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Interest Rate Benchmark Reform – Update on Phase II Issues Paper

Objective

- 1 The objective of this paper is to provide an update on the IASB’s work on Phase II of the *Interest Rate Benchmark Reform* project as well as a work plan on the upcoming EFRAG Secretariat activities.

Background and IASB project plan

- 2 The IASB decided to split the project in two phases in order to focus, in the first phase, on a narrow set of issues related to hedge accounting requirements as a result of uncertainty arising from IBOR reform that were particularly urgent and for which a solution was needed in time for the 2019 financial reporting.
- 3 The IASB published the Amendments to IFRS 9 *Financial Instruments* and IAS 39 *Financial Instruments: Recognition and Measurement* relating to Phase I of the *Interest Rate Benchmark Reform* project on 26 September 2019. EFRAG Endorsement Advice on the Amendments to Phase I was issued on 16 October 2019.
- 4 The IASB has started its deliberations on Phase II in October 2019. Similar to Phase I, Phase II of the project needs to address the issues with a similar level of urgency. The Phase II will first cover the classification and measurement issues, such as modification and derecognition of “substantially modified” financial instruments.
- 5 As a reminder, the following topics were mentioned in EFRAG’s final comment letter on Phase I of the project as a suggestion for the IASB to consider (without EFRAG having formed a view on these):
 - (a) Derecognition, including the additional consequential topics of SPPI-criterion, business model and Hedge accounting discontinuation;
 - (b) Modification;
 - (c) Recalibration of hedging relationship;
 - (d) Hedge documentation; and
 - (e) IFRS 17 *Insurance Contracts* – interest guarantees in insurance contracts.
- 6 The IASB proposed to address the following issues over the next months.

October 2019	November 2019	December 2019	January 2020
Classification and measurement	Hedge accounting	Hedge accounting (continued) Other IFRS Standards	Other/new issues identified Disclosures

FASB developments

- 7 The FASB issued a proposed Accounting Standards Update (ASU) to provide temporary optional expedients and exceptions to contracts, hedging relationships, and other transactions affected by reference rate reform if certain criteria are met.
- 8 There are some general differences between the FASB and the IASB approach. For example, the FASB proposed a one-step approach instead of the IASB two-steps approach for the project. Also, the FASB proposals provide temporary optional expedients and exceptions if certain criteria are met, while the IASB reliefs for hedge accounting are mandatory for hedging relationships affected by the reference rate reform. Further the FASB requires a change in the contract's reference interest rate to be accounted for as a continuation of the contract and this applies to the hedging relationship as a whole; in contrast the IASB proposals apply to each leg of the hedging relationship separately.
- 9 The comment letter period on the ASU closed on October 7, 2019. The FASB Board is now considering the feedback received.

The IASB tentative decisions taken in October

Classification and measurement—modification of financial instruments

- 10 The IASB tentatively decided to amend IFRS 9 to:
 - (a) clarify that, even in the absence of an amendment to the contractual terms of a financial instrument, a change in the basis on which the contractual cash flows are determined that alters what was originally anticipated constitutes a modification of a financial instrument in accordance with IFRS 9. Twelve of 14 IASB members agreed, and one disagreed with this decision. One IASB member abstained;
 - (b) provide a practical expedient allowing an entity to apply paragraph B5.4.5 of IFRS 9 to account for modifications related to IBOR reform and to provide examples in IFRS 9 of modifications that are related to IBOR reform, and examples of those that are not. 13 of 14 IASB members agreed with this decision. One IASB member abstained; and
 - (c) clarify that an entity should first apply paragraph B5.4.5 of IFRS 9 to account for modifications related to IBOR reform to which the practical expedient applies. Thereafter, an entity should apply the current IFRS 9 requirements to determine if any other modifications are substantial; if those modifications are not substantial, the entity should apply paragraph 5.4.3 of IFRS 9. 13 of 14 IASB members agreed with this decision. One IASB member abstained.

Accounting implications from derecognition of a modified financial instrument

- 11 The IASB tentatively decided that, in the context of IBOR reform, current requirements in IFRS 9 provide sufficient guidance to determine the appropriate accounting treatment in the following situations:
 - (a) derecognising a financial asset or a financial liability from the statement of financial position and the recognition of the resulting gain or loss in profit or loss following a substantial modification;
 - (b) determining an entity's business model for managing financial assets;
 - (c) determining whether the interest component of the contractual cash flows of a new financial asset referenced to alternative benchmark rates meets the criteria for solely payments of principal and interest on the principal amount outstanding (SPPI), as required by IFRS 9. The Board also tentatively decided to add an example to IFRS 9 to illustrate the application of the SPPI assessment in the context of IBOR reform;

Interest Rate Benchmark Reform – Update on Phase II - Issues Paper

- (d) recognising the expected credit losses for a new financial asset; and
- (e) accounting for embedded derivatives for financial liabilities.

12 All 14 IASB members agreed with these decisions.

Implications for EFRAG work plan

13 The EFRAG Secretariat proposes to address the following issues over the next months.

	October 2019	November 2019	December 2019	January 2020	February 2020
IASB	Classification and measurement (22-23 October)	Hedge accounting (18-22 November)	Hedge accounting (continued) Other IFRS Standards (9–12 December)	Other/new issues identified Disclosures (27-31 January)	
EFRAG FIWG	-	Classification and measurement (15 November)	-	Hedge accounting Other IFRS Standards (20 January)	Other/new issues identified Disclosures (24 February)
EFRAG TEG	-	Presentation of the work plan (4-5 November)	Classification and measurement (5 December)	Hedge accounting Other IFRS Standards (29-30 January)	Other/new issues identified Disclosures (4 -5 March)

14 As presented in the work plan above, EFRAG TEG will discuss the issues that are in this paper in the December EFRAG TEG meeting. This will include the views of EFRAG FIWG meeting on the 15 November 2019.

15 The EFRAG IAWG will be involved in all the phases of the work plan mentioned above in order to obtain a more detailed analysis of the concepts and interaction with IAS 39, where appropriate.

Question to EFRAG TEG	
16	Does EFRAG TEG have observations on the IASB project plan or on the approach to the deliberations so far?