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Comments on EFRAG Draft comment Letter to the IASB Exposure Draft on Interest Rate Benchmark Reform ("ED") – Proposed amendments to IFRS 9 and IAS 39

We are pleased to provide BNP Paribas' comments on EFRAG draft comment letter on IASB Exposure Draft on Interest Rate Benchmark Reform - Proposed amendments to IFRS 9 and IAS 39.

We welcome the efforts and work accomplished by the IASB to provide in a short time frame the first reliefs on hedge accounting requirements that should help avoiding the discontinuation of hedging relationships because of uncertainty surrounding the transition from interest rate benchmarks such as Interest Bank Offered Rate (IBOR) towards Risk Free Rates (RFR), as required by the interest rate benchmarks' reform.

We generally share the view expressed by the EFRAG that the IASB proposal provides an appropriate solution to the issues raised by the IBOR Reform as regards the forward looking hedge accounting requirements during the pre-transition phase (referred to as Phase 1 of the project). Indeed, the reliefs provided through the proposed amendments enable to address most of the concerns linked to the period where there is still uncertainty about when and how the hedged items and hedging instruments will move towards a Risk Free Rate.

There are however a few issues that we would like to raise:

The first one relates to the situation where the hedged item and hedging instrument would not move to a RFR at the same pace and consequently phase I relief would end for either the hedged item or hedging instrument. In such case, because the prospective effectiveness test will be based on the contractual terms of each item which by nature will differ and will not reflect the expected future contractual terms for both of them, some additional ineffectiveness will be measured which does not reflect the actual future expected ineffectiveness. For entities applying IAS 39 this may trigger the breach of the 80§-125% threshold and the discontinuation of a hedging relationship even though this hedging relationship would prove to be highly effective once both items have moved to a RFR. This situation may also lead to breach the retrospective test for which no relief is provided even though the extra ineffectiveness (above the 80%-125%) is only temporary and directly linked to the non-simultaneous transition of items to a RFR.

The second issue relates to disclosures, as we believe that the information to be provided on the hedging relationships that benefit from the proposed amendment (ie in the scope of the relief) will require significant modifications in the systems. We also consider that the benefit of such detailed disclosures for users is questionable as we assume that users would likely be more interested in a qualitative disclosure about the path at which the transition is implemented and the basis on which modifications are performed.

As regards the effective date and transition we welcome the possibility to early apply the amendments as this would avoid the discontinuation of hedging relationships in the annual period ending at December 31st, 2019, provided – for EU entities- a prompt European endorsement process can be achieved.

Because €STR will be published on 1st October, 2019 and other risk free rates are already quoted, we agree with EFRAG on the urgency for the IASB to address the second phase of the project to handle accounting issues after transition (referred to as Phase II of the project). We welcome EFRAG work accomplished to identify these issues and comment in appendix to this letter those which we consider the most significant. Because some of them may arise before phase II is issued, we would encourage the IASB to achieve the needed amendments as soon as possible with the aim to limit as much as possible the undue impacts of such reform on preparers' financial statements.

We also draw the attention of the EFRAG on the importance of ensuring as much as possible consistency between proposed amendments across different Gaaps.

More generally, we believe that the discontinuation of a hedging relationship due to the IBOR reform should be avoided as much as possible to prevent a misalignment with risk management, while any ineffectiveness shall be reflected in the financial statements.

Should you have any questions regarding our comments, please do not hesitate to contact us.

Yours sincerely,

Lars Machenil

Appendix

EFRAG has identified a number of issues related to phase II. We have listed below those we believe are the most important:

- **Different transition path of the hedged item and hedging instrument** (see above in our letter)

- **Reclassification of the Cash Flow Hedge reserve**

Without a phase II relief succeeding to the one provided in phase I, once there is no more uncertainty about the modification of the hedged item expected cash flows towards RFR cash flows, the cash flows hedge reserve would have to be reclassified to profit & loss as if the new cash flows were not a continuation of the initially hedged IBOR cash flows.

- **Modification and derecognition**

When a non-derivative financial asset indexed on an IBOR rate is modified so that the IBOR rate is replaced by a RFR, we believe that as long as the initial instrument meets the SPPI test and the interest rate modification does not alter the SPPI assessment, the instrument before and after the modification shall be considered as substantially the same leading to no derecognition of the initial instrument. This approach is grounded on the fact that such replacement is required by regulation and is expected to achieve a continuation between initial rate and RFR.

- **Accounting for modified financial instruments**

If a modified debt instrument is not derecognised after transition to a RFR, the following step is to determine how the modification shall be accounted for. Because the transition to a RFR is meant to be a change in the existing interest rate compliant with the regulation requirements, we share EFRAG's view that it would be consistent to account for such change by analogy to a change in a market interest rate, as a revision of the EIR as stated in IAS 39 § AG7 or IFRS 9 § B 5.4.5.

- **Cash Flow Hedge discontinuation**

Assuming either the hedged item or the hedging instrument is derecognised following the transition of the hedged item and hedging instrument to a RFR, it is likely that the re designation of a new hedging relationship would not be possible as the hedging derivative would have a fair value at the re designation date different from that of the hypothetical derivative (ie zero). Assuming such new hedging relationship would have been highly effective had it been designated at the inception of the initial hedging relationship, we believe it should be eligible to a re designation. We would welcome a relief in phase II for such situations.