be retrospectively applied. *EFRAG's tentative position* EFRAG supported the IASB proposals on effective date and transition. *Constituents' comments* Constituents highlighted the importance of the early application of the amendments and swift European endorsement process in order to avoid discontinuation of hedge accounting in 2019.	*EFRAG final position* EFRAG concurred with the comment regarding the early application of the amendments and urged the IASB to issue the amendments as soon as possible. The remainder of the draft position was kept unchanged.

EFRAG's tentative views expressed in the draft comment letter and constituents' comments

Preparation for phase II (replacement issues)

EFRAG's tentative position

EFRAG listed three transition paths of IBORs that were relevant for European constituents noting that as the transition paths differ, also the potential accounting effects may differ. EFRAG described the transition paths for EURIBOR, EONIA and LIBOR.

Constituents' comments

Some constituents suggested to add the transition path from CHF LIBOR to SARON to the already identified IBOR transition paths.

Also, some constituents noted that EURIBOR is not being replaced but undergoes an evolution in its estimation methodology. As a result it was considered that the amendments to IFRS 9 and IAS 39 were not applicable to this particular transition.

EFRAG further listed a number of topics that may need to be considered when dealing with replacement issues. These topics were:

1. Derecognition
2. Modification
3. Retrospective assessment: hedge accounting ineffectiveness
4. Hedge accounting discontinuation
5. Recalibration of hedging relationship
6. Hedge documentation
7. IAS 8 - Change in estimates

EFRAG's response to constituents' comments

EFRAG final position

EFRAG confirmed the position as expressed in the draft comment letter and added a reference to the transition path from CHF LIBOR to SARON as another example of the LIBOR transition.

EFRAG acknowledged the feedback from constituents and re-ordered the topics mentioned in the final comment letter as follows:

Topic 1: Derecognition;

Subtopic 1.1: IFRS 9 – SPPI criterion;

Subtopic 1.2: IFRS 9 – Business model;

Subtopic 1.3: Hedge accounting discontinuation;

Topic 2: Modification

Topic 3: Recalibration of hedging relationship;

Topic 4: Hedge documentation; and

Topic 5: IFRS 17 – interest guarantees in insurance contracts.

The topic relating to the accounting treatment of the OCI-balances has been proposed as an issue to be addressed during phase I of the IBOR-project.

EFRAG's tentative views expressed in the draft comment letter and constituents' comments	EFRAG's response to constituents' comments
8. IFRS 9 – SPPI criterion 9. IFRS 9 – business model 10. IFRS 17 – interest guarantees in insurance contracts 11. Accounting treatment of OCI balances at the end of relief; and 12. Collateralised derivatives discounting using €STR **Question to Constituents** *In your view which of the above topics should be addressed by the IASB when dealing with the replacement issues? Please explain the reasons why and your suggested accounting treatment.* *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.* *Constituents' comments* Constituents supported the topics raised by EFRAG to be addressed in phase two of the IASB project and highlighted that this phase should start as soon as possible. However, constituents indicated the following topics as being more important: 1. retrospective assessment: hedge accounting ineffectiveness; 2. derecognition and modification; 3. hedge accounting discontinuation and hedge documentation; 4. IFRS 9 – SPPI-criterion;	EFRAG's cover letter also includes a general request to the IASB to address all potential impacts of the IBOR reform across the different standards during the second phase. In addition, the issues relating to the application of cross-currency swaps, portfolio fair value hedges of interest rate risk and retrospective hedge ineffectiveness have been included in the cover letter.

EFRAG's tentative views expressed in the draft comment letter and constituents' comments	EFRAG's response to constituents' comments
5. The accounting treatment of OCI-balances at the end of the relief. Other topics were considered as less important or as a subset of the major topics described above. One constituent commented that the IASB is to clarify whether or not a change from IBOR or overnight rates to RFR would impact the valuation and measurement of financial instruments and other standards such as IFRS 16 *Leases* and IAS 19 *Employee Benefits*. One constituent noted it to be unclear whether the reliefs that are provided are also applicable to situations where cross-currency swaps are being used for hedging purposes or when applying a portfolio fair value hedge for interest rate risk as continuous designation and de-designation of hedges is being applied. The constituent also noted that relief should be provided for the retrospective hedge ineffectiveness assessment under IAS 39 to avoid that hedges being discontinued. **Questions to Constituents** *EFRAG has been informed that, during the period while the relief is ongoing, it will be necessary to have clarity on the outcome of not only the prospective assessment of a cash flow hedge relationship under IAS 39, but also of the retrospective assessment. This in order to determine, at the end of each reporting period, how much of the value difference between the hedged item and the hedging instrument is assigned to other comprehensive income and which amount is assigned to profit or loss. As such, the retrospective assessment at the beginning of the cash flow hedge relationship should be able to be carried forward during the period*	

EFRAG's tentative views expressed in the draft comment letter and constituents' comments	**EFRAG's response to constituents' comments**
of the relief solely for the purpose of determining the cash flow hedge reserve. *In your view, are there particular circumstances in which a relief of the retrospective test is needed applying IAS 39? If so, please describe the reasons why as well as the specific fact patterns it would apply to.*	
Constituents' comments Constituents raised concerns that during the transition period, a relief of the retrospective test under IAS 39 would be needed to avoid that certain hedges fail the hedge accounting. The above concerned the prospective and retrospective hedge effectiveness assessments under IAS 39. One constituent noted that the IASB should consider providing a relief that one-off valuation effects resulting from the transition to the new benchmark rates should not disqualify hedging relationships from meeting the hedge effectiveness requirements. I.e. they should not lead to discontinuation of hedges.	As mentioned above, EFRAG has included the issue of retrospective assessment of hedge effectiveness in its cover letter as part of the items to be addressed during phase I. EFRAG considered the valuation issues as a topic that was to be addressed during phase II of the IBOR project which was covered in EFRAG's comment letter by the general request to the IASB to review all IFRSs.

Appendix 1: List of respondents

Table 1: List of respondents

***Name of constituent*[1]**	***Country***	***Type / Category***
Fédération Bancaire Française	France	Professional organisation
European Savings and Retail Banking Group	Europe	Professional organisation
Erste Group	Austria	Listed company
Insurance Europe	Europe	Professional organisation
BNP Paribas	France	Listed company
OIC	Italy	National Standard Setter
ANC	France	National Standard Setter

[1] Respondents whose comment letters were received timely to be considered by the EFRAG Board before finalisation of the comment letter.