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IBOR reform and its effect on financial reporting

Project update

Objective

- 1 The objective of this session is to provide the EFRAG Board with an update on the developments in the IASB's forthcoming amendments to IFRS 9 *Financial Instruments* and IAS 39 *Financial Instruments: Recognition and Measurement* for phase 1 of the IBOR project.

Background

- 2 Interest rate benchmarks (e.g. EURIBOR) play a key role in financial markets. These benchmarks index trillions of euros in a wide variety of financial products, from derivatives to residential mortgages. Recently such benchmarks are in the process of being replaced by alternative, nearly risk-free rates, which are based to a higher extent on transaction data ("the IBOR reform").
- 3 The IASB is aware of the potential significant impact of IBOR reform on financial reporting and has split its work into two phases. The first phase is addressing issues affecting financial reporting in the period before the replacement of an existing interest rate benchmark with an alternative interest rate. The second phase deals with issues that might affect financial reporting when an existing interest rate benchmark is replaced with an alternative interest rate.
- 4 On 3 May 2019, the IASB issued Exposure Draft ED/2019/1 *Interest Rate Benchmark Reform* (proposed amendments to IFRS 9 and IAS 39) (the 'ED') with a comment period of 45 days ending on 17 June 2019.
- 5 The ED covers the first phase of the IBOR project and modifies hedge accounting requirements so that entities would apply them assuming that the interest rate benchmark on which the hedged cash flows and the cash flows from the hedging instrument are based will not be altered as a result of the uncertainty created by the IBOR reform. The proposals are not intended to provide relief from any other consequences arising from the IBOR reform.
- 6 EFRAG published its final comment letter on 20 June 2019. EFRAG emphasised the urgency of the project and asked the IASB to issue the amendments as soon as possible in order to provide clarity to the entities affected by the reform.
- 7 In its comment letter, EFRAG generally supported the direction of the project. However EFRAG recommended that the amendments to IFRS 9 and IAS 39 should also:
 - (a) provide relief from including the uncertainties of IBOR reform in the retrospective assessment;

- (b) permit the application of the proposed amendments retrospectively to hedges that were discontinued because entities were unable to apply the proposed reliefs;
- (c) clarify the application of the proposed amendments to a portfolio fair value hedge of interest rate risk and the use of cross-currency swaps; and
- (d) reconsider the proposed disclosure, as qualitative disclosures are sufficient in this phase

IASB developments

- 8 The IASB considered comments on the ED at its meeting on 28 August 2019.
- 9 The IASB decided that, among other changes:
- (a) IAS 39 should be amended to provide an exception for retrospective assessment, so that, during the period of uncertainty arising from IBOR reform, an entity would continue to apply hedge accounting to a hedging relationship for which effectiveness is outside the 80–125% range;
 - (b) For ‘macro hedges’ designated under either IFRS 9 or IAS 39, an entity should assess whether a non-contractually specified risk component is separately identifiable only when the hedged item is initially designated within the ‘macro hedge’. Once a hedged item has been designated within a ‘macro hedge’, there should be no reassessment of whether the risk component is separately identifiable at any subsequent designation of that hedged item in the same hedging relationship;
 - (c) The final amendments to IFRS 9 and IAS 39 should clarify that, when an entity designates a group of items as the hedged item in accordance with paragraph 6.6.1 of IFRS 9 or paragraph 83 of IAS 39, the end of application requirement proposed in the Exposure Draft should apply to each item within the designated group of items; and.
 - (d) Entities should be exempt from the disclosure requirements in paragraph 28(f) of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* upon the initial application of the amendments. The disclosure requirements accompanying the exceptions proposed in the Exposure Draft should also be simplified so that limited information is required in the notes to the financial statements for hedging relationships directly affected by interest rate benchmark reform.
- 10 In summary, the IASB’s proposed changes addressed three of the four issues raised in EFRAG’s comment letter (as listed in paragraph 7 above).

Next steps

- 11 At its meeting in July 2019, the EFRAG Board noted the urgency of providing endorsement advice on the anticipated amendments to IFRS 9 and IAS 39 so that entities might have the option to early adopt the amendments for reporting for 2019. Accordingly, where necessary, the EFRAG Board decided to accelerate the endorsement process by approving the draft and final endorsement advices by written procedure and substantially shortening the comment period.
- 12 Based on that decision, the EFRAG Secretariat is proposing the following ambitious timetable for preparing the endorsement advice, subject to the final text of the amendments being aligned with the contents of the information available at this stage:

Date	Action
16 September	EFRAG TEG to consider a working draft of the draft endorsement advice and provide preliminary approval
26 September (estimated)	Amendment to IFRS 9 and IAS 39 issued by IASB
26 September (estimated)	EC request for endorsement advice received
26 September	EFRAG TEG approval
27–30 September	EFRAG Board written procedure for draft endorsement advice (procedure closes at noon)
30 September	Draft endorsement advice issued for comment
10 October	Draft endorsement advice comment period ends
14 October	EFRAG TEG conference call to consider final endorsement advice
16–17 October	EFRAG Board written procedure for final endorsement advice
18 October	Endorsement advice sent to EC

- 13 It is important to note that, given the urgency of the project, there will be no separate impact analysis. However, the EFRAG Secretariat is confident that EFRAG can rely on the expertise of the official observers on the EFRAG Board.

Questions for EFRAG Board

- 14 Does the EFRAG Board approve the draft endorsement plan?
- 15 Does the EFRAG Board have any other comments?