

International Accounting Standards Board
7 Westferry Circus, Canary Wharf
London E14 4HD
United Kingdom

26 May 2020

Dear Mr Hoogervorst,

Re: Exposure Draft *ED/2020/1 Interest Rate Benchmark Reform—Phase 2*

On behalf of the European Financial Reporting Advisory Group (EFRAG), I am writing to comment on the Exposure Draft *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’).

This letter is intended to contribute to the IASB’s due process and does not necessarily indicate the conclusions that would be reached by EFRAG in its capacity as advisor to the European Commission on endorsement of definitive IFRS Standards in the European Union and European Economic Area.

EFRAG generally supports the proposed amendments in the ED, as it will enable entities to reflect the effects from transitioning from IBOR to alternative benchmark rates without giving rise to accounting impacts that would not provide useful information to users of financial statements.

EFRAG notes that the IASB proposes to clarify that 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 *Financial Instruments*. As an assessment of the impact of this clarification is not possible within the limited timeframe available for this urgent project, EFRAG agrees with limiting the scope of this clarification to the changes solely related to the IBOR reform.

EFRAG agrees with providing a practical expedient requiring an entity to apply paragraph B.5.4.5 of IFRS 9 to account for modifications related to the IBOR reform. EFRAG considers that this practical expedient would provide more useful information to users of financial statements and is also expected to significantly reduce the operational burden on preparers.

EFRAG notes that under the current IFRS requirements, a hedging relationship may have to be discontinued solely because of transitioning from IBOR to an alternative benchmark rate by way of a modification of contractual terms of the underlying financial instruments as directly required by the reform. This may be because the entities would have to update the hedge documentation to redefine the hedged risk or to redefine the characteristics of the hedged item or the hedging instrument, or because it would be impracticable to apply the same method of effectiveness measurement after transition. EFRAG observes that the IASB’s proposals address such accounting consequences appropriately by enabling

entities to continue their hedging relationships to reflect the transition to an alternative benchmark rate. EFRAG agrees that such relief is made available provided that the modifications are done on an economically equivalent basis. In addition, EFRAG agrees with the proposed amendments in relation to groups of hedged items.

EFRAG suggests that the IASB consider the following when finalising the standard:

- (a) One of the IASB's tentative decisions taken during the project is not reflected in the ED: 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. EFRAG suggests including such amendment to the final standard.
- (b) To relocate the paragraphs proposed on modifications of financial assets and financial liabilities (paragraphs 6.9.1 to 6.9.6) to section 5.4 rather than section 6 of IFRS 9 so that the scope of the requirements is clarified. This will also increase clarity for entities that apply the requirements on hedge accounting in IAS 39 *Financial Instruments: Recognition and Measurement* and hence do not apply the requirements of section 6 of IFRS 9 in accordance with paragraph 7.2.21 of IFRS 9.
- (c) In order to apply the practical expedient, a modification or activation of fallback provisions has to be required in accordance with paragraphs 6.9.3 (a) and 6.9.5(b). EFRAG notes that an entity may replace IBOR voluntarily before the legal discontinuation of the old benchmark, in preparation to the end of the transition period. The IASB should reconsider the use of the word "required" in both paragraphs.
- (d) To clarify that there may be instances of historical fallback terms where the economic equivalence can be assessed at the date when the fallback clauses were included.
- (e) In case of fair value hedges of fixed rate financial instruments, EFRAG has been made aware of the need to remeasure the hedged items to consider the alternative benchmark rate used to remeasure the fair value of the hedging instrument. In absence of such a remeasurement of the hedged item, an impact on profit or loss does not represent real ineffectiveness. EFRAG suggests the IASB to clarify that the remeasurement can be seen as a part of amending the formal designation of the hedging relationship as previously documented.
- (f) The wording in paragraph BC35 of the ED may be interpreted as contradicting the order for application of the requirements in paragraph 6.9.6.
- (g) Pending a future discussion and consultation on what constitutes a modification, the wording of paragraphs BC24 and BC25 of the ED seems to provide guidance for modification that may have unintended consequences.
- (h) The current wording used in paragraphs 6.9.11 and 6.9.12 of 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, 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.
- (i) The IASB might consider clarifying the wording used in paragraph BC92 of the ED, 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.

- (j) The disclosures in paragraph 24J(b) of IFRS 7 should not require comparative information because such comparative information is of limited relevance to users given current progress of the IBOR reform.

In relation to the proposed amendment to IAS 39 *Financial Instruments: Recognition and Measurement* to reset the cumulative fair value changes to zero for the purpose of effectiveness measurement, EFRAG agrees that this amendment will avoid recognising ineffectiveness that would otherwise arise because of the differences between IBOR and the alternative benchmark rate.

EFRAG also supports the proposed amendments on IFRS 16 *Leases* and IFRS 4 *Insurance Contracts*, noting that these amendments are proposed for similar reasons as the amendments to apply paragraph B.5.4.5 of IFRS 9, i.e. providing more useful information to users of financial statements and significantly reducing the operational burden on preparers, and hence increase relevance and comparability.

EFRAG agrees with the proposed disclosures as they will assist users of financial statements in understanding the effects of the IBOR reform for an entity to the extent they reflect the entity-specific impacts from transitioning from IBOR to an alternative benchmark rate. EFRAG notes that the disclosure requirements based on carrying amounts may be perceived by some of our constituents as unbalanced in terms of cost/benefit. EFRAG suggests the IASB to allow alternatively disclosing quantitative information used by entities in managing the reform when information based on carrying amounts as otherwise required by paragraph 24J(b) is not available without undue cost or effort.

The proposed temporary relief in the context of non-contractually specified risk components on the “separately identifiable” requirement is also supported by EFRAG. However, EFRAG is concerned about paragraphs BC87 and BC89 of the ED, as these paragraphs seem to introduce application guidance to the current hedge accounting requirements that may result in a narrower scope for hedge designation, compared with some practices that exist in European jurisdictions in the banking sector, such as certain hedges of loan or deposit books, for which there is not necessarily an active market. EFRAG, therefore, recommends that the IASB reconsiders the wording in these paragraphs, to avoid unintended implications to current practice outside the scope of IBOR reform. Against the background of the current market disruption linked to the COVID-19 pandemic, EFRAG recommends that the IASB continues to monitor future developments of alternative rate markets to assess whether it may become necessary to extend the 24-month temporary relief period for the separately identifiable assessment since the establishment of sufficient liquid alternative rate markets could take longer than initially envisaged.

EFRAG agrees that the proposed amendments should be mandatory in order to increase comparability across entities. EFRAG also agrees that no specific end of application requirements need to be specified, because this allows application of the proposed amendments under the different transition paths of the IBOR reforms.

EFRAG supports the proposed effective date and transition requirements. Although entities may have to discontinue hedging relationships when transitioning to an alternative benchmark rate before the proposed amendments become applicable, EFRAG considers that both the possibility to early adopt the proposed amendments and the requirement to reinstate hedging relationships that had to be discontinued due to modifications required as direct consequences of the IBOR reform will enable entities to limit the impact of having to discontinue such hedging relationships.

EFRAG’s detailed comments and responses to the questions in the ED are set out in the Appendix.

EFRAG Final Comment Letter - Interest Rate Benchmark Reform - Phase 2

If you would like to discuss our comments further, please do not hesitate to contact Didier Andries, Galina Borisova, Almudena Alcalá or me.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'JP Gauzès', written in a cursive style.

Jean-Paul Gauzès
President of the EFRAG Board

Appendix - EFRAG's responses to the questions raised in the ED

Question 1: (paragraphs 6.9.1–6.9.6 of the [Draft] amendments to IFRS 9, paragraphs 20R–20S and 50–51 of the [Draft] amendments to IFRS 4 and paragraphs 10A–10C and C1A–C1B of the [Draft] amendments to IFRS 16)

Paragraphs 6.9.2–6.9.6 of the draft amendments to IFRS 9 propose that:

- (a) a financial asset or financial liability would be modified if the basis for determining the contractual cash flows is changed after the initial recognition of the financial instrument. In this context, a modification can arise even if the contractual terms of the financial instrument are not amended.
- (b) an entity would apply paragraph B5.4.5 of IFRS 9 as a practical expedient to account for a modification of a financial asset or financial liability that is required by interest rate benchmark reform.
- (c) a modification is required by interest rate benchmark reform if and only if
 - (i) it is required as a direct consequence of interest rate benchmark reform; and
 - (ii) the new basis for determining the contractual cash flows is economically equivalent to the previous basis (i.e. the basis immediately preceding the modification).
- (d) an entity would also apply the practical expedient proposed in paragraph 6.9.3 if an existing contractual term is activated that results in a change in the basis for determining the contractual cash flows of a financial asset or a financial liability, and particular other conditions are met.

Paragraphs BC10–BC36 of the Basis for Conclusions describe the IASB's reasons for these proposals.

- (e) The ED proposes to make corresponding amendments to IFRS 4 that would require insurers applying the temporary exemption from IFRS 9 to apply the same practical expedient as described above.
- (f) The ED proposes amendments to IFRS 16 that would require entities to apply paragraph 42 of IFRS 16 to account for a lease modification that is required by interest rate benchmark reform.

Paragraphs BC39–BC41 and paragraphs BC118–BC125 of the Basis for Conclusions describe the IASB's reasons for these proposals.

Do you agree with these proposals? Why or why not? If you agree with only parts of the proposals, please specify what you agree and disagree with. If you disagree with the proposals, please explain what you propose and why.

EFRAG's response

EFRAG notes the proposed amendment that a financial asset or a financial liability would be modified if the basis for determining the contractual cash flows is changed after the initial recognition of the financial instrument, even if the contractual terms of the financial instrument are not amended.

As an assessment of the impact of this clarification is not possible within the limited timeframe available for this urgent project, EFRAG agrees with limiting the scope of this clarification to the changes solely due to the IBOR reform.

EFRAG suggests to relocate the paragraphs proposed on modifications of financial assets and financial liabilities (paragraphs 6.9.1 to 6.9.6) to section 5.4 rather than section 6 of IFRS 9 so that the scope of the requirements is clarified. This will also increase clarity for entities that apply the requirements on hedge accounting in IAS 39 and hence are not applying the requirements of section 6 of IFRS 9 in accordance with paragraph 7.2.21 of IFRS 9.

EFRAG agrees with providing a practical expedient allowing an entity to apply paragraph B5.4.5 of IFRS 9 to account for modifications related to the IBOR reform. This is because EFRAG considers that this practical expedient has the potential to provide more useful information to users of financial statements and is also expected to significantly reduce the operational burden on preparers.

The proposed amendments would also apply to fallback provisions. EFRAG agrees with this proposal. In this context, EFRAG suggests to the IASB to clarify that there may be instances of historical fallback terms where the economic equivalence can be assessed at the date when the fallback clauses were included. EFRAG agrees with the clarification that an entity should first apply paragraph B5.4.5 of IFRS 9 to account for modifications related to the IBOR reform to which the practical expedient applies; and thereafter, apply the current IFRS 9 requirements to determine if any other modifications that are not directly required by the IBOR reform are substantial; if those modifications are not substantial, the entity should apply paragraphs 5.4.3 or B5.4.6 of IFRS 9.

EFRAG agrees with the proposed amendments to IFRS 16 and IFRS 4, EFRAG also agrees that no amendments to other IFRS Standards are necessary.

EFRAG suggests to reconsider the wording in paragraph BC35 (as it may be interpreted as contradicting the order of the application of the requirements in paragraph 6.9.6) and of paragraphs BC24 and BC25 (as it seems to provide guidance for modification that may have unintended consequences).

- 2 EFRAG notes the proposed amendment that if the basis for determining the contractual cash flows is changed after the initial recognition of the financial instrument, it constitutes a modification of a financial instrument, even if the contractual terms of the financial instrument are not amended.
- 3 EFRAG observes that the proposed practical expedient to apply paragraph B5.4.5 of IFRS 9 as drafted in the ED would apply to all financial instruments regardless of their classification. However, the practical expedient provides guidance on how to account for modifications in the context of applying the effective interest rate method which is not applicable to all financial instruments.
- 4 Furthermore, EFRAG became aware of concerns from entities that apply the requirements on hedge accounting in IAS 39 and hence are not applying the requirements of section 6 of IFRS 9 in accordance with IFRS 9.7.2.21. For those entities, the proposed requirements on modifications of financial assets and financial liabilities may not be applicable if they were included in section 6 as proposed in the ED.
- 5 EFRAG therefore suggests to relocate the paragraphs proposed on modifications of financial assets and financial liabilities (paragraphs 6.9.1 to 6.9.6) to section 5.4 rather than section 6 of IFRS 9 so that both the scope of the requirements is clarified and clarity for entities that apply the requirements on hedge accounting in IAS 39 is increased.
- 6 EFRAG agrees with the IASB's proposal to limit the scope of the clarification solely to the changes directly related to the IBOR reform. EFRAG considers in particular that broadening the scope of such a clarification could have possible unintended consequences whose implications would require a separate project with sufficient

time for due consideration to be assessed which would run counter to the efforts to issue the proposed amendments expeditiously. As an assessment of the impact of this clarification is not possible within the limited timeframe available for this urgent project, EFRAG agrees with limiting the scope of this clarification to the changes directly related to the IBOR reform and considers that the implications of such clarification will be limited.

- 7 EFRAG agrees with the proposed amendment to apply paragraph B5.4.5 of IFRS 9 instead of modification accounting. This would provide more useful information to users of financial statements by better reflecting the economics of a floating-rate financial instrument transitioning to an alternative benchmark on an economically equivalent basis. Such an approach is also expected to significantly reduce the operational burden on preparers as they would apply the well-known accounting requirement of updating the effective instrument rate for floating-rate instruments.
- 8 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 not meeting the description of a modification in paragraph 6.9.2 of the ED as they arise from already existing contractual terms. 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.
- 9 In order to apply the practical expedient, a modification has to be required in accordance with paragraphs 6.9.3 (a) and 6.9.5 (b). EFRAG notes that an entity may replace IBOR voluntarily before the legal discontinuation of the old benchmark, in preparation to the end of the transition period even if it is not required to do so at this stage. Hence, EFRAG recommends deleting the term “required” in paragraph 6.9.3 (a) and 6.9.5 (b) so that it reads “the modification is a direct consequence of interest rate benchmark reform.”
- 10 EFRAG agrees with the IASB’s proposal to clarify that an entity should first apply paragraph B5.4.5 of IFRS 9 to account for changes required by the IBOR reform (meeting the conditions in paragraph 6.9.3 of this ED) to which the practical expedient applies. As a second step, the entity should apply the paragraphs 5.4.3 or B5.4.6 of IFRS 9. EFRAG observes that this would enable entities to reflect the transition to an alternative benchmark rate in the same way regardless of whether the transition was connected with other modifications. The proposed amendment is limited to modifications as directly required by the IBOR reform, hence EFRAG agrees that the proposed amendment to apply paragraph B5.4.5 of IFRS 9 should not apply to those other modifications. Applying the proposed amendment first will also enable entities to use the updated effective interest rate, i.e. based on the alternative benchmark rate, to recalculate the cash flows of the modified financial instrument, which will avoid using the original IBOR rate for purposes of subsequent measurement after the transition to the alternative benchmark rate took place.
- 11 EFRAG notes the prescriptive and stringent guidance on modification that the IASB proposes to add in paragraphs BC24 and BC25 of the ED. Such a definitive wording could give rise to unintended consequences and be inconsistent with some practices currently applied. Pending a future discussion and consultation on what constitutes a modification, EFRAG suggests the IASB uses less prescriptive language in those paragraphs, for example including the word “generally”.
- 12 EFRAG agrees with the IASB’s conclusions in paragraphs BC37-BC38 of the ED to retain the current requirements of IFRS Standards that apply when a modification results in derecognition. The same applies in case of a modification that does not result in derecognition and is not required as a direct consequence of the IBOR reform or is not done on an economically equivalent basis. This is because EFRAG observes that the proposed amendments in the ED are limited to the IBOR reform, hence any other modifications that are not directly required by the IBOR reform,

including their accounting impacts, should be dealt with under the current IFRS requirements in the same way as any other modifications.

- 13 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.
- 14 EFRAG has been informed that not all historical fallback terms would have been amended before transition takes place, and that these historical fallbacks might not qualify for the practical expedient since the new cash flows may not be economically equivalent when the fallback rate is triggered but were economically equivalent when it was included in the underlying contract. EFRAG therefore suggests to the IASB to clarify in the Basis for Conclusions that there may be instances where the economic equivalence can be assessed at the date when the fallback clauses were included.
- 15 EFRAG observes that the proposed amendment in paragraph 6.9.6 reflects the wording currently included only in the Basis for Conclusions to IFRS 9, paragraph BC4.253. EFRAG supports this proposal, as including this text in the main body of the standard will increase clarity on the accounting requirements applicable to the modifications of financial liabilities that are not due to the IBOR reform and do not result in derecognition.
- 16 However, EFRAG notes that the wording of paragraph BC35 may be interpreted as being inconsistent with the requirement in paragraphs 6.9.6. Paragraph BC35 refers first to the application of the requirements in IFRS 9 to the changes made in addition to those required by the IBOR reform. On the contrary, according to paragraph 6.9.6, an entity first accounts for modifications required by the reform by applying the practical expedient in paragraph 6.9.3, then it applies the requirements in IFRS 9 to other changes and, if those changes do not result in derecognition, it applies paragraphs 5.4.3 or B5.4.6. EFRAG suggests clarifying the wording in BC35 to avoid any confusion.
- 17 EFRAG observes that the proposed amendments on IFRS 16 and IFRS 4 enable entities to arrive at an accounting outcome for lease liabilities of a lessee or insurance contracts similar to the proposed amendment to apply paragraph B5.4.5 of IFRS 9 to financial instruments. Hence, the effect of modifications made as a direct consequence of the IBOR reform will be reflected in a similar way in entities' financial statements. This will increase comparability of the effects of the IBOR reform across entities and items affected. In addition, EFRAG observes that the objective of the proposed amendments to IFRS 16 and IFRS 4 is equally providing more useful information to users of financial statements and significantly reducing the operational burden on preparers, which increases relevance.
- 18 EFRAG agrees with the IASB's conclusions in paragraphs BC126-BC135 of the ED that the current requirements in other IFRS Standards provide sufficient and adequate guidance to determine the appropriate accounting treatment for potential consequences of the IBOR reform.

Question 2: Amendments to hedging relationships (paragraphs 6.9.7–6.9.10 of the [Draft] amendments to IFRS 9 and paragraphs 102O–102R of the [Draft] amendments to IAS 39)

Paragraphs 6.9.7–6.9.10 of the draft amendments to IFRS 9 and paragraphs 102O–102R of the draft amendment to IAS 39 propose that an entity would amend the formal designation of the hedging relationship only to make one or more of the changes

specified in paragraph 6.9.7 and paragraph 102O as and when uncertainty arising from interest rate benchmark reform is no longer present with respect to the hedged risk and/or the timing and the amount of interest rate benchmark-based cash flows of the hedged item or of the hedging instrument.

Paragraphs BC42–BC50 of the Basis for Conclusions describe the IASB's reasons for these proposals.

Do you agree with these proposals? Why or why not? If you agree with only parts of the proposals, please specify what you agree and disagree with. If you disagree with the proposals, please explain what you propose and why.

EFRAG's response

EFRAG observes that the proposed amendments to hedge accounting will generally enable entities to continue hedging relationships when modifying hedged items and hedging instruments as a direct consequence of the IBOR reform.

EFRAG agrees with the proposed amendments that permit an entity to amend the hedge documentation to reflect the alternative benchmark rate without requiring discontinuation of underlying hedging relationships. 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.

- 19 EFRAG agrees that a discontinuation of hedge accounting would not provide useful information if this would only be caused by modifications to the hedging relationship directly required by the IBOR reform. This corresponds with the rationale of the amendments the IASB has made relating to so-called pre-replacement issues (IBOR Phase 1), which were supported by EFRAG for the same reason.
- 20 Against this background, EFRAG observes that the proposed amendments on hedge accounting will generally enable an entity that has modified financial instruments as directly required by the IBOR reform to continue the hedging relationships affected.
- 21 EFRAG agrees with the proposed exception from the current requirements so that changes in hedge documentation necessary to reflect modifications that are required as a direct consequence of the IBOR reform and are done on an economically equivalent basis do not result in the discontinuation of hedge accounting. This should apply to redefining the hedged risk to refer to an alternative benchmark rate and redefining the description of the hedging instruments or the hedged items to refer to the alternative benchmark rate (paragraphs 6.9.7 and 102O of the ED).
- 22 EFRAG observes that this exception corresponds with the proposed amendment to apply paragraph B5.4.5 of IFRS 9 to modifications directly required by the IBOR reform. When an entity modifies the contractual terms to refer to an alternative benchmark rate accordingly, this will have an impact on the definition of the hedged risk, the description of the hedging instruments and/or the hedged items in the hedge documentation and hedge effectiveness assessment.
- 23 EFRAG agrees with the IASB's analysis in paragraph BC46 of the ED that discontinuation of hedge accounting and the consequential accounting implications, in particular in terms of ineffectiveness and volatility in profit or loss, would not always provide useful information to users of financial statements. This is because

changes in hedge documentation, necessary to reflect modifications directly required by the IBOR reform, are not expected to constitute a change in the general risk management strategy and the risk management objective for hedging underlying risks. Instead, these would generally continue to be either hedge of the exposure to variability in cash flows, albeit now associated with movements in alternative benchmark rate (for a cash flow hedge), or hedge of the exposure to changes in fair value, albeit now associated with movements in alternative benchmark rate (for a fair value hedge).

- 24 Hence, EFRAG agrees with the proposed exception to permit an entity redefining the hedged risk to refer to an alternative benchmark rate and redefining the description of the hedging instruments or the hedged items to refer to the alternative benchmark rate. This will provide clarity to entities that they can reflect the alternative benchmark rate in the hedge documentation without having to discontinue the hedging relationships affected.
- 25 EFRAG agrees with the proposed amendment to IAS 39 to provide an exception from the current requirements relating to the method used for assessing hedge effectiveness (paragraph 102O(d) of the ED). Under such exception, a change to this method would not result in the discontinuation of hedge accounting when, due to the IBOR reform, it is impractical to continue using the same method defined in the hedge documentation at the inception of the hedging relationship.
- 26 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.

Question 3: Accounting for qualifying hedging relationships and groups of items (paragraphs 6.9.11–6.9.15 of the [Draft] amendments to IFRS 9 and paragraphs 102S–102X of the [Draft] amendments to IAS 39)

Paragraphs 6.9.11–6.9.15 of the draft amendments to IFRS 9 and paragraphs 102S–102X of the draft amendments to IAS 39 propose that:

- (a) 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.
- (b) the amount accumulated in the cash flow hedge reserve at the date the entity amends the description of the hedged item would be deemed to be based on the alternative benchmark rate on which the hedged future cash flows are determined.
- (c) when there is a change in the basis for determining the contractual cash flows of a financial asset or a financial liability previously designated as a hedged item in a hedging relationship that has been discontinued, the amount accumulated in the cash flow hedge reserve for the discontinued hedging relationship would be deemed to be based on the alternative benchmark rate on which the hedged future cash flows will be based.
- (d) when applying paragraph 6.9.7 or paragraph 102O to groups of items designated as hedged items, the hedged items would be allocated to sub-groups within the same hedging relationship based on the benchmark rate

to which they are referenced and that the proportionality test would be applied to each sub-group separately.

- (e) for the purpose of assessing retrospective effectiveness as required by IAS 39, the cumulative fair value changes of the hedged item and hedging instrument would be reset to zero when paragraph 102G of IAS 39 ceases to apply. Paragraphs BC51–BC79 of the Basis for Conclusions describe the IASB’s reasons for these proposals.

Paragraphs BC51–BC79 of the Basis for Conclusions describe the IASB’s reasons for these proposals.

Do you agree with these proposals? Why or why not? If you agree with only parts of the proposals, please specify what you agree and disagree with. If you disagree with the proposals, please explain what you propose and why.

EFRAG’s response

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 when each underlying financial instrument is modified. 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.

EFRAG agrees with the proposed amendment to IAS 39 to provide an exception from the current requirements relating to the method used for assessing hedge effectiveness.

Moreover, EFRAG agrees with the proposed amendments in relation to hedges of groups of items because these amendments are consistent with the objective to continue hedging relationships when transitioning from IBOR to an alternative benchmark rate.

In case of fair value hedges of fixed rate financial instruments, EFRAG has been made aware of the need to remeasure the hedged items to consider the alternative benchmark rate used to remeasure the fair value of the hedging instrument. In absence of such a remeasurement of the hedged item, an impact on profit or loss arises which does not represent real ineffectiveness. EFRAG asks the IASB to clarify that the remeasurement can be seen as part of amending the formal designation of the hedging relationship as previously documented.

- 27 EFRAG agrees that an entity is (subject to paragraph 102S of this ED) generally required to continue to apply requirements in IFRS Standards to measure the hedging instrument and the hedged item and to recognise in profit or loss hedge ineffectiveness that may arise due to any consequential valuation adjustments required by IFRS 9 and IAS 39. EFRAG observes that this reflects the economics of the hedging relationships and its underlying items and hence provides useful information to users of financial statements. This also corresponds with EFRAG’s view on Phase 1 where no corresponding relief was supported either.
- 28 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.

- 29 However, EFRAG observes that the current wording used in the paragraphs 6.9.11/102T and 6.9.12/102U of 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, regardless of whether the underlying financial instruments are already based on the alternative benchmark rate or still based on IBOR. EFRAG understands that the wording “to the extent relevant” in paragraph 6.9.10 refers to the fact that the timing might not be identical for the hedging instrument and the hedged item. 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.
- 30 EFRAG agrees with the IASB’s tentative decisions with regard to hedges of a group of items. The IASB proposed to amend IFRS 9 and IAS 39 that apply when items within a designated group are amended for modifications that are required as a direct consequence of the IBOR reform and are done on an economically equivalent basis. If so, as described in paragraph 6.9.15 of the ED, an entity would be permitted to amend the hedge documentation to define the hedged items by way of two subgroups within the designated group of items and apply the requirements for group designations to each group separately. One group would be referencing the original interest rate benchmark and the other would be referencing the alternative benchmark rate. In addition, both rates would be treated as if they share similar risk characteristics (but only in relation to a group of items designated under IAS 39).
- 31 EFRAG observes that these proposed amendments are consistent with the objective to continue hedging relationships when transitioning from IBOR to an alternative benchmark rate. EFRAG observes that the proposed two subgroups would enable entities to do so without a need to amend key requirements that apply when designating groups of items, the so-called proportionality test and the requirement of similar risk characteristics under IAS 39. Hence, EFRAG agrees with the proposed amendments on subgroups because this will enable entities to reflect the transition to an alternative benchmark rate within a group of hedged items without amending the key requirements that apply in such cases.
- 32 In case of fair value hedges of fixed rate financial instruments, EFRAG has been made aware of the need to remeasure the hedged items by adjusting its parameters (in particular the spread over the benchmark rate as defined at the inception of the hedge) to take into account the alternative benchmark rate used to remeasure the fair value of the hedging instrument. In absence of such a remeasurement, there would be an impact in profit or loss which relevance is questionable, as it does not represent real ineffectiveness. EFRAG notes that the amendments require (paragraph 6.9.7) that an entity amends the formal designation of the hedging relationship as previously documented. EFRAG understand that the remeasurement of the spread as described above is one of the adjustments that would be considered when amending the formal designation. EFRAG suggests that the IASB clarifies in the main body of the standard that this is the case.

33 Question 4: Designation of risk components and portions (paragraphs 6.9.16–6.9.18 of the [Draft] amendments to IFRS 9 and paragraphs 102Y–102Z1 of the [Draft] amendments to IAS 39)

Paragraphs 6.9.16–6.9.18 of the draft amendments to IFRS 9 and paragraphs 102Y–102Z1 of the draft amendments to IAS 39 propose that:

- (a) an alternative benchmark rate designated as a non-contractually specified risk component that is not separately identifiable at the date it is designated, would be deemed to have met that requirement at that date, if and only if, the entity reasonably expects the alternative benchmark rate will be separately identifiable

within a period of 24 months from the date the alternative benchmark rate is designated as a risk component.

- (b) if subsequently, an entity reasonably expects that the alternative benchmark rate will not be separately identifiable within 24 months from the date it was designated as a risk component, an entity would cease applying the requirement in paragraph 6.9.16 and paragraph 102Y and discontinue hedge accounting prospectively from the date of that reassessment.

Paragraphs BC87–BC97 of the Basis for Conclusions describe the IASB’s reasons for these proposals.

Do you agree with this proposal? Why or why not? If you disagree with the proposal, please explain what you propose and why.

EFRAG’s response

EFRAG agrees with the IASB’s proposal to provide temporary relief in the context of non-contractually specified risk components on the “separately identifiable” criterion. However, EFRAG is concerned about paragraphs BC87 and BC89, as they seem to introduce application guidance of the current hedge accounting requirements inconsistent with some practices that exist in European jurisdictions.

EFRAG observes that the IASB might consider clarifying the wording used in paragraph BC92 of the ED, 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.

EFRAG recommends that the IASB continues to monitor future developments of alternative rate markets to assess whether it may become necessary to extend the 24-month temporary relief period for the separately identifiable assessment.

- 34 EFRAG observes that limiting the temporary relief to a 24-month period is not expected to be an impediment for timely transition to alternative benchmark rates.
- 35 EFRAG observes that, in absence of such a relief period or if the relief period would be significantly shorter than the proposed 24-month period, it could be more complex for entities to designate such risk component when transitioning to alternative benchmark rates in the early stages of an IBOR reform.
- 36 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.
- 37 EFRAG observes that the IASB does not propose an equivalent relief on the requirement of a risk component being reliably measurable. EFRAG notes that usually both criteria for designating a risk component are intertwined so that generally either both or none are met. Granting a relief only in relation to the criterion of a risk component being separately identifiable may therefore not ensure that a particular alternative benchmark interest rate will be eligible as being a designated risk component.
- 38 EFRAG considers that reliable measurement is one of the key principles of hedge accounting and, consequently, any exception from a component being reliably measurable could undermine the objective and discipline of hedge accounting and

result in information with little, or no, information value to users of financial statements. Against this background, EFRAG agrees that, from a conceptual perspective, it is difficult to grant a robust relief in relation to this basic principle of reliable measurement.

- 39 Moreover, EFRAG is concerned about paragraphs BC87 and BC89, in particular where the IASB refers to sufficiently developed market or sufficient volume and liquidity in a particular market or jurisdiction. These paragraphs seem to introduce application guidance to the current hedge accounting requirements that may result in a narrower scope for hedge designation compared with some practices that exist in European jurisdictions in the banking sector, such as certain hedges of loan or deposit books, for which there is not necessarily an active market and hence sufficient volume and liquidity of respective debt instruments. EFRAG, therefore, recommends that the IASB reconsiders the wording in these paragraphs to avoid unintended implications to current practice outside the scope of the IBOR reform.
- 40 Finally, against the background of the current market disruption linked to the COVID-19 pandemic, EFRAG recommends that the IASB continues to monitor future developments of alternative rate markets to assess whether it may become necessary to extend the 24-month temporary relief period for the separately identifiable assessment since the establishment of sufficiently liquid alternative rate markets could take longer than initially envisaged.

Question 5: Effective date and transition (paragraphs 7.1.9 and 7.2.36–7.2.38 of the [Draft] amendments to IFRS 9 and paragraphs 108H–108J of the [Draft] amendments to IAS 39)

- (a) The ED proposes that the amendments would have an effective date of annual periods beginning on or after 1 January 2021. Earlier application would be permitted.
- (b) The ED proposes that the amendments would be applied retrospectively in accordance with IAS 8, except as specified in (ii) below. An entity would:
- (i) reinstate a discontinued hedging relationship if and only if the entity discontinued that hedging relationship solely due to changes required by interest rate benchmark reform and, therefore, the entity would not have been required to discontinue that hedging relationship if the amendments had been applied at that time.
 - (ii) not be required to restate prior periods to reflect the application of these amendments. However, the entity may restate prior periods if, and only if, it is possible without the use of hindsight.

Paragraphs BC110–BC115 of the Basis for Conclusions describe the IASB's reasons for these proposals.

Do you agree with these proposals? Why or why not? If you agree with only parts of the proposals, please specify what you agree and disagree with. If you disagree with the proposals, please explain what alternative you propose and why.

EFRAG's response

EFRAG agrees with the IASB's proposal on effective date and transition requirements.

EFRAG agrees that the proposed amendments should be mandatory in order to increase comparability across entities. EFRAG agrees that no specific end of application requirements need to be specified, because this allows application of

the proposed amendments under the different transition paths of the IBOR reforms.

Although entities may have to discontinue hedging relationships when transitioning to an alternative benchmark rate before the proposed amendments become applicable, EFRAG considers that both the possibility to early adopt the proposed amendments and the requirement to reinstate hedging relationships that had to be discontinued due to modifications required as direct consequences of the IBOR reform will enable entities to limit the impact of having to discontinue such hedging relationships.

- 41 EFRAG agrees that the initial application of the proposed amendments is proposed to be for annual periods beginning on or after 1 January 2021, with earlier application permitted. This corresponds with the current benchmark rate reforms going on mainly in 2020 and 2021.
- 42 EFRAG observes that mandatory application of the proposed amendments will increase comparability across entities that are affected by the IBOR reform.
- 43 EFRAG agrees that the proposed amendments can only be applied to modifications of financial instruments and changes to hedging relationships that satisfy the relevant criteria and, as such, no specific end of application requirements need to be specified. This is because, as expressed in EFRAG's comment letter to Phase 1, the transition paths of different IBORs are not identical. EFRAG notes that a specific end date would bear the risk for entities not to be able to apply the proposed amendments if transition under a particular IBOR reform would be ongoing during a specific end date.
- 44 EFRAG also agrees with the proposed retrospective applications of the proposed amendments, in particular on the requirement to reinstate hedging relationships that had to be discontinued due to modifications required as direct consequences of the IBOR reform.
- 45 In general, EFRAG observes that the transition from IBOR to an alternative benchmark rate should not be delayed due to accounting considerations. If an entity transitions financial instruments to be based on an alternative benchmark rate as required as a direct consequence of the reform, EFRAG observes that discontinuation of hedging relationships may be required under the current accounting provisions. However, by retrospective application with the requirement to reinstate such hedging relationships, the effect of such discontinuation would only be temporary.

Question 6: Disclosures (paragraphs 24I–24J and paragraphs 44HH–44II of [Draft] amendments to IFRS 7 *Financial Instruments - Disclosures*)

The ED proposes that entities provide specific disclosures in order to provide information about:

- (a) the nature and extent of risks arising from interest rate benchmark reform to which the entity is exposed, and how it manages those risks; and
- (b) the entity's progress in completing the transition from interest rate benchmarks to alternative benchmark rates, and how the entity is managing that transition.

Paragraphs BC105–BC109 of the Basis for Conclusions describe the IASB's reasons for this proposal.

Do you agree with this proposal? Why or why not? If you disagree with the proposals, please explain what you propose instead and why.

EFRAG's response

EFRAG agrees that the proposed disclosures will assist users of financial statements in understanding the effects of the IBOR reform for an entity to the extent they reflect the entity specific impacts from transitioning from IBOR to an alternative benchmark rate.

However, EFRAG observes that the proposed disclosures in paragraph 24J(b) of IFRS 7 should not require comparative information. In addition, an entity should be permitted to disclose alternative quantitative information if information based on carrying amounts is not be available without undue cost or effort.

EFRAG notes that the disclosures in paragraph 24J(c) of IFRS 7 may be less helpful to users of financial statements because the disclosures are expected to be less entity specific.

As the new disclosure requirements refer not only to hedge accounting, the IASB should consider a cross-reference to the risk disclosures section of IFRS 7.

- 46 EFRAG observes that the disclosures suggested by paragraph 24J(b) of the ED should not require comparative information upon initial adoption of the amendments because such comparative information is of limited relevance to users given current progress of the IBOR reform.
- 47 Furthermore, the disclosure requirement in paragraph 24J(b) is perceived by some of EFRAG's constituents as unbalanced in terms of costs/benefits. EFRAG suggest the IASB to allow alternatively disclose quantitative information used by entities in managing the reform when information based on carrying amounts as otherwise required by paragraph 24J(b) is not available without undue cost or effort.
- 48 As outlined in paragraph 24J(c) of IFRS 7, the IASB proposes disclosing an explanation of how an entity determined the base rate and relevant adjustments to the rate to assess whether the modifications to contractual cash flows were required as a direct consequence of the IBOR reform and have been done on an economically equivalent basis. EFRAG observes that transitioning from IBOR to an alternative benchmark rate under a market wide reform will require similar assessments across entities in this regard.
- 49 In addition, EFRAG observes that an assessment of whether modifications to contractual cash flows were required as a direct consequence of the IBOR reform and have been done on an economically equivalent basis is a necessary requirement to apply the proposed amendments.
- 50 Against this background, the IASB may reconsider whether disclosing information as proposed in paragraph 24J(c) of IFRS 7 will provide entity-specific information that is useful to users of financial statements and not be considered boilerplate.
- 51 In addition, as the proposed disclosure requirements provide information also on other topics than hedge accounting, EFRAG suggests the IASB to consider a cross-reference in the risk disclosure section of IFRS 7.