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Banking supervision
And Accounting issues Unit

The Director

Paris, May 29th, 2019.

EFRAG's Draft Letter to the IASB ED/2019/1 Interest Rate Benchmark Reform (Proposed amendments to IFRS 9 and IAS 39)

The French Banking Federation (FBF) appreciates to comment on EFRAG draft comment letter on IABS ED/2019/1 *Interest Rate Benchmark Reform.*

We share the views expressed by the EFRAG that the IASB proposals are an appropriate solution for providing relief on hedge accounting during the periods before the transition.

However, we would like to make the following comments.

- Concerning **hedge effectiveness**, no relief has been provided to the retrospective test as the Board considered that retrospective assessment is "*based on the actual results of the hedging relationships*" (BC23). This raises concerns regarding the hedge relationships under IAS 39 as IAS 39 requires retrospective assessment. Indeed, the issue would result from timing differences in the benchmark rate between the hedged item and the hedging instrument. While identified by EFRAG as an issue to be addressed by the IASB in the second phase (Topic 3 in the appendix II of the EFRAG draft letter), we consider that it should be included in the scope of the first phase.

- Concerning **disclosures,** while we agree that relevant information should be provided about the effects of the proposed amendments on the hedging relationships, the proposed disclosure is burdensome and will generate undue costs.
  Costs will be on the disaggregation of carrying amounts and gains and losses arising from IBOR hedges that are not naturally disaggregated. We question the relevance of the information and its usefulness for users of financial information. Moreover, under IAS 39 amendments *"Novation of derivatives and continuation of hedge accounting"* additional disclosures were not required.
  Thus, we suggest that disclosures on the effects of the IBOR Reform should remain qualitative to explain how the entity uses the proposed exceptions.

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EFRAG has identified a number of **topics to be addressed by the IASB in the second phase.** (appendix II of the EFRAG draft letter)

In our views, priority should be given to the following topics:

- Discontinuation of existing hedge relationship due to changes of critical terms (topic 4: hedge accounting discontinuation). A change of the underlying reference interest rate as a result of IBOR transition should not be seen as a substantial modification and it should not trigger derecognition of the hedged or hedging instrument.

- Gains or losses that may arise on modifications of contracts that do not result in derecognition (topic 2: modification). We share EFRAG's view that IAS 39 paragraph AG7 or IFRS 9 paragraph B5.4.5 should be applied.

- Hedge documentation of the hedged risk (topic 6: hedge documentation). Hedge documentation would need to be updated following replacement of original indexes, when no longer published, by new indexes according to the BMR regulation. This should not be seen as discontinuance of hedge accounting relationship or as a change in the hedged risk.

- Different transition path of the hedged item and hedging instrument and retrospective assessment (topic 3: retrospective assessment and hedge accounting ineffectiveness). If the topic was not addressed in phase 1 as mentioned above, then it should be addressed in phase 2.
  Due to the differences existing between the derivatives markets and cash instruments markets, we expect that in a cash flow hedge relationship, hedged items and hedging instruments will be affected at different path by the transition to RFRs. In such situations, we consider that discontinuing the hedge accounting because of a temporary higher ineffectiveness (leading to breach the 80%-125% test) would not reflect risk management and would not bring a useful information to users. Continuing the hedging relationship while measuring and accounting through P&L any additional ineffectiveness due to this only transition to RFRs would be much more meaningful for users. Therefore, we suggest the IASB to consider this situation and propose a relaxation from applying the 80%-125% threshold for both the retrospective and prospective effectiveness tests during that period as long as it can be documented qualitatively that the foreseen changes are expected to achieve an effective economic hedge.

However, among the topics that EFRAG has listed to be reviewed in the second phase, we question the relevance of some of them. Indeed, these topics do not seem to be directly linked to the issues that may be raised within the replacement phase.

These are as follows:

- Topic 7: IAS 8 – change in estimates. We believe that the other provisions of IFRS 9 or IAS 39 would apply before any other consideration related to IAS 8 Change in estimates.
- Topic 8 : IFRS 9 – SPPI criterion. In our view, it is not the most important topic to date.
- Topic 9: IFRS 9 – business model. Contract modifications that are a direct consequence of the IBOR reform should not trigger a reassessment of the business model and should also not result in derecognition (cf. topic 1). Otherwise, the direct link of the contract modification to the index change may be questioned. Moreover, IFRS 9 guidance seems already clear that the business model assessment is based on "sale" frequency and volume which is obviously different from derecognition upon contractual modification.

- Topic 10: IFRS 17 – interest guarantees in insurance contracts
- Topic 12: collateralised derivatives discounting using €STER. The topic seems to be similar to topic 2: modification.

Finally, concerning the date of application and as far as Europe is concerned, attention must be given to the **European endorsement process** of the proposed amendments and its prompt launching prior to the end of 2019. It is of the utmost importance that the European entities could be in position to possibly early apply the amendments, even if the final approval of the text by the EU occur shortly after end of 2019.

We hope you find them useful and would be pleased to provide any further information you might require.

Yours sincerely,

Bertrand Lussigny