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Interest Rate Benchmark Reform – Classification and Measurement Issues Paper

Objective

- 1 The objective of this paper is to:
 - (a) seek views of EFRAG TEG members on the IASB tentative decisions on classification and measurement issues dealt with in the Phase 2 of the IBOR project; and
 - (b) Inform EFRAG TEG about the views of EFRAG FIWG members.

The IASB tentative decisions taken in October

Classification and measurement—modification of financial instruments

- 2 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. Twelve of 14 IASB members agreed, and one disagreed with this decision. One IASB member abstained;
 - (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. 13 of 14 IASB members agreed with this decision. One IASB member abstained; and
 - (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. 13 of 14 IASB members agreed with this decision. One IASB member abstained.

Accounting implications from derecognition of a modified financial instrument

- 3 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 Board 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; and
 - (e) accounting for embedded derivatives for financial liabilities.
- 4 All 14 IASB members agreed with these decisions.

EFRAG FIWG views

- 5 EFRAG FIWG members made the following comments in respect of the IASB tentative decision that a change in the basis on which the contractual cash flows are determined, constitute a modification even in the absence of an amendment to the contractual terms:
- (a) The EFRAG FIWG observer noted that in his view, underlying interest rate did not change, irrespective of the amendments to the calculation methodology. He also emphasised that such methodology changes already happened before and will continue to happen periodically without changes to the economics.
 - (b) Several EFRAG FIWG members expressed concern about the new IASB approach shifting the emphasis from the contractual to the methodology changes and asked if there would be a need to look elsewhere for such changes and what impact it might have.
 - (c) Some EFRAG FIWG members questioned the overall necessity to define the modification.
 - (d) One EFRAG FIWG member noted that this change can create a contract continuity risk for the whole legacy portfolio of retail mortgages for example.
 - (e) Another EFRAG FIWG member noted that EURIBOR reform was completed in Q4 2019 and that all the modifications already took place. This member asked how to account for it by the year end 2019 since Phase 2 was still in progress.
 - (f) EFRAG FIWG members questioned the treatment of modified time value of money for the purposes of SPPI test after moving to the new rate. The IASB clarified that there was no need to reperform SPPI test after the modification.
- 6 EFRAG FIWG members were generally supportive for the second IASB tentative decision providing a practical expedient to allow 'modifications that are related to the reform' and made on an economically equivalent basis, to be accounted for as an update to EIR rather than a modification gain or loss.
- 7 EFRAG FIWG members also welcomed the third IASB tentative decision on the order of modification accounting.
- 8 Several EFRAG FIWG members questioned the interaction between the end of relief with prospective and retrospective assessments of the hedge effectiveness.
- 9 The IASB noted that the hedge accounting issues as well as interactions with other standards, such as IFRS 16 *Leases*, will be addressed in its December meeting and Disclosures – in its January meeting. It also noted that at this stage the entity wide disclosures about the broad sense impact of IBOR transition management are considered.

- 10 The EFRAG FIWG observer questioned if the reliefs would be applicable to other changes of the Benchmark Regulation given that it requires continues changes. The IASB responded that the reliefs were specific to this particular reform and would not be applicable to any other changes.
- 11 EFRAG secretariat shares the support expressed by FIWG members to the directions of the project and the tentative decisions, however considers that further assessment is needed with reference to the possible consequences of the proposed approach that the IASB is taking to define what a “modification” is and to shift the emphasis from the contractual to the methodology changes.

Question to EFRAG TEG

- 12 Does EFRAG TEG agree with the IASB tentative decisions on classifications and measurement?
- 13 Does EFRAG TEG share the concerns of EFRAG FIWG and EFRAG secretariat on the consequences of the IASB approach to the modification?