EFRAG
European Financial Reporting Advisory Group

EFRAG's Letter to the European Commission Regarding Endorsement of the *Interest Rate Benchmark Reform (Amendments to IFRS 9, IAS 39 and IFRS 7)*

Olivier Guersent
Director General, Financial Stability, Financial Services and Capital Markets Union
European Commission
1049 Brussels

16 October 2019

Dear Mr Guersent

Endorsement of the *Interest Rate Benchmark Reform (Amendments to IFRS 9, IAS 39 and IFRS 7)*

Based on the requirements of the Regulation (EC) No 1606/2002 of the European Parliament and of the Council on the application of international accounting standards, EFRAG is pleased to provide its opinion on the *Interest Rate Benchmark Reform (Amendments to IFRS 9, IAS 39 and IFRS 7)* ('the Amendments') was issued by the IASB on 26 September 2019. An Exposure Draft ED/2019/1 *Interest Rate Benchmark Reform* (IBOR) was issued on 3 May 2019. EFRAG provided its comment letter on that Exposure Draft on 20 June 2019.

The objective of the Amendments is to avoid the discontinuation of hedging relationships as a result of uncertainties related to the IBOR transition, in particular due to the inability to meet specific forward-looking hedge accounting requirements in the periods before the transition.

The Amendments shall be applied retrospectively for annual periods beginning on or after 1 January 2020, with earlier application permitted. A description is included in Appendix 1 to this letter.

In order to provide our endorsement advice as you have requested, we have first assessed whether the Amendments would meet the technical criteria for endorsement, in other words whether the Amendments would provide relevant, reliable, comparable and understandable information required to support economic decisions and the assessment of stewardship, lead to prudent accounting and is not contrary to the true and fair view principle. We have then assessed whether the Amendments would be conducive to the European public good. We provide our conclusions below. We also have assessed whether entities should be allowed to early adopt the Amendments in accordance with the IASB's transition arrangements.

The Amendments provide relief from the highly probable and prospective assessments required by IFRS 9 and IAS 39 insofar these tests relate to hedging relationships that are affected by the uncertainties of the IBOR reform. With the same objective, the Amendments also provide relief from the retrospective assessment under IAS 39. The exceptions described in the Amendments apply only to those hedging relationships directly affected by uncertainties of the IBOR reform including some types of cross-currency interest rate swaps.

Do the Amendments meet the IAS Regulation technical endorsement criteria?

EFRAG has concluded that the Amendments meet the qualitative characteristics of relevance, reliability, comparability and understandability required to support economic decisions and the assessment of stewardship, and raise no issues regarding prudent accounting. EFRAG has also assessed that the Amendments do not create any distortion in their interaction with other IFRS Standards and that all necessary disclosures are required. Therefore, EFRAG has concluded that the Amendments are not contrary to the true and fair view principle. EFRAG's reasoning is explained in Appendix 2 to this letter.

Are the Amendments conducive to the European public good?

EFRAG has assessed that the Amendments would improve financial reporting and would reach an acceptable cost-benefit trade-off. EFRAG has not identified that the Amendments could have any adverse effect on the European economy, including financial stability and economic growth. Accordingly, EFRAG assesses that endorsing the Amendments is conducive to the European public good. EFRAG's reasoning is explained in Appendix 3 to this letter.

Our advice to the European Commission

On the basis of the conclusions illustrated above, we recommend the Amendments for endorsement without further delay.

We bring to the attention of the European Commission that the effective date of the Amendments is 1 January 2020, with earlier application being permitted. We have been advised that the ability to apply the Amendments already during 2019 is crucial for preparers. Otherwise, some preparers might have to discontinue some hedges during 2019 before being able to apply the reliefs provided by the Amendments during 2020. Consequently, EFRAG has accelerated the development of its endorsement advice in order to complete its part of the endorsement process as speedily as possible.

On behalf of EFRAG, I would be happy to discuss our advice with you, other officials of the European Commission or the Accounting Regulatory Committee as you may wish.

Yours sincerely,

Jean-Paul Gauzès
President of the EFRAG Board

Appendix 1: Understanding the changes brought about by the Amendments

Background of the Amendments

1 Recent market developments have brought into question the long-term viability of some interbank offered rates (IBORs). IBORs (EURIBOR, LIBOR, etc.) are reference interest rates which are used as benchmarks for a broad range of financial products and contracts. In this context, the G20 asked the Financial Stability Board (FSB) to undertake a fundamental review of major interest benchmarks and develop plans for reform to ensure that these benchmarks are robust and appropriately used by market participants. The FSB set out its recommendations for reforming major interest rate benchmarks in its July 2014 report.[1]

2 In response, the European Benchmark Regulation (BMR) was issued in June 2016 and starting from 1 January 2022, only benchmarks that are compliant with the BMR may be used in the EU.

3 In analysing the accounting impacts from the benchmark reform, the IASB has identified two types of implications:

(a) Issues affecting financial reporting in the periods before replacement of an existing interest rate benchmark with an alternative interest rate (pre-replacement issues); and

(b) Issues affecting financial reporting when an existing interest rate benchmark is replaced with an alternative interest rate (replacement issues).

4 The Amendments only focus the issues that affect financial reporting before replacement of an existing interest rate benchmark (pre-replacement issues). The replacement issues will be dealt with in a second phase.

The issue and how it has been addressed

5 The pre-replacement issues identified relate to the hedge accounting requirements in IFRS 9 *Financial Instruments* and IAS 39 *Financial Instruments: Recognition and Measurement* which require forward-looking analysis. As a result of the benchmark reform, contractual cash flows of hedged items and hedging instruments that are based on an existing interest rate benchmark will likely change when this benchmark is replaced with an alternative interest rate. Therefore, until regulators have made decisions about what the alternative benchmark rate is and when and how the reform will occur, the exact transition pattern remains unknown and uncertainties will exist regarding the timing and the amount of future cash flows of the hedged items and the hedging instruments.

6 In some cases, solely due to those uncertainties, entities could be required to discontinue hedge accounting for hedging relationships that would otherwise qualify for hedge accounting. Discontinuation of hedge accounting would require an entity to recognise gains or losses in profit or loss, the amounts and timing of which are based on the specific requirements of the above-mentioned standards.

7 In the IASB's view, discontinuation of hedge accounting solely due to such uncertainties before the reform's economic effects are known would not provide useful information to users of financial statements. Therefore, the IASB decided to propose exceptions to specific hedge accounting requirements in IFRS 9 and IAS 39 to provide relief during this period of uncertainty. The proposed reliefs will allow entities to continue hedge accounting relationships.

[1] The FSB report 'Reforming Major Interest Rate Benchmarks' can be found here.

What has changed?

8 The Amendments provide exceptions so that entities would apply hedge accounting requirements assuming that the interest rate benchmark on which the hedged risk or hedged cash flows of the hedged item or cash flows of the hedging instrument are based is not altered as a result of the IBOR reform. The proposed exceptions apply only to the hedge accounting requirements and the Amendments do not provide relief from any other consequences arising from interest rate benchmark reform.

9 To avoid the discontinuation of the hedge accounting due to the reform the Amendments:

(a) Provide relief from the uncertainties arising from IBOR for the highly probable requirement and prospective assessments required by IFRS 9 and IAS 39;

(b) Provide an exception for retrospective assessment in IAS 39, so that, an entity would continue to apply hedge accounting for hedging relationships directly affected by the reform, even if the actual results of the hedge accounting relationship are outside the range of 80–125% because of uncertainty arising from the reform or other sources, subject to satisfying the other conditions in paragraph 88 of IAS 39 to qualify for hedge accounting, including the prospective assessment;

(c) Allow the hedged risk component or risk portion only be separately identifiable at inception of the hedging relationship for the hedges of benchmark component of interest rate risk;

(d) Include in the scope all hedging relationships directly affected by interest rate benchmark reform (which includes cross-currency swaps for example).

10 When an entity, consistent with its hedge documentation, uses a dynamic process in which both the exposure and the hedging instruments used to manage that exposure do not remain the same for long, the Amendments allow that the hedged risk component is separately identifiable only when an entity initially designates an item as a hedged item in a particular hedging relationship. A hedged item that has been assessed at the time of its initial designation in the hedging relationship, whether it was at the time of the hedge inception or subsequently, is not reassessed at any subsequent re-designation in the same hedging relationship.

11 Also, when designating a group of items as the hedged item or a combination of financial instruments as the hedging instrument, entities assess whether the uncertainty is still present for each individual item in the group or financial instrument in the combination.

12 The Amendments are limited in scope. If a hedging relationship no longer meets the requirements for hedge accounting for reasons *other than* those specified by the Amendments, then discontinuation of hedge accounting is still required.

13 To inform users about of the impacts of the reform, IFRS 7 was amended to require additional disclosure about the effects of the reform. These disclosures provide qualitative information about hedging relationships directly affected by interest rate benchmark reform, entity risk exposure and risk management strategy. In addition, the Amendments require a disclosure of the nominal amount of the hedging instruments in hedging relationships for which the entity is applying the exceptions.

14 In the reporting period in which an entity first applies the Amendments, entities are exempted from the presentation of the quantitative comparative information required by paragraph 28(f) of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors.*

15 In addition, the Amendments clarify that if an entity designated interest rate benchmark-based cash flows as the hedged item in a cash flow hedge, the entity

would not assume for the purpose of measuring hedge ineffectiveness that the expected replacement of the interest rate benchmark with an alternative benchmark rate will result in zero cash flows after the replacement. The hedging gain or loss should be measured using the interest rate benchmark-based cash flows when applying a present value technique, discounted at a market-based discount rate that reflects market participants' assumptions about the uncertainty arising from the reform.

16 The Amendments are mandatory to all hedging relationships to which the exceptions are applicable and cease:

(a) For a hedged item at the earlier of:

(i) when the uncertainty arising from interest rate benchmark reform is no longer present with respect to the timing and the amount of the interest rate benchmark-based cash flows of the hedged item; and

(ii) when the hedging relationship that the hedged item is part of is discontinued.

(b) For the amount accumulated in the cash flow hedge reserve, at the earlier of:

(i) when the uncertainty arising from interest rate benchmark reform is no longer present with respect to the timing and the amount of the interest rate benchmark-based future cash flows of the hedged item; and

(ii) when the entire amount accumulated in the cash flow hedge reserve with respect to that discontinued hedging relationship is reclassified to profit or loss.

(c) For assessment of the economic relationship between the hedged item and the hedging instrument:

(i) to a hedged item, when the uncertainty arising from interest rate benchmark reform is no longer present with respect to the hedged risk or the timing and the amount of the interest rate benchmark-based cash flows of the hedged item; and

(ii) to a hedging instrument, when the uncertainty arising from interest rate benchmark reform is no longer present with respect to the timing and the amount of the interest rate benchmark-based cash flows of the hedging instrument.

When do the Amendments become effective?

17 The amendments have an effective date of annual periods beginning on or after 1 January 2020. Earlier application is permitted. The amendments would be applied retrospectively to those hedging relationships that existed at the beginning of the reporting period in which the entity first applies the Amendments and to the gain or loss recognised in other comprehensive income that existed at the beginning of the reporting period in which an entity first applies the Amendments (i.e. even if the reporting period is not an annual period).

Appendix 2: EFRAG's technical assessment on the Amendments against the endorsement criteria

Does the accounting that results from the application of the Amendments meet the technical criteria for endorsement in the European Union?

1 EFRAG has considered whether the Amendments meet the technical requirements of the European Parliament and of the Council on the application of international accounting standards, as set out in Regulation (EC) No 1606/2002 (The IAS Regulation), in other words that the Amendments:

(a) are not contrary to the principle set out in Article 4 (3) of Council Directive 2013/34/EU (The Accounting Directive); and

(b) meet the criteria of understandability, relevance, reliability, and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management.

2 Article 4(3) of the Accounting Directive provides that:

The annual financial statements shall give a true and fair view of the undertaking's assets, liabilities, financial position and profit or loss. Where the application of this Directive would not be sufficient to give a true and fair view of the undertaking's assets, liabilities, financial position and profit or loss, such additional information as is necessary to comply with that requirement shall be given in the notes to the financial statements.

3 The IAS Regulation further clarifies that *'to adopt an international accounting standard for application in the Community, it is necessary firstly that it meets the basic requirement of the aforementioned Council Directives, that is to say that its application results in a true and fair view of the financial position and performance of an enterprise - this principle being considered in the light of the said Council Directives without implying a strict conformity with each and every provision of this Directive'* (Recital 9 of the IAS Regulation).

4 EFRAG's assessment as to whether the Amendments would not be contrary to the true and fair view principle has been performed against the European legal background summarised above.

5 In its assessment, EFRAG has considered the Amendments from the perspectives of both usefulness for decision-making and assessing the stewardship of management. EFRAG has concluded that the information resulting from the application of the Amendments is appropriate both for making decisions and assessing the stewardship of management.

Relevance

6 Information is relevant when it influences the economic decisions of users by helping them evaluate past, present or future events or by confirming or correcting their past evaluations. Information is also relevant when it assists in evaluating the stewardship of management.

7 EFRAG considered whether the Amendments would result in the provision of relevant information – in other words, information that has predictive value, confirmatory value or both – or whether it would result in the omission of relevant information.

8 In assessing the relevance EFRAG has considered:

(a) Reliefs provided by the Amendments;

(b) Reinstatement of previously discontinued hedging relationships;

(c) End of application;

(d) Disclosure requirements; and

(e) Effective date of the Amendments.

Reliefs provided by the Amendments

9 The IBOR reform is initiated by the G20 and driven by regulators with the aim to provide the financial markets with more reliable interest rate benchmarks. In the transition phase uncertainties exist that can affect the ability of entities to either continue existing or initiate new hedge accounting transactions. This may result in discontinuation of some hedge accounting as a result of not meeting the forward-looking requirements of IFRS 9 and IAS 39. Such discontinuations affect profit or loss simply because of the uncertainties created by the IBOR reform, are misleading and not relevant for users.

10 To avoid this, the Amendments provide the exceptions from:

(a) Highly probable requirement;

(b) Assessment of the economic relationship between the hedged item and the hedging instrument (IFRS 9) and Effectiveness assessment (IAS 39);

(c) Hedges of risk components and portions; and

(d) Retrospective assessment (IAS 39).

Highly probable requirement

11 Currently, the highly probable requirement under IFRS 9 and IAS 39 requires that changes in fair value of designated hedging instruments are recorded in the cash flow hedge reserve in other comprehensive income only for those hedged forecast transactions for which there is a high probability of occurrence. The uncertainty resulting from the interest rate benchmark reform is such that the hedged cash flows are no longer considered to be highly probable, and in the absence of any corrective measures, the hedge accounting may be discontinued.

12 The Amendments provide an exception to the highly probable requirement. More specifically, if the hedged future cash flows are based on an existing interest rate benchmark that would be altered by the reform, an entity would assume that the interest rate benchmark on which hedged cash flows are based will not be altered when assessing whether the future cash flows are highly probable.

13 EFRAG considers that discontinuation of hedging relationships solely due to the uncertainties regarding the timing and the amount of cash flows arising from the reform of interest rate benchmarks will not provide useful and relevant information to the users of financial statements and therefore supports the relief from the highly probable requirement.

Assessment of the economic relationship between the hedged item and the hedging instrument (IFRS 9) and Effectiveness assessment (IAS 39)

14 Currently, IFRS 9 and IAS 39 require entities to discontinue hedge accounting if the prospective assessments (the existence of an economic relationship for IFRS 9 and whether the hedge is expected to be highly effective) are not met. Once hedge accounting is discontinued, the entity is required to recognise in profit or loss gains or losses for cash flow hedges that were previously recognised in other comprehensive income (the amounts and timing of which are based on the specific requirements of the above-mentioned standards), and for fair value hedges amortise the cumulative fair value hedge adjustment earlier than had the hedge relationship continued.

15 The Amendments also provide an exception for discontinued hedging relationships, applying which any amount remaining in the cash flow hedge reserve would be reclassified to profit or loss in the same period(s) during which the hedged cash flows

affect profit or loss, assuming that the interest rate benchmark on which the hedged cash flows are based is not altered as a result of the reform. If, however, the hedged future cash flows are no longer expected to occur for other reasons, the entity shall immediately reclassify to profit or loss any amount remaining in the cash flow hedge reserve.

16 The Amendments override existing requirements of IFRS 9 and IAS 39 to allow entities to continue assessing hedging relationship as if the reform did not take place. EFRAG considers that given the temporary and regulatory driven nature of the reform, the discontinuation of existing hedging relationships would not result in relevant information (i.e. information about the outcome and performance of an entity's risk mitigation strategy) and would not reflect the economics underlining the hedge accounting relationships.

17 Therefore, EFRAG supports the reliefs from the assessment of the economic relationship between the hedged item and the hedging instrument (IFRS 9) and effectiveness assessment (IAS 39) as they will result in a more relevant information provided to the users in the period of uncertainty.

Hedges of risk components and portions

18 According to IFRS 9 and IAS 39, an entity may designate an item in its entirety or a component of an item as the hedged item in a hedging relationship. Both standards require that the risk component be separately identifiable and reliably measurable in order to be eligible for hedge accounting.

19 IBOR reform could affect an entity's assessment of whether a non-contractually specified IBOR component is separately identifiable and therefore can be an eligible hedged item in a hedging relationship.

20 The Amendments aim to ensure that entities do not discontinue hedge accounting solely because the specified IBOR component in the hedged item is no longer separately identifiable as the reform progresses. The separate identification requirement for hedges of the benchmark component of interest rate risk is only applied at the inception of those hedging relationships affected by the reform.

21 The Amendments provide a similar exception for hedging relationships that are frequently reset, consistently with the hedge documentation.

22 In EFRAG's view, until uncertainty regarding the timing and amount of future cash flows of the hedged items and the hedging instruments ceases to exist, sufficient information is not available to make informed decisions. Volatility created in the financial reporting as a result of these uncertainties would not provide useful information. Therefore, EFRAG supports the proposed exception as providing relevant information.

Retrospective assessment (IAS 39)

23 The Amendments provide a relief for retrospective assessment. For the purpose of applying par. 88 (e) of IAS 39 and AG105 (b) an entity shall not discontinue a hedging relationship during the period of uncertainty arising from the interest rate benchmark reform, solely because the actual results of the hedge effectiveness test are outside the range of 80 – 125 per cent; in such a situation the entity shall apply the other conditions in paragraph 88, including the prospective assessment, to assess whether the hedging relationship shall be discontinued.

24 EFRAG acknowledges that, in the application of this relief, the Amendments do not require to isolate ineffectiveness originated by other reasons than the uncertainty due to the IBOR reform from ineffectiveness solely due to such uncertainty, therefore potentially resulting in a broader scope of the relief.

25 However, EFRAG considers that separating the different sources of ineffectiveness would have added complexity. On balance, EFRAG supports the relief from discontinuing a hedge during due to the retrospective assessment in the period of uncertainty, as it is responding to the need to avoid discontinuation as a result of the uncertainty of the benchmark reform.

Reinstatement of previously discontinued hedging relationships

26 The Amendments do not allow the reinstatement of hedge accounting that had previously been discontinued because entities were unable to apply the proposed reliefs. For example, entities would not be allowed to reinstate in their 2020 financial statements any hedge accounting that had been discontinued in their 2019 financial statements, as a result of the unavailability of the relief. Considering the speed that the IASB project has taken, EFRAG is working on the assumption that the Amendments will be available for use in Europe for the 2019 financial statements reporting expecting that the Endorsement is completed before the date of issuance of 2019 reporting, EFRAG considers that such risk is appropriately mitigated.

27 Accordingly, EFRAG considers that not allowing for reinstatement of discontinued hedging relationships is not negatively affecting the qualitative characteristics of the resulting information for most preparers. EFRAG acknowledges that for those preparers that publish their financial statements between the date of publication of the Amendments (26 September 2019) and the endorsement of these Amendments in the EU there is a risk of not being able to apply the Amendments to their 2019 financial statements if needed. EFRAG considers the requirements appropriate as they would solve the issue for most preparers.

End of application

28 The end of relief as described in the Amendments does not apply to the hedging relationship as a whole, but separately to each leg of a hedging relationship. In EFRAG's view, in some cases this could lead to difficulties in passing the prospective assessment for hedge accounting.

29 When the hedging instrument transitions to the new rate earlier than the hedged item, the relief on hedging instrument will not be applicable anymore whereas it will still be applicable to the hedged item. This in turn may create ineffectiveness in prospective assessment where the hedged item assumes that the cash flows are not affected by the IBOR reform, even though the entity expects to move from the old to the new rate. Depending on the difference existing between the two interest rate curves, this may result in the discontinuation of a hedging relationship, as it would not pass the prospective test.

30 EFRAG acknowledges that it is impossible to quantify the percentage of derivatives affected by this mismatch or how long a mismatch could exist for at a current stage of the reform.

31 When the difference between the two interest rates curves is such that the prospective assessment fails, EFRAG considers that discontinuation of hedging relationship only due to the fact that the entity shall assume that the hedged item will not transition to the new rate, while the hedging instrument has already transitioned to the new rate, would not provide relevant information to users. However, EFRAG is convinced that this issue does not reduce the assessment that the Amendments will result in more relevant information.

Disclosure requirements

32 The Amendments propose additional disclosure requirements about the effect of the uncertainty arising from IBOR. These requirements generally require qualitative information about the extent to which the entity is affected by the reform, risk exposure and risk management strategy.

33 EFRAG is of the view that qualitative disclosures of the impacts of the reform, the uncertainty it creates and the extent of use of the reliefs proposed by the Amendments provide relevant information to users and therefore supports the disclosure requirements. The disclosures enhance the transparency of the IBOR reform and in doing so support the European public good. EFRAG also relies on the general disclosure requirements in IAS 1 *Presentation of Financial Statements* that mandate the provision of additional information where necessary.

34 The Amendments require a disclosure of the nominal amount of the hedging instruments in hedging relationships for which the entity is applying the exceptions.

35 In addition, in the reporting period in which an entity first applies the Amendments, entities are exempted from the presentation of the quantitative information required by paragraph 28(f) of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* which requires an entity, on the initial application of an accounting policy, to disclose, for the current period and each prior period presented, the amount of any adjustment for each financial statement line item affected.

36 EFRAG considers that the above IAS 8 requirement would not provide useful information to users of financial statements and would be unduly onerous for preparers.

Effective date of the Amendments

37 As IBOR is progressing at a different speed within different jurisdictions, it is important to provide level playing field for all the entities. To achieve this, entities need to be able to use the Amendments as soon as possible without having to discontinue their current hedge accounting before the initial application. Hence it is important that the effective date of 1 January 2020 with an earlier application permitted is applied.

38 Therefore, considering the publication date of the Amendments 26 September 2019, EFRAG assesses that the effective date proposed in the Amendments with an earlier application permitted results in information relevant to the users of financial statements.

Conclusion

39 EFRAG's overall assessment is that the requirements in the Amendments will on balance result in relevant information.

Reliability

40 EFRAG also considered the reliability of the information that will be provided by applying the Amendments. Information has the quality of reliability when it is free from material error and bias and can be depended upon by users to represent faithfully what it either purports to represent, or could reasonably be expected to represent, and is complete within the bounds of materiality and cost.

41 There are a number of aspects to the notion of reliability: freedom from material error and bias, faithful representation, and completeness.

42 In assessing the reliability EFRAG has considered:

(a) Overall aim of the Amendments; and

(b) Mandatory application and end of application.

Overall aim of the Amendments

43 The overall aim of IBOR reform is to provide financial markets with new more reliable and almost risk-free interest rates. The reform is driven by the regulators and is obligatory for all the market participants.

44 The uncertainty of the IBOR transition may oblige entities to discontinue hedge accounting relationships solely as an unintended consequence of uncertainty

temporarily existing in the pre-replacement period. The Amendments provide the reliefs (described in paragraphs 9 to 27 of this document) which would allow entities to continue hedge accounting as if the current benchmark interest rates would continue to exist.

45 EFRAG is of the view that providing a short-term and limited relief in these specific circumstances that are the result of regulatory changes does not significantly hinder reliability. The IBOR reform is a well-publicised issue and the limited timing of the reliefs means that the normal requirements of IFRS 9 will only be suspended for a relatively short time.

Mandatory application and end of application

46 The application of the Amendments is mandatory for all hedging relationships affected by interest rate benchmark reform. EFRAG considers that the mandatory application avoids earnings management and therefore results in a more reliable information.

47 The Amendments cease to apply at the earlier of:

(a) When the uncertainty arising from interest rate benchmark reform is no longer present with reference to both the hedging instrument and the hedged item; or

(b) When the hedging relationship is discontinued.

48 EFRAG agrees with the temporary nature of the relief as it is in line with the overall aim of the Amendments and will result in a reliable information provided during the IBOR transition period.

Conclusion

49 EFRAG's overall assessment is that the Amendments would result in the provision of sufficiently reliable information and therefore satisfy the reliability criterion.

Comparability

50 The notion of comparability requires that like items and events are accounted for in a consistent way through time and by different entities, and that unlike items and events should be accounted for differently.

51 EFRAG has considered whether the Amendments result in transactions that are:

(a) economically similar being accounted for differently; or

(b) transactions that are economically different being accounted for as if they are similar.

52 In assessing comparability, EFRAG has considered:

(a) Continuation of existing hedging relationships;

(b) Mandatory application and the end of application; and

(c) Reinstatement of previously discontinued hedging relationships.

Continuation of existing hedging relationships

53 EFRAG notes that, in absence of the Amendments, existing hedge accounting relationships may be discontinued or designation of new hedge accounting relationships may be prevented because of the uncertainty related to the interest rate benchmark reform. The Amendments allow the continuation of existing hedging relationships and therefore ensure that comparable information about hedging results (and its effectiveness) is provided between prior periods and future periods, thus eliminating the disturbing effects created by the temporary uncertainty about the impact of IBOR reform on the cash flows of the hedged item and of the hedging instrument.

Mandatory application and end of the application

54 As the application of the Amendments is mandatory, it results in continuation of hedge accounting for hedges that are not and for hedges that are affected by the IBOR reform. This includes, for example, different timing of the IBOR transition in different jurisdictions or different legs of the hedging relationship transitioning at the different time. However, in EFRAG's view, the possible reduced ability to differentiate between the two different types of hedges is mitigated by the short-term nature of the reform and the additional disclosures required by the Amendments.

55 The mandatory application also removes the possibility to apply the Amendments selectively and avoids any potential for earnings management.

56 EFRAG notes that application of the Amendments is limited in time. By stating end date on the applicability of the Amendments, comparability is indeed enhanced, as once the uncertainty is no longer present all entities will stop applying the Amendments.

Reinstatement of previously discontinued hedging relationships

57 The Amendments do not allow the reinstatement of hedge accounting that had previously been discontinued because entities were unable to apply the proposed reliefs. As mentioned in paragraph 26 above, EFRAG is working on the assumption that the Endorsement is completed before the date of issuance of 2019 reporting and as a result the Amendments will be available for use in Europe for the 2019 financial statements.

58 Accordingly, EFRAG considers that comparability of the financial statements of most European constituents with their non-European counterparts is ensured.

Conclusion

59 EFRAG's overall assessment is that the requirements in the Amendments will result in sufficiently comparable information.

Understandability

60 The notion of understandability requires that the financial information provided should be readily understandable by users with a reasonable knowledge of business and economic activity and accounting, and the willingness to study the information with reasonable diligence.

61 Although there are a number of aspects related to the notion of 'understandability', EFRAG believes that most of the aspects are covered by the discussion above about relevance, reliability and comparability.

62 In assessing understandability, EFRAG has looked at the temporary exceptions from applying specific hedge accounting requirements which cover the following specific subtopics:

(a) Temporary exceptions from applying specific hedge accounting requirements; and

(b) Disclosure requirements.

Temporary exceptions from applying specific hedge accounting requirements

63 EFRAG notes that each of the above subtopics has been assessed against relevance or reliability in the paragraphs above. As a consequence, the assessment on understandability will focus on the temporary exceptions as a whole, not on each of the subtopics.

64 EFRAG assesses that without application of the temporary exceptions, entities may encounter impacts in the statement of comprehensive income as a result of failing hedge accounting relationships. In case these failures are solely due to the

uncertainties brought by IBOR, EFRAG is of the view that these effects do not result in understandable information for users as this is a form of short-term accounting mismatch. Hence, applying the temporary exceptions will restore the understandability of the information resulting from hedge accounting relationships.

Disclosure requirements

65 Despite the uncertainty surrounding the impact the reform will have on cash flows, the Amendments ensure that the statement of financial position and financial performance do not change as a result of this uncertainty. This could be difficult to understand for users who would like to be informed about the potential or actual impacts of the IBOR reform on a particular entity. EFRAG considers that additional qualitative disclosure requirements proposed by the Amendments would help users to gain necessary understanding about the impacts of the reform, risks associated with it and risk management strategy put in place, thus improving understandability.

Conclusion

66 EFRAG's overall assessment is that the Amendments satisfy the understandability criterion in all material respects.

Prudence

67 For the purpose of this endorsement advice, prudence is defined as caution in conditions of uncertainty. In some circumstances, prudence requires asymmetry in recognition such that assets or income are not overstated and liabilities or expenses are not understated.

68 EFRAG acknowledges that the Amendments do affect prudence, as they allow entities to continue existing hedging accounting relationships which may otherwise be discontinued due to the uncertainty created by IBOR reform. As observed above, until uncertainty regarding the timing and amount of future cash flows of the hedged items and the hedging instruments ceases to exist, sufficient information is not available to make informed decisions. In addition, the Amendments have short-term impact and respond to unintended consequences created by a reform that is of regulatory nature and, as such, closely monitored by regulators. Therefore, EFRAG considers that the proposed exceptions do not have an adverse impact on prudence.

True and Fair View Principle

69 A Standard will not impede information from meeting the true and fair view principle when, on a stand-alone basis and in conjunction with other IFRS Standards, it:

(a) does not lead to unavoidable distortions or significant omissions in the representation of that entity's assets, liabilities, financial position and profit or loss; and

(b) includes all disclosures that are necessary to provide a complete and reliable depiction of an entity's assets, liabilities, financial position and profit or loss.

70 The Amendments affect three IFRS Standards: IFRS 9, IAS 39 and IFRS 7 and do not create any negative interactions with other IFRS Standards. In EFRAG's opinion, any reduction in reliability and understandability is mitigated by the increased relevance of avoiding the short-term impact on profit or loss of unintended discontinuing of hedge accounting caused by temporary uncertainty about the impact of this regulatory reform on cash flows of the hedges.

71 Accordingly, EFRAG has assessed that the Amendments do not lead to unavoidable distortions or significant omissions as they aim to provide continuity of existing accounting and therefore do not impede financial statements from providing a true and fair view.

72 EFRAG has concluded that the Amendments require appropriate disclosures about the impacts of the reform which would provide useful information for users and would not incur undue costs to preparers.

73 As a result, EFRAG concludes that the application of the Amendments would not lead to information that would be contrary to the true and fair view principle.

Conclusion

74 Accordingly, for the reasons set out above, EFRAG's assessment is that the Amendments meet the technical requirements for EU endorsement as set out in the IAS Regulation.

Appendix 3: Assessing whether the Amendments are conducive to the European public good

Introduction

1 EFRAG considered whether it would be conducive to the European public good to endorse the Amendments. In addition to its assessment included in Appendix 2, EFRAG has considered potential negative effects for the European economy on the application of the Amendments. In doing this, EFRAG considered:

(a) Whether the Amendments improve financial reporting. This requires a comparison of the Amendments with the existing requirements and how it/they fit into IFRS Standards as a whole;

(b) The costs and benefits associated with the Amendments; and

(c) Whether the Amendments could have an adverse effect to the European economy, including financial stability and economic growth.

2 These assessments allow EFRAG to draw a conclusion as to whether the Amendments will be conducive to the European public good. If the assessment concludes there is a net benefit, the Amendments will be conducive to the objectives of the IAS Regulation.

EFRAG's evaluation of whether the Amendments are likely to improve the quality of financial reporting

3 EFRAG notes that the Amendments are designed to ensure continuity of existing hedge accounting relationships and therefore provide short-term exceptions from the IAS 39 and IFRS 9 hedge accounting requirements during the periods of uncertainty caused by IBOR. The Amendments will allow entities to apply hedge accounting requirements of IAS 39 and IFRS 9 assuming the interest rate benchmark on which the hedged cash flows and cash flows of the hedging instruments are based is not altered as a result of the reform.

4 Without application of these temporary exceptions, entities may encounter volatility in profit or loss a result of failing hedge accounting relationships or the inability to designate new hedge accounting relationships. In case these failures are solely due to the uncertainties caused by the reform, EFRAG is of the view these effects do not result in useful information. Applying the Amendments will address these inadequacies.

5 EFRAG has therefore concluded that the Amendments will improve the quality of financial reporting.

EFRAG's initial analysis of the costs and benefits of the Amendments

6 EFRAG first considered the extent of the work. For some Standards or Interpretations, it might be necessary to carry out some extensive work, in order to fully understand the cost and benefit implications of the Standard or Interpretation being assessed. However, in the case of the Amendments, EFRAG's view is that the cost and benefit implications can be assessed by carrying out a more modest amount of work.

Costs for preparers

7 EFRAG has carried out an assessment of the cost implications for preparers resulting from the Amendments.

8 EFRAG acknowledges that the IBOR reform itself creates costs for preparers as they revisit their risk management approaches in light of new benchmark interest rates and make changes to the terms of financial instruments. However, EFRAG is of the

view that the costs of the Amendments do not bring significant costs as they are designed to ensure the continuity of existing hedge accounting.

9 With regard to the disclosure requirements, EFRAG notes that some of them such as disclosure of nominal amounts of hedges for which an entity is applying the exceptions might be costly for preparers, however IFRS 7 already requires disclosure of the extent of hedging so they can be seen as an extension of the existing requirements. However, other qualitative disclosures proposed by the Amendments are not expected to generate significant costs for preparers.

10 Overall, EFRAG's assessment is that the Amendments will not result in significant undue costs for preparers related to their implementation.

Costs for users

11 EFRAG has carried out an assessment of the cost implications for users resulting from the Amendments.

12 EFRAG does not expect significant additional costs for users as the existing hedge accounting requirements will be maintained and the users are already acquainted with the disclosures required by IFRS 7 *Financial Instruments: Disclosures*. The main cost for users would be understanding the scope of hedge accounting relationships affected by the reform.

13 Overall, EFRAG's assessment is that implementation of the Amendments will not result in increased costs to users; that is, it is likely to be cost neutral.

Benefits for preparers and users

14 EFRAG has carried out an assessment of the benefits for users and preparers resulting from the Amendments.

15 The Amendments address the uncertainty about the long-term viability of some interest rate benchmarks, their replacement with risk-free rates and the financial reporting implications of that change.

16 The aim of the Amendments is to ensure the continuity of the existing hedge accounting relationships in a period of uncertainty caused by the reform. EFRAG is of the view that the Amendments improve the financial reporting requirements of IAS 39 and IFRS 9 as they remove accounting effects created by the uncertainties solely caused by the reform and which do not reflect the underlying hedging strategies. Therefore, in EFRAG's view, users will benefit from financial information reflecting the underlying economic substance of these hedging strategies without being affected by the temporary uncertainty created by the interest rate benchmark reform. Also, preparers will benefit from the Amendments which will help avoiding the undue disruption of the hedge accounting which would otherwise be caused by the reform.

Conclusion

17 EFRAG's overall assessment is that the benefits resulting from the Amendments are likely to outweigh costs associated with their implementation.

EFRAG's evaluation of impact on financial stability

18 The derivatives market in Europe amounts to over 660 trillion euros[2] (notional amounts) of which many are used in hedging and associated hedge accounting. The uncertainty during the transition period created by the reform could adversely impact

---

[2] Source : ESMA Annual Statistical Report – EU Derivatives Markets 2018 (69% relating to interest rates, 12% currency derivatives, equity, credit and commodity derivatives count for less than 5% each)

the quality of the information provided in IFRS financial reporting and, as a consequence, financial markets and thus the financial stability. Without the Amendments, entities' reported profit or loss would be impacted significantly, potentially leading to real market impacts.

19 The Amendments aim to mitigate unintended volatility in financial reporting during this period of uncertainty and therefore EFRAG supports the Amendments as having a positive effect on financial stability. EFRAG is aware that if, after the reform is completed, some hedge accounted relationships no longer meet the effectiveness test and other criteria for hedge accounting, financial statements will be impacted to show the effect of this change in benchmark rates.

20 The timing of IBOR reform is different for different rates and jurisdictions but the terms of the different transitions, including how and when the old interest rates will cease and be replaced by new rates, are progressively being clarified. As a consequence, entities are starting to arrange the change of their relevant contractual agreements in preparation of the transition. As a result of these market developments, EFRAG has received a clear message from all the interested parties that contributed to EFRAG assessment during the due process, that it is paramount to have the relief provided in the Amendments available as soon as possible. This resulted in adoption of an accelerated timing for the endorsement advice.

FASB – International level playing field

21 EFRAG notes that in the US the Financial Accounting Standards Board is working on similar reliefs for US preparers. EFRAG assesses that the application of the Amendments can increase the level playing field and comparability of financial statements of European preparers with their US counterparts even when not all detailed requirements are identical in both frameworks.

Conclusion

22 EFRAG believes that the Amendments will generally bring improved financial reporting when compared to the unchanged requirements of IAS 39, IFRS 9 and IFRS 7. As such, their endorsement is conducive to the European public good in that improved financial reporting improves transparency and assists in the assessment of management stewardship.

23 EFRAG has not identified any adverse effect to the European economy, including financial stability and economic growth the Amendments could potentially have.

24 EFRAG further notes that completing the endorsement process as soon as possible is crucial in allowing preparers to benefit from the reliefs provided by the Amendments as this would reduce unintended negative consequences related to the discontinuation of the hedges solely as a result of the uncertainty about IBOR reform.

25 Furthermore, EFRAG has not identified any other factors that would mean endorsement is not conducive to the public good.

26 Having considered all relevant aspects, including the trade-off between the costs and benefits of implementing the Amendments, EFRAG assesses that endorsing the Amendments is conducive to the European public good.