

Pre-Consultation Document – IASB Project IBOR Phase 2

This document provides a preparatory working version of EFRAG’s draft comment letter in relation to expected IASB Exposure Draft relating to Phase 2 of the Interest Rate Benchmark Reform (EFRAG Pre-Consultation Document, or ‘PCD’).

This EFRAG PCD has exceptionally been prepared and published before the publication of the IASB Exposure Draft, in order to allow sufficient time to constituents to form and express a view on the expected IASB proposals.

The EFRAG PCD assumes that the IASB proposals in the Exposure Draft are aligned to the decisions taken by the IASB during its deliberations on the project on IBOR Reform and its Effects on Financial Reporting—Phase 2, between October 2019 and February 2020 (‘the IASB tentative decisions’).

The EFRAG views on the Exposure Draft will be presented in the draft comment letter. The views exposed for comments in this PCD will constitute the basis for the preparation of the draft comment letter.

The consultation process is intended to proceed fast, in order to allow constituents to benefit from the Amendments on Phase 2 as soon as possible. Once the IASB Exposure Draft is officially published by the IASB, EFRAG will adapt the wording of this document in preparing its draft comment letter, with a very short reaction time for constituents.

This document has been approved by EFRAG TEG and presents EFRAG TEG views on the basis of the IASB tentative decisions available on 31 March 2020. For this reason, EFRAG’s views in this document are preliminary and subject to changes depending on the final wording in the Exposure Draft.

You are invited either to reply to this document or to wait for the publication of the EFRAG draft comment letter (expected to be published in April 2020).

For both documents (this PCD and the forthcoming draft comment letter) please provide your comments by the 15 May at the latest.

Pre-Consultation Draft of EFRAG Draft Comment Letter

You can submit your comments on EFRAG's PCD by using the '[Express your views](#)' page on EFRAG's website, then open the relevant news item and click on the 'Comment publication' link at the end of the news item.

Comments should be submitted by 15 May 2020.

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

[XXApril 2020]

Dear Mr Hoogervorst,

Re: **IBOR Reform and its Effects on Financial Reporting—Phase 2**

On behalf of the European Financial Reporting Advisory Group (EFRAG), I am writing to comment on the exposure draft *IBOR Reform and its Effects on Financial Reporting—Phase 2*, issued by the IASB on [date] (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 tentatively decided to clarify that a change in the basis on which the contractual cash flows are determined that alters what was originally anticipated constituted 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 allowing an entity to apply paragraph B.5.4.5 of IFRS 9 to account for modifications related to IBOR reform. EFRAG observes that this practical expedient is eligible to provide more useful information to users of financial statements and is also expected to significantly reduce the operational burden on preparers.

Under the current IFRS requirements, a hedging relationship would 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 method of effectiveness measurement after transition. EFRAG observes that this addresses 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 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 and portfolio hedges for the same reason.

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 agrees with the proposed amendments on IFRS 16 *Leases* and IFRS 4 *Insurance Contracts*, observing that these amendments are proposed for similar reasons as the proposed amendments to apply paragraph B.5.4.5 of IFRS 9 and hence increase comparability.

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

The proposed temporary relief in the context of non-contractually specified risk components on the “separately identifiable” criterion is also supported by EFRAG.

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 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.

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

Yours sincerely,

Jean-Paul Gauzès
President of the EFRAG Board

Appendix - EFRAG's responses to the tentative decisions taken by the IASB in anticipation of an ED

Notes to constituents – Summaries of expected proposals in the ED are based on the IASB's tentative decisions taken during its deliberations on the project on *IBOR Reform and its Effects on Financial Reporting—Phase 2*, as published by the IASB in the IASB Updates October 2019, December 2019, January 2020 and February 2020.

IASB tentative decision 1:

Classification and measurement—modification of financial instruments (October 2019)

- 1 The IASB tentatively decided to amend IFRS 9 to:
 - (a) clarify that, even in the absence of an amendment to the contractual terms of a financial instrument, 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.
 - (b) provide a practical expedient allowing an entity to apply paragraph B5.4.5 of IFRS 9 to account for modifications related to IBOR reform and to provide examples in IFRS 9 of modifications that are related to IBOR reform, and examples of those that are not.
 - (c) clarify that an entity should first apply paragraph B5.4.5 of IFRS 9 to account for modifications related to IBOR reform to which the practical expedient applies. Thereafter, an entity should apply the current IFRS 9 requirements to determine if any other modifications are substantial; if those modifications are not substantial, the entity should apply paragraph 5.4.3 of IFRS 9.

Sweep issue—Modification of financial instruments (February 2020)

- 2 The IASB tentatively decided the proposed amendment to clarify what constitutes a modification of a financial instrument should apply only to changes made in the context of IBOR reform.

EFRAG TEG view on the basis of the IASB's tentative decision 1

EFRAG notes the proposed clarification that a change in the basis on which the contractual cash flows are determined that alters what was originally anticipated constituted a modification of a financial instrument in accordance with IFRS 9.

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 agrees with providing a practical expedient allowing an entity to apply paragraph B5.4.5 of IFRS 9 to account for modifications related to IBOR reform. This is because EFRAG observes 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.

EFRAG agrees with the clarification that an entity should first apply paragraph B5.4.5 of IFRS 9 to account for modifications related to 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 IBOR reform are substantial; if those modifications are not substantial, the entity should apply paragraph 5.4.3 of IFRS 9.

- 3 EFRAG notes the IASB proposal to clarify that a change in the basis of 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. EFRAG agrees with the proposal to limit the scope of the clarification solely to the changes due 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 solely due to the IBOR reform and considers that the implications of such clarification will be limited.
- 4 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.
- 5 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 modifications related to IBOR reform to which the practical expedient applies. As a second step, the entity should apply the current IFRS 9 requirements to determine if any other modifications are substantial; if those modifications are not substantial, the entity should apply paragraph 5.4.3 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 IBOR reform, hence EFRAG agrees that it 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.

Questions to constituents

- 6 Do Constituents agree with EFRAG view?

IASB tentative decision 2:

Accounting implications from derecognition of a modified financial instrument (October 2019)

- 7 *The IASB tentatively decided that, in the context of IBOR reform, current requirements in IFRS 9 provide sufficient guidance to determine the appropriate accounting treatment in the following situations:*
 - (a) *derecognising a financial asset or a financial liability from the statement of financial position and the recognition of the resulting gain or loss in profit or loss following a substantial modification.*
 - (b) *determining an entity's business model for managing financial assets.*
 - (c) *determining whether the interest component of the contractual cash flows of a new financial asset referenced to alternative benchmark rates meets the criteria for solely payments of principal and interest on the principal amount outstanding (SPPI), as required by IFRS 9. The IASB also tentatively decided*

to add an example to IFRS 9 to illustrate the application of the SPPI assessment in the context of IBOR reform.

- (d) *recognising the expected credit losses for a new financial asset.*
- (e) *accounting for embedded derivatives for financial liabilities.*

EFRAG TEG view on the basis of the IASB's tentative decision 2

EFRAG agrees with the IASB's tentative decision not to amend the current accounting requirements in the context of IBOR reform that describe the accounting consequences from the derecognition of a modified financial instrument.

This is because EFRAG observes that the existing requirements already provide sufficient guidance to account for the consequences from derecognition of a modified financial instrument.

- 8 As outlined in paragraph 5, EFRAG agrees that the proposed amendment to apply paragraph B5.4.5 of IFRS 9 will apply to changes that are directly required by IBOR reform in a first step. In a second step, the current IFRS requirements, including those on accounting consequences from derecognition, will apply to any other changes that are not directly required by IBOR reform in the same way as they would apply to any other modification not made in the context of IBOR reform.
- 9 EFRAG hence observes that a modification as directly required by IBOR reform will already be accounted for under the proposed amendment to apply paragraph B5.4.5 of IFRS 9 in the first step exclusively. Thus, if this was the only modification, the current accounting requirements that describe the accounting consequences from derecognition of a modified financial instrument will not apply due to this proposed amendment.
- 10 However, in case of further modifications that are not directly required by IBOR reform, EFRAG observes that such modifications would go beyond the scope of the ED. EFRAG hence concludes that there is no need for further amendments of current accounting standards in this regard in the context of IBOR reform.

Questions to constituents

- 11 Do Constituents agree with EFRAG view?

IASB tentative decision 3:

Hedge accounting (December 2019)

- 12 *The IASB tentatively decided to:*
 - (a) *retain the requirements in IFRS 9 Financial Instruments and IAS 39 Financial Instruments: Recognition and Measurement that determine whether a hedging relationship should be discontinued after:*
 - (i) *a substantial modification that results in derecognition of the hedged item or the hedging instrument; or*
 - (ii) *a modification that does not result in derecognition and is not required as a direct consequence of IBOR reform or is not done on an economically equivalent basis.*
 - (b) *amend IFRS 9 and IAS 39 to provide an exception from the current requirements so that the following changes in hedge documentation necessary to reflect modifications that are required as a direct consequence of IBOR reform and are done on an economically equivalent basis do not result in the discontinuation of hedge accounting:*

- (i) *redefining the hedged risk to refer to an alternative benchmark rate; and*
 - (ii) *redefining the description of the hedging instruments or the hedged items to refer to the alternative benchmark rate.*
 - (c) *amend IAS 39 to provide an exception from the current requirements so that a change to the method used for assessing hedge effectiveness does not result in the discontinuation of hedge accounting when, due to IBOR reform, it is impractical to continue using the same method defined in the hedge documentation at the inception of the hedging relationship.*
- 13 *The IASB also tentatively decided to amend IAS 39 to require an entity changing the hedged risk in the hedge documentation for a portfolio hedge of interest rate risk, as noted in paragraph 12 (b)(i) above, to assume that all items included in the portfolio of financial assets or financial liabilities share the risk being hedged.*
- 14 *For changes in hedge documentation noted in paragraph 12 (b) and (c), an entity is required to continue to apply requirements in IFRS Standards to measure the hedging instrument and the hedged item and to recognise hedge ineffectiveness that may arise due to any consequential valuation adjustments required by IFRS 9 and IAS 39.*
- 15 *With regard to hedges of a group of items, the IASB tentatively decided to amend IFRS 9 and IAS 39 so that, when items within a designated group are amended for modifications that are required as a direct consequence of IBOR reform and are done on an economically equivalent basis, an entity is permitted to:*
- (a) *amend the hedge documentation to define the hedged items by way of two subgroups within the designated group of items—one referencing the original interest rate benchmark and the other, the alternative benchmark rate;*
 - (b) *perform the proportionality test separately for each subgroup of items designated in the hedging relationship;*
 - (c) *treat the hedge designation as a single hedging relationship and amend the hypothetical derivative to reflect the combination of the subgroups of items; and*
 - (d) *treat IBOR and its alternative benchmark rate as if they share similar risk characteristics (but only in relation to a group of items designated under IAS 39).*

EFRAG TEG view on the basis of the IASB's tentative decision 3

EFRAG observes that the proposed amendments on 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.

In particular, 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.

For the same reason, 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 and portfolio hedges because these amendments are consistent with the objective to continue hedging relationships when transitioning from IBOR to an alternative benchmark rate.

- 16 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 as directly required by 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.
- 17 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 IBOR reform to continue the hedging relationships affected.
- 18 EFRAG agrees to retain the current requirements of IFRS Standards that apply in when a substantial modification results in derecognition of the hedged item or the hedging instrument (paragraph 12(a)(i)). The same applies in case of a modification that does not result in derecognition and is not required as a direct consequence of IBOR reform or is not done on an economically equivalent basis (paragraph 12(a)(ii)). This is for the same reason as outlined in paragraph 10, because EFRAG observes that the proposed amendments in the ED are limited to IBOR reform, hence any other modifications that are not directly required by IBOR reform, including their accounting impacts, should be dealt with under the current IFRS requirements in the same way as any other modifications.
- 19 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 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 (paragraph 12(b)).
- 20 EFRAG observes that this exception corresponds with the proposed amendment to apply paragraph B5.4.5 of IFRS 9 to modifications directly required by IBOR reform. When an entity modifies the contractual terms to refer to an alternative benchmark rate accordingly, this will have impact on the definition of the hedged risk and the description of the hedging instruments or the hedged items in the hedge documentation.
- 21 EFRAG agrees with the IASB's analysis (IASB December 2019 meeting, Agenda Paper 14A) that discontinuation of hedge accounting and the consequential accounting implications, in particular in terms of ineffectiveness and volatility in profit or loss, would not provide useful information to users of financial statements. This is because changes in hedge documentation, necessary to reflect modifications directly required by 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).
- 22 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.
- 23 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 12(c)). Under such exception, a change to this method would not result in the discontinuation of hedge accounting when, due to IBOR reform, it is impractical to continue using the same method defined in the hedge documentation at the inception of the hedging relationship. Such an impracticability may arise, for example, when an entity uses regression analysis to assess hedge effectiveness and, at the time that hedging instruments and hedged items are modified to replace IBOR with an alternative benchmark rate, the available historical information for the alternative benchmark rate might not be sufficient to perform the regression analysis.

- 24 EFRAG agrees with the IASB's tentative decision in paragraph 13, which is to amend IAS 39 to require an entity changing the hedged risk in the hedge documentation for a portfolio hedge of interest rate risk, as noted in paragraph 12(b)(i) above, to assume that all items included in the portfolio of financial assets or financial liabilities share the risk being hedged. This is 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.
- 25 EFRAG agrees that an entity is (subject to paragraph 29(a)) generally required to continue to apply requirements in IFRS Standards to measure the hedging instrument and the hedged item and to recognise hedge ineffectiveness that may arise due to any consequential valuation adjustments required by IFRS 9 and IAS 39 (paragraph 14). 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.
- 26 EFRAG agrees with the IASB 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 IBOR reform and are done on an economically equivalent basis. If so, as described in paragraph 15 (a)-(d), 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).
- 27 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.

Questions to constituents

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| 28 Do Constituents agree with EFRAG view? |
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IASB tentative decision 4:

End of application—Phase 1 exceptions (January 2020)

29 The IASB tentatively decided to:

- (a) amend IAS 39, only for the purpose of assessing retrospective effectiveness, to require entities to reset to zero the cumulative fair value changes of the hedging instrument and the hedged item at the date the exception to the retrospective assessment in paragraph 102G of IAS 39 ceases to apply; and
- (b) make no amendments to the end of application requirements for the Phase 1 exceptions to the highly probable requirement for cash flow hedges and prospective assessments in IFRS 9 and IAS 39.

EFRAG TEG view on the basis of the IASB's tentative decision 4

EFRAG agrees with the proposed amendment to IAS 39 to reset to zero the cumulative fair value changes of the hedging instrument and the hedged item to avoid recognising ineffectiveness that would arise without the proposed amendment.

However, EFRAG observes that the IASB may consider providing additional clarification on the end of Phase 1 exceptions to the highly probable requirement.

- 30 EFRAG agrees with the proposed amendment to require entities to reset to zero the cumulative fair value changes of the hedging instrument and the hedged item at the date the exception to the retrospective assessment in paragraph 102G of IAS 39 ceases to apply. This is because the proposed amendment will avoid failure of the retrospective effectiveness test because the cumulated fair value changes before transitioning to an alternative benchmark rate were driven by IBOR and would hence give rise to ineffectiveness after the fair value changes are driven by the alternative benchmark rate.
- 31 EFRAG observes that the Phase 1 exception on whether the hedged future cash flows are expected to occur in IFRS 9 paragraph 6.8.5 or IAS 39 paragraph 102D respectively will cease to apply as required by IFRS 9 paragraph 6.8.10 or IAS 39 paragraph 102k respectively. However, the IASB may consider providing additional clarification on the application of IFRS 9 paragraph 6.8.10(a) or IAS 39 paragraph 102(a) respectively. These paragraphs require an entity to prospectively cease applying IFRS 9 paragraph 6.8.5 or IAS 39 paragraph 102D 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. EFRAG observes that uncertainty is no longer present once the proposed amendments on Phase 2 apply. Hence, the IASB may consider clarifying that prospectively ceasing to apply IFRS 9 paragraph 6.8.5 or IAS 39 paragraph 102D because the uncertainty is no longer present when the proposed amendments on Phase 2 apply, does not imply that the hedged future cash flows were no longer expected to occur for the purposes of IFRS 9 paragraph 6.5.12.

Questions to constituents

- 32 Do Constituents agree with EFRAG's view?

IASB tentative decision 5:

Other IFRS Standards (January 2020)

33 The IASB tentatively decided to amend:

- (a) *IFRS 16 Leases to require a lessee to apply paragraphs 42(b) and 43 of IFRS 16 to account for lease modifications to the interest rate benchmark on which lease payments are based that are required as a direct consequence of IBOR reform and done on an economically equivalent basis (modifications directly required by IBOR reform).*
 - (b) *IFRS 4 Insurance Contracts to require insurers that apply the temporary exemption from IFRS 9 to apply the amendments resulting from the IASB tentative decisions in Phase 2 of the project in accounting for modifications directly required by IBOR reform.*
- 34 *The IASB also tentatively decided that no amendments are made in the context of IBOR reform to:*
- (a) *IFRS 13 Fair Value Measurement because it provides sufficient guidance to determine if and when a financial asset or financial liability should be transferred to a different level within the fair value hierarchy. These transfers reflect the economic effects of IBOR reform, therefore providing useful information to users of financial statements.*
 - (b) *IFRS 17 Insurance Contracts because it provides an adequate basis for an entity to account for insurance contract modifications in the context of the IBOR reform. Such accounting results in useful information to users of financial statements.*
 - (c) *the current requirements in IFRS Standards with respect to discount rates as they already provide adequate guidance to determine the appropriate accounting treatment for the potential effects of changes to the discount rates resulting from the replacement of interest rate benchmarks.*

IFRS 13 day-one gain or loss

- 35 *EFRAG discussed whether an issue would arise in the context of fair value measurements classified as level 3 when the input parameters for an alternative benchmark rate were not sufficiently observable yet. If so, a difference between transaction price and fair value may arise (commonly referred to as “day one gain or loss”). Such difference is only recognised in profit or loss on initial recognition if it is evidenced by a quoted price in an active market. When this is not the case for an alternative benchmark rate, EFRAG observed that such difference would be deferred until (and no later than) when the alternative benchmark rate becomes observable.*
- 36 *EFRAG also observed that the issue of day-one gains or losses will only arise for instruments that are initially recognised. However, when transitioning from IBOR to an alternative benchmark rate and the contractual cash flows are modified as directly required by the reform, entities will apply the practical expedient to apply paragraph B5.4.5 of IFRS 9. Thus, no derecognition event will occur and hence no issue of day-one gains or losses will arise for existing contracts based on IBOR when transitioning to an alternative benchmark rate as directly required by the reform. In addition, also when derecognition would apply, when a subsequent observable market price appears, the deferred day-one gain would be recognised.*
- 37 *Against this background, EFRAG concluded that the issue of day one gains or losses in the context of IBOR reform should not be raised in the draft comment letter.*

EFRAG TEG view on the basis of the IASB's tentative decision 5

EFRAG agrees with the proposed amendments on IFRS 16 and IFRS 4. EFRAG observes that these amendments are proposed for similar reasons as the proposed amendments in paragraph 1(b) and hence increase comparability.

EFRAG also agrees that no amendments on other IFRS Standards are assessed by the IASB are necessary because the current requirements already provide a sufficient basis to reflect the effects of IBOR reform.

- 38 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 IBOR reforms 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.
- 39 EFRAG agrees 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.

Questions to constituents

- 40 Do Constituents agree with EFRAG view?

IASB tentative decision 6:

Disclosures (January 2020)

- 41 *The IASB tentatively decided to amend IFRS 7 Financial Instruments: Disclosures to require an entity to provide disclosures that enable users of financial statements to understand:*
- (a) *the nature and extent of risks arising from IBOR 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 the transition.*
- 42 *To achieve this objective, an entity would disclose information about:*
- (a) *how it is managing the transition from interest rate benchmarks to alternative benchmark rates and the progress made at the reporting date, and the risks arising from this transition;*
 - (b) *the carrying amount of financial assets and financial liabilities, including the nominal amount of the derivatives, that continue to reference interest rate benchmarks subject to the reform, disaggregated by significant interest rate benchmark;*
 - (c) *for each significant alternative benchmark rate to which the entity is exposed, an explanation of how the 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 IBOR reform and have been done on an economically equivalent basis; and*
 - (d) *to the extent that IBOR reform has resulted in changes to an entity's risk management strategy, a description of these changes and how is the entity managing those risks.*

EFRAG TEG view on the basis of the IASB's tentative decision 6

EFRAG agrees that the proposed disclosures will assist users of financial statements in understanding the effects of 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 42(c) above may be less helpful to users of financial statements because the disclosures are expected to be less entity-specific.

- 43 As outlined in paragraph 42(c) above, 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 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.
- 44 In addition, EFRAG observes that an assessment of whether modifications to contractual cash flows were required as a direct consequence of IBOR reform and have been done on an economically equivalent basis is a necessary requirement to apply the proposed amendments.
- 45 Against this background, the IASB may reconsider whether disclosing information as proposed in paragraph 42(c) will provide entity-specific information that is useful to users of financial statements and not be considered boilerplate.

Questions to constituents

- 46 Do Constituents agree with EFRAG view?

IASB tentative decision 7:

Hedges of risk components—Separately identifiable criteria (February 2020)

- 47 *The IASB tentatively decided to provide temporary relief for hedging relationships amended to reflect modifications that are required as a direct consequence of IBOR reform. Applying this relief, a non-contractually specified risk component is considered to satisfy the 'separately identifiable' criteria if, and only if:*
- (a) *the entity reasonably expects that the alternative benchmark rate will satisfy the requirement in IFRS 9 or IAS 39 to be a separately identifiable risk component within the particular market structure within 24 months from the date the rate is designated as a risk component for hedge accounting purposes; and*
 - (b) *the risk component can be reliably measured from the date it is designated as the risk component.*

EFRAG TEG view on the basis of the IASB's tentative decision 7

EFRAG agrees with the IASB's tentative decision to provide temporary relief in the context of non-contractually specified risk components on the "separately identifiable" criterion.

- 48 EFRAG observes that limiting the temporary relief to a period of 24 months is not expected to be an impediment for timely transition to alternative benchmark rates.
- 49 EFRAG observes that, in absence of such a relief period or if the relief period would be significantly shorter than the proposed 24 months, 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.

- 50 EFRAG observes that the IASB does not propose an equivalent relief on the requirement of a risk component being reliably measurable. EFRAG observes 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.
- 51 However, EFRAG shares the IASB's analysis (IASB meeting February 2020, AP 14B) 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.

Questions to constituents

- 52 Do Constituents agree with EFRAG view?

IASB tentative decision 8:

End of Phase 2 amendments and voluntary versus mandatory application (February 2020)

- 53 *The IASB tentatively decided application of all proposed amendments in Phase 2 should be mandatory. The IASB also tentatively decided that the nature of the proposed amendments is such that they 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.*

EFRAG TEG view on the basis of the IASB's tentative decision 8

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 IBOR reforms.

- 54 EFRAG observes that mandatory application of the proposed amendments will increase comparability across entities that are affected by the IBOR reform.
- 55 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.

Questions to constituents

- 56 Do Constituents agree with EFRAG view?

IASB tentative decision 9:

Effective date and transition requirements (February 2020)

57 *The IASB tentatively decided that:*

- (a) *entities should apply the proposed amendments for annual periods beginning on or after 1 January 2021, with earlier application permitted.*
- (b) *the proposed amendments in Phase 2 should apply retrospectively. Retrospective application:*
 - (i) *relates to items that existed at the beginning of the reporting period in which an entity first applies the proposed amendments, including to amounts accumulated in the cash flow hedge reserve related to hedging relationships that have already been discontinued.*
 - (ii) *includes reinstating hedging relationships that were discontinued before the entity first applies the proposed amendments solely due to changes in hedging relationships (and the related documentation) necessary to reflect the modifications required as a direct consequence of the reform. These hedging relationships must be reinstated if the entity can demonstrate that the hedging relationship would not have been discontinued if the proposed amendments were available at the time and that it can be done without the use of hindsight.*
- (c) *in the reporting period in which an entity first applies the proposed amendments, an entity is not required to present the disclosures required by paragraph 28(f) of IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors.*

EFRAG TEG view on the basis of the IASB's tentative decision 9

EFRAG agrees with the tentative decisions taken by the IASB on 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.

- 58 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.
- 59 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.
- 60 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.

- 61 EFRAG observes that the term “items that existed at the beginning of the reporting period in which an entity first applies the proposed amendments” may be clarified in the sense that it relates not to financial instruments as items in general but to items that have been designated in hedging relationships.

Questions to constituents

- 62 Do Constituents agree with EFRAG view?