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EFRAG draft comment letter on IASB ED ED/2020/1 - IBOR Phase 2 Cover Note

Objective

- 1 The objective of this session is to discuss and agree to recommend to the EFRAG Board the EFRAG draft comment letter (the 'DCL') on the IASB ED ED/2020/1 *Interest Rate Benchmark Reform—Phase 2 Proposed amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16* issued by the IASB on 9 April 2020 (the 'ED').

Background

- 2 EFRAG FIWG and EFRAG TEG have discussed the IASB tentative decisions in a number of meetings between November 2019 and March 2020.
- 3 EFRAG TEG discussed and approved in the webcast meeting on 26 March 2020 the Pre-Consultation Document, issued by EFRAG on 27 March 2020, to allow to the constituents for a longer consultation period.
- 4 On 9 March 2020 the IASB has issued its ED, as anticipated. The contents of the pre-consultation document have been used in the preparation of this version of EFRAG DCL on the ED. The pre-consultation document had been prepared on the basis of the IASB tentative decisions.
- 5 The IASB ED is open for consultation until the 25 May.
- 6 EFRAG FIWG provided inputs on the draft EFRAG DCL, EFRAG TEG will be updated verbally on their comments.

Comparison between the IASB tentative decisions and the ED

- 7 Agenda Paper 06-05 provides a comparison of the IASB wording in the tentative decisions, which was the basis of the pre-consultation document, and the IASB wording in the ED, to which EFRAG DCL refers. The words in yellow mark the key differences in wording.
- 8 EFRAG Secretariat has identified the following wording changes for which would like to confirm with EFRAG TEG that no wording changes are needed to the EFRAG DCL:
 - (a) Explanation of the need to clarify what constitute a modification (BC 16/ BC 20). The Board explains in these BCs that without clarification proposed in the amendments, there is a risk of diversity in practice and that extending this proposal to ALL the modifications (outside the scope of the IBOR reform) could assist entities in assessing the changes. The IASB announces that there will be a narrow-scope amendment to IFRS 9 for all modifications;

- (b) Examples of modifications in scope of the relief have been added (paragraphs 6.9.4, and 6.9.5). Please note that the latter refers to the fallback clauses and we propose to amend the EFRAG DCL (as explained in the table below);
- (c) Refer to “formal hedging designation” instead of “hedge documentation” (6.9.7);
- (d) Introduce a requirement to amend the designation “as and when” uncertainty ceases to exist. The previous version of the wording stated that in case of changes to the documentation for amendments due to the IBOR reform, the change to the documentation would not trigger discontinuation. The new wording states that as and when the uncertainty ceases to exist, the entity shall amend the formal designation and this does not trigger discontinuation, if required by the IBOR reform;
- (e) The text of paragraph 6.9.12 on cash flow hedge has been added (previous wording was not as detailed as this);
- (f) Assessment of separability: wording of paragraphs BC 87 and 89. These two paragraphs may provide a reading of IFRS 9/IAS 39 eligibility criteria for hedge accounting that may be more narrow than what is currently applied in practice for some hedging strategies, in particular for hedged items that do not have an active secondary market;
- (g) Continuous assessment of separability within 24 months. The new wording seems to imply that there is a continuous assessment of the separability criteria during the 24 months; such a continuous assessment was not explicitly mentioned in the tentative decisions;
- (h) The following IASB tentative decision is not reflected in the ED: ‘Retrospective application relates to items that existed at the beginning of the reporting period in which an entity first applies the proposed amendments, including to amounts accumulated in the cash flow hedge reserve related to hedging relationships that have already been discontinued’;
- (i) The text of paragraph 7.2.38 on reinstatement of prior periods has been added and was not in the tentative decisions;
- (j) The detailed text of the Disclosure requirements is different (requirement to show separately assets, liabilities, derivatives; requirement to disclose significant judgement applied).

Changes proposed to the text of the pre-consultation document and incorporated in the DCL

9 The following table represents changes compared to the IASB tentative decisions identified by EFRAG Secretariat:

Change reference (question or ED paragraph) and brief description	EFRAG proposed response	EFRAG proposed detailed response
<p>Paragraph 6.9.5 of the ED on fallback provisions was not included in the IASB tentative decisions. In this paragraph the IASB states that activation of existing contractual terms (e.g. fallback clauses) does not meet the definition of a modification in paragraph 6.9.2 because these contractual terms were already present at initial recognition of the financial instrument.</p>	<p>The proposed amendments would also apply to fallback provisions. EFRAG agrees with this proposal because the accounting consequences would then be similar to those under a modification of contractual terms when no fallback provisions exist. However, EFRAG observes that it is unclear why activation of fallback provision would not meet the proposed description of a modification.</p>	<p>Paragraph 31 of DCL.</p> <p>The proposed amendments would also apply in relation to fallback provisions as outlined in paragraph 6.9.5 of the ED even though these changes are described as not meeting the description of a modification in paragraph 6.9.2 of the ED. EFRAG agrees with this proposal because the accounting consequences would then be similar to those under a modification of contractual terms when no fallback provisions exist. However, the description of a modification says that a modification exists when the basis for determining the contractual cash flows is changed after the initial recognition of the financial instrument and can arise even if the contractual terms of the financial instrument are not amended. EFRAG suggests to clarify why activation of fallback provisions would not meet the proposed description of a modification; in fact a fallback actually changes the basis for determining the contractual cash flows without changing the underlying contractual terms.</p>

Change reference (question or ED paragraph) and brief description	EFRAG proposed response	EFRAG proposed detailed response
<p>Question 2 – Portfolio hedges. The IASB December tentative decision that IAS 39 should be amended so that, when entities change the hedged risk to an alternative benchmark rate in the hedged documentation, it is assumed that all items included in the portfolio of financial assets or financial liabilities share the risk being hedged was not carried forward to the ED.</p> <p>In the IASB view, if separately identifiable criteria is met, it is already proven that all items in the pool share the same risk characteristics.</p>	<p>EFRAG observes that the IASB’s tentative decision to amend IAS 39 to require an entity changing the hedged risk in the hedge documentation for a portfolio hedge of interest rate risk to assume that all items included in the portfolio of financial assets or financial liabilities share the risk being hedged is not reflected in the ED. EFRAG suggests including such amendment to the final standard.</p>	<p>Paragraph 47 of DCL. EFRAG observes that the IASB’s tentative decision to amend IAS 39 to require an entity changing the hedged risk in the hedge documentation for a portfolio hedge of interest rate risk to assume that all items included in the portfolio of financial assets or financial liabilities share the risk being hedged is not reflected in the ED. EFRAG suggests including such amendment to the final standard because such amendment would be consistent with the objective of the other proposed amendments in that transition from IBOR to an alternative benchmark rate as directly required by the reform should not require an entity to discontinue hedging relationships.</p>
<p>Question 2, paragraph BC49 of the ED “If the additional changes do not result in discontinuation of hedge accounting, the designation of the hedging relationship would be amended only as required by paragraph 6.9.7 and paragraph 102O of this ED.”</p> <p>In the IASB view ‘only’ means that if other changes not related to IBOR transition are made to the hedge documentation, the hedge accounting should be discontinued. The paragraph 102O lists the changes allowed to be made in hedge documentation in relation to</p>	<p>No changes</p>	<p>Paragraph 48 of DCL. EFRAG observes that the IASB might consider clarifying the wording used in paragraph BC49 of the ED: “If the additional changes do not result in discontinuation of hedge accounting, the designation of the hedging relationship would be amended only as required by paragraph 6.9.7 and paragraph 102O of this ED.” EFRAG suggests clarifying these words in that the “only” is not meant to say that the additional changes were not to be reflected in the documentation.</p>

Change reference (question or ED paragraph) and brief description	EFRAG proposed response	EFRAG proposed detailed response
<p>IBOR without discontinuation of the hedge accounting.</p>		
<p>Question 3, paragraphs 6.9.11/102T of the ED</p> <p>‘For the purpose of applying paragraph 6.5.8 to account for a fair value hedge at the time that the hedge designation is amended applying paragraph 6.9.7, an entity shall:</p> <p>(a) remeasure the hedging instrument based on the alternative benchmark rate and recognise a corresponding gain or loss in profit or loss; and</p> <p>(b) remeasure the carrying amount of the hedged item based on the alternative benchmark rate designated as the hedged risk and recognise a corresponding gain or loss in profit or loss.’</p> <p>The issue is ‘and’ between (a) and (b).</p> <p>In the IASB view the remeasurement is linked to the end of uncertainty described in paragraph 6.9.7 of the ED and hence can be done at different times for hedged item and hedging instrument. It can only be done when the rate is changed, not on the assumption it will change.</p>	<p>However, EFRAG observes that the current wording used in the ED could imply that remeasurement of both the hedging instrument and the hedged item is required at the time the hedge documentation is amended.</p>	<p>Paragraph 60 of DCL. EFRAG agrees that the requirements in IFRS 9 and IAS 39 would be applied when the designation of a hedging relationship is amended to remeasure the hedging instrument and hedged item based on the alternative benchmark rate and recognise any resulting ineffectiveness in profit or loss. This should take place only when the underlying financial instrument is modified and should relate only to this financial instrument. However, EFRAG observes that the current wording used in the ED could imply that remeasurement of both the hedging instrument and the hedged item was required at the time the hedge documentation is amended, regardless of whether the underlying financial instruments are already based on the alternative benchmark rate or still based on IBOR. Hence EFRAG suggests to clarify the wording in the final amendments to require remeasurement of a financial instrument only if it is actually based on alternative benchmark rate.</p>

Change reference (question or ED paragraph) and brief description	EFRAG proposed response	EFRAG proposed detailed response
<p>Question 4, paragraph B92 of the ED last sentence: “When an entity reasonably expects that an alternative benchmark rate will not meet the separately identifiable requirement, either during, or at the end of, the 24-month period, the entity must discontinue hedge accounting prospectively.”</p> <p>In the IASB view, if now it is known that the separately identifiable requirement will not be met at the end of 24-month period, the hedge accounting should be discontinued.</p>	<p>No changes</p>	<p>Paragraph 71 of DCL. EFRAG observes that the IASB might consider clarifying the wording used in paragraph BC92 of the ED: “When an entity reasonably expects that an alternative benchmark rate will not meet the separately identifiable requirement, either during, or at the end of, the 24-month period, the entity must discontinue hedge accounting prospectively.” EFRAG suggests clarifying these words in that the expectation should always relate to the end of 24-month period, regardless of whether this expectation is made either during or at the end of the 24-month period.</p>

Questions for EFRAG TEG

- 10 Does EFRAG TEG agree with the EFRAG proposed changes to the text in the pre-consultation document described in the table above?
- 11 Does EFRAG TEG consider that additional comments should be included in the EFRAG DCL to take into accounting the changes in the wording described in this Cover Note (paragraph 8)?
- 12 Does EFRAG TEG has additional comments on the EFRAG DCL?
- 13 Does EFRAG TEG agree to recommend the EFRAG DCL for approval to the EFRAG Board?

Agenda Papers

- 14 In addition to this cover note, agenda papers for this session are:
 - (a) Agenda paper 06-02 – EFRAG DCL on IASB ED IBOR – Phase 2;

- (b) Agenda paper 06-03 – EFRAG DCL on IASB ED IBOR – Phase 2 - Track changes; and
- (c) Agenda paper 06-04 – IASB ED ED/2020/1 IBOR – Phase 2 – for background only; and
- (d) Agenda paper 06-05 – Detailed comparison between the IASB tentative decisions and the ED