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Chairman

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PDC N°28

Mr Gauzès  
EFRAG President  
35 Square de Meeûs  
B-1000 Bruxelles

**Re: EFRAG's draft comment letter on ED/2019/1 amendments to IFRS 9 and IAS 39 related to interest rate benchmark reform (IRBR)**

Dear Mr Gauzès, *cher Jean-Paul,*

I am writing on behalf of the Autorité des Normes Comptables (ANC) to express our views on the above-mentioned EFRAG's draft comment letter (DCL) on ED regarding proposed amendments to hedge accounting (Phase I) related to the impact of the interest rate benchmark reform (IRBR). This letter sets out some of the most critical comments raised by interested stakeholders involved in ANC's due process.

### **Overall approach and general comments**

ANC concurs with the objectives assigned to the amendments to tackle any undesirable accounting effect of the IRBR on a hedge relationship. Accordingly, we acknowledge the necessity to take into consideration any possible hedge ineffectiveness that may result from the new raised uncertainties, but also concur with IASB view that the change of benchmark *per se* should not trigger a discontinuation of the hedge relationship.

The continuity of the hedge relationship constitutes, in our view, the main issue to be addressed by the proposed relief, in case of modifications restricted to the IRBR. A temporary relief in the first phase of the project, focused on the presumed continuity of the hedge effectiveness, would have been sufficient and less burdensome than the proposed approach based on a contract by contract basis.

Additionally, regarding the issues for Phase II, ANC encourages IASB to assess whether its proposals will ensure a level playing field with proposals that other standard setters may provide, especially if the latter appear more economical and practical, or if they encompass additional issues such as retrospective assessments.

### **Comments on the proposed amendments in phase I (as discussed in the ED)**

ANC agrees that the relief provided by the suggested amendments will address the issues raised in phase I except for the following topics detailed hereunder.

#### *Additional issue not raised by the ED on phase I*

We believe that the relief provided for hedge accounting should not be restricted to the interest rate risk, but should also be applicable for hedges including both interest and foreign currency risks (cross currency swaps).

#### *Hedging relationship assessment (Question 1)*

When differences in the changes of cash flows of the hedged item and of the hedging instrument arise from the reform (including different timing in the benchmark rate replacement), the additional ineffectiveness should be recorded into P&L as any other ineffectiveness but should not preclude the continuation of the hedge accounting.

Consequently, we do not share the Board's view expressed in BC 23 and consider that a relief should also be provided for retrospective testing without waiting for additional consideration under phase II. Discontinuing the hedge accounting before the replacement of benchmark interest rate because of a temporary higher ineffectiveness (leading to breach the 80%-125% test) would be inconsistent with the entity's interest rate risk management and would not provide a useful information to users of financial statements. A similar relief should also be provided regarding IFRS 9, as far as the sole effect of the IRBR is not expected to break the "*economic relationship*" supporting the hedge documentation.

Excluding the retrospective test from the relief would run counter the amendments: if the Board's view expressed in BC 23 were confirmed, then the ED would not provide any relief we believe it was originally designed to achieve as there will be significant disruptions to hedge accounting solely because of the IRBR.

#### *Conditions to the end of the relief (Question 3)*

We share the Board's view when it states that "*discontinuation of hedge accounting solely due to such uncertainties [about the timing and the amount of future cash flows] before the reform's economic effects are known would not provide useful information to users of financial statements.*". Nevertheless, we consider that such uncertainties do not disappear when the transition process is adopted, but remain opened until the new contractual cash flows are effectively modified by the implementation of the new benchmark rate. Such modification is not always expected to occur on a fixed date when transition periods are provided by the relevant authorities (which is the case for the transition from EONIA to ESTER, for instance).

Additionally, conditions set in determining the end of the relief need to be adjusted. In fact, BC 40 of the ED deals with uncertainties on both hedged and hedging instruments, but not with uncertainties on

either hedged or hedging instruments. For instance, in fair value hedge, there can be cases arising before the end of 2019 where a hedging relationship would be set-up with a derivative, such as an Interest Rate Swap, and a non-derivative instrument, such as a loan granted to a corporate or an individual, and for which:

- The derivative, with fall-back clauses set-up by market setter (e.g. ISDA), is required to migrate to an RFR benchmark (before the end of the IBOR quotation); and
- The non-derivative instrument, requiring a bilateral negotiation to be amended, has not yet migrated to an RFR benchmark rate.

We are aware that such issues are expected to be addressed in the second phase of the IASB project. We therefore urge IASB to undertake the phase II as soon as possible.

#### *Disclosures (Question 4)*

Since the purpose of the relief is to reflect in the financial statements the continuity of the hedge relationship, and that any possible inefficiency will be recognised through P&L, we question the relevance and the usefulness of further disclosure about the “*magnitude of the hedging relationships to which the exception applies*”. The Board noted that disruption due to the IBOR reform would not provide meaningful information, then why would it be meaningful to require such disclosure when the basis for the ED is to keep a *status quo*? The Basis for Conclusions does not provide details about the nature and extent of additional users’ need. If the criteria for applying the ED’s reliefs are passed, then the hedge accounting continues as before and it would be consistent to leave the related disclosures unchanged.

Unlike expected by the Board (BC 44), disaggregating information already required to be disclosed by IFRS 7 according to a new criterion (whether the exceptions have been applied or not) will be costly. It would require from preparers the implementation in the IT tools of this new criterion, the modification of the reporting tools used by groups to consolidate the contributions of their subsidiaries and affiliates, and the adaptation of the consolidation tool to be able to provide the new disaggregated figures in the notes to consolidated financial statements. All these tasks also require time to ensure a proper implementation. Furthermore, ANC questions the expected costs versus benefits of such a temporary amendment as those disclosures would cease to be provided at the end of the relief.

We also note that the Board did not require new disclosure when issuing IAS 39 amendments “*Novation of derivatives and continuation of hedge accounting*” in 2013.

We rather suggest providing qualitative information about the transition to the new benchmark rates, the absence (or not) of consequences on the risk management and the related hedging transactions, and whether the entity has applied the reliefs proposed by these amendments.

#### *Effective date and transition: early application*

The Board proposes an effective date on 1 January 2020 with a possible early application of the amendments. To be able to early apply the amendments, they should have been issued before the end of 2019 and then endorsed by local authorities when such endorsement is required (which is the case within the European Union). We then ask the Board to issue the amendments at a date that would allow such an early application.

**Issues to be addressed in phase II (as addressed in Appendix II of the EFRAG’s comment letter)**

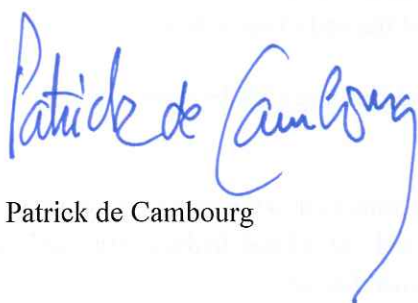
The Board has organised its work into two successive phases assessing separately pre-replacement issues and replacement issues. As far as replacement issues could arise before the end of 2019 for some benchmark rates, we warmly encourage the Board to address these issues as soon as possible with the objective to provide the appropriate reliefs on a timely basis for a possible early application in 2019.

Among the topics identified by EFRAG in its DCL, ANC highlights the following issues as to be preferentially addressed in phase II:

- Modification versus derecognition: assessing how an amendment of contractual interest rate to reflect the new benchmark rate, as it is required by external regulation, would not result in the derecognition of the instrument (topic 1 of the DCL).
- Prospective change of the effective interest rate versus recognition of a modification gain or loss: assessing whether it should be allowed to prospectively adjust the effective interest rate (EIR) when this adjustment is a consequence of the sole IBOR reform. ANC especially supports a solution proposed by the EFRAG which deals with changing yields to offset the expected decrease of benchmark rates<sup>1</sup> (topic 2 of the DCL).
- Hedge accounting effectiveness: if not addressed in Phase I, assessing how to relieve the retrospective test (see here above) (topic 3 of the DCL).
- Hedge documentation: to avoid burdensome updates of the hedging documentation affected by the reform, assessing whether a relief should be granted to the extent that discontinuation of the hedge accounting relationship would solely be due to the need of such an update of the documentation (topic 6 of the DCL).
- ANC shares the view of EFRAG to maintain the cash flows hedge reserve in OCI, even after the end of the relief (topic 11 of the DCL).

Please do not hesitate to contact us should you want to discuss any aspect of our letter.

Yours sincerely, *Avec mes amitiés.*



Patrick de Cambourg

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<sup>1</sup> It is expected that new-RFRs will be lower than the old IBORs. When IBOR-based financial instruments are modified to be based on the new RFR they may include a higher fixed spread. To the extent the present value of the increase in the spread is offset by lower forecast floating rate cash flows, at the date of the modification the relationship between the lender and borrower is unchanged. Accordingly, to the extent the modification does not result in a gain or loss for either borrower or lender, both parties should be able to apply IAS 39.AG 7 or IFRS 9.B5.4.5.