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Interest Rate Benchmark Reform – comment letter analysis

Objective

- 1 The objective of this paper is to provide an overview of the comments received in response to EFRAG's Invitation to Comment on its draft comment letter on *IASB ED/2019/1 Interest Rate Benchmark Reform (Proposed amendments to IFRS 9 and IAS 39)*.

Background

- 2 The IASB issued the Amendments on 3 May 2019. The Amendments cover the first phase of the Interest Rate Benchmark Reform and modify 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 reform. The proposals are not intended to provide relief from any other consequences arising from interest rate benchmark reform.
- 3 EFRAG has issued its Draft Comment Letter on 13 May 2019. Comments were requested by 31 May 2019. In its draft comment letter, EFRAG noted that the IBOR reform creates more accounting issues than the ones addressed in the Amendments. EFRAG supported to focus during phase I on the pre-replacement issues only and listed in the Appendix II of the comment letter a number of topics that could potentially be addressed in the second phase (replacement issues).
- 4 EFRAG received comment letters from five respondents representing three preparer organisations and two preparers (banks). The respondents are listed in Appendix II.

Summary of respondents' views

- 5 The respondents supported the IASB initiative to provide limited relief for the financial instruments qualifying for hedge accounting as long as uncertainty due to IBOR reform exists.
- 6 The respondents on overall agreed with the EFRAG draft comment letter on the *IASB ED ED/2019/1 Interest Rate Benchmark Reform (Proposed Amendments to IFRS 9 and IAS 39)*. In particular:
 - (a) They appreciated the IASB addressing the issues through the fast procedure and stressed the importance of swift endorsement of the Amendments in Europe as they need to be applied already in 2019.
 - (b) The respondents welcomed the EFRAG call to the IASB to address the issues in the second phase of the project as soon as possible and in parallel to the finalisation of the first phase.
 - (c) They highlighted that the IASB should consider different transition fact patterns worldwide and not to focus only on LIBOR transition.

Interest Rate Benchmark Reform – Comment letter analysis

- (d) In addition, the respondents would like the IASB to provide an assurance that the modification of a calculation methodology of a rate does not result in a modification of that rate and hence of the underlying instrument. This would ensure a continuity of existing contracts and accounting treatment and concerns EURIBOR transition path in particular.
- (e) The respondents considered necessary that the IASB provides relief for the retrospective assessment of hedge effectiveness under IAS 39 as soon as possible, considering even the phase one of the project.

Question to EFRAG TEG

- 7 Does EFRAG TEG agree with EFRAG Secretariat's recommendations in *Appendix 1: Analysis and Summary of Comments* received?

Appendix 1 - Detailed analysis of responses to questions in EFRAG's draft comment letter, EFRAG Secretariat recommendations and questions to EFRAG TEG

Question 1 paragraphs 6.8.4–6.8.6 of IFRS 9 and paragraphs 102D–102F of IAS 39]

Highly probable requirement and prospective assessments

- | | |
|---|--|
| 8 | <p>For hedges of interest rate risk that are affected by interest rate benchmark reform, the IASB proposes amendments to IFRS 9 and IAS 39 as described below.</p> <p>(a) For the reasons set out in paragraphs BC8–BC15, the IASB proposes exceptions for determining whether a forecast transaction is highly probable or whether it is no longer expected to occur. Specifically, the Exposure Draft proposes that an entity would apply those requirements assuming that the interest rate benchmark on which the hedged cash flows are based will not be altered as a result of interest rate benchmark reform.</p> <p>(b) For the reasons set out in paragraphs BC16–BC23, the IASB proposes exceptions to the hedge accounting requirements in IFRS 9 and IAS 39 so that an entity would assume that the interest rate benchmark on which the hedged cash flows are based, and/or the interest rate benchmark on which the cash flows of the hedging instruments are based, will not be altered as a result of interest rate benchmark reform when the entity determines whether:</p> <p>(i) there is an economic relationship between the hedged item and the hedging instrument applying IFRS 9; or</p> <p>(ii) the hedge is expected to be highly effective in achieving offsetting applying IAS 39.</p> |
| 9 | <p>Do you agree with these proposals? Why or why not? If you agree with only parts of the proposals, please specify what you agree and disagree with. If you disagree with the proposals, please explain what you propose instead and why.</p> |

Proposals in the ED

- 10 *As part of the pre-replacement phase before existing interest rate benchmarks are replaced with alternative, nearly risk-free interest rates (RFRs), the IASB 'considered the implications for specific 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 reform, contractual cash flows of hedged items and hedging instruments that are based on an existing interest rate benchmark will likely change when that existing interest rate benchmark is replaced with an alternative interest rate'. 'Until decisions are made with respect to what alternative interest rate is used and when that replacement will occur, uncertainties will exist regarding the timing and the amount of future cash flows of the hedged item and the hedging instrument'.*

Highly probable requirement

- 11 *The highly probable requirement ensures 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 IASB noted that if the effects of the interest rate benchmark reform are such that the hedged cash flows are no longer highly probable, then hedge accounting would be discontinued. Nevertheless, the IASB noted that uncertainty exists regarding how the reform will affect the hedged cash flows because the details of the replacement of interest rate benchmarks are*

unknown. In the IASB's view, discontinuing all affected hedging relationships solely due to such uncertainty would not provide useful information to users of financial statements.

- 12 *Therefore, the IASB decided to propose amendments to IFRS 9 and IAS 39 to provide an exception to the highly probable requirement that would provide relief during this period of uncertainty. 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 *The IASB is also 'proposing an exception for discontinued hedging relationships': any amount remaining in the cash flow hedge reserve would be reclassified to profit or loss in the same period or periods during which the hedged cash flows affect profit or loss, assuming that the interest rate benchmark on which the hedged cash flows are based will not be altered as a result of interest rate benchmark reform.*

Prospective assessments

- 14 *The requirements in paragraph 6.4.1(c)(i) of IFRS 9 (the existence of an economic relationship) and paragraph AG105(a) of IAS 39 (whether the hedge is expected to be highly effective) are collectively referred to as 'prospective assessments'.*
- 15 *IFRS 9 and IAS 39 require entities to discontinue hedge accounting if the prospective assessment is not met. Once hedge accounting is discontinued, the entity is required to recognise in profit or loss the changes in the fair value of the derivatives (i.e. the hedging instruments before discontinuation), in the same way as trading derivatives.*
- 16 *The IASB considered the usefulness of the resulting information and decided to provide relief from the 'prospective assessments' requirements in IFRS 9 and IAS 39.*
- 17 *Applying the proposed relief, entities would assess whether the economic relationship required by IFRS 9 exists, or whether the hedge is expected to be highly effective in achieving offsetting as required by IAS 39, assuming the interest rate benchmark on which the hedged item and the hedging instrument are based will not be altered as a result of interest rate benchmark reform. Similarly, if an entity designates a highly probable forecast transaction as the hedged item, the entity would perform the prospective assessments assuming no amendments will be made to future contracts as a result of interest rate benchmark reform with respect to the interest rate benchmark of those forecast transactions.*

Retrospective assessments

- 18 *According to paragraph AG105 of IAS 39, a hedge is regarded as highly effective only if both the requirement relating to retrospective and prospective assessments are met. If an entity fails either of these assessments, then paragraphs 91(b) and 101(b) of IAS 39 require the entity to discontinue hedge accounting. IFRS 9 does not require a retrospective assessment.*
- 19 *In the IASB view, 'disregarding the effects of IBOR reform on the actual results of a hedge could impact measurement of the hedging instrument and hedged item. This would undermine the fundamental principle in hedge accounting of offset between gains and losses on the hedging instrument and the hedged item. As noted at the IASB December 2018 meeting, the IASB is not considering evaluating that principle'.*

EFRAG's tentative position

EFRAG agrees that the relief from the uncertainties arising from the interest rate benchmark reform should be provided for highly probable requirement and prospective assessments required by IFRS 9 and IAS 39.

Summary of constituents' comments

- 20 The respondents did not provide any comments on this question but agreed overall with the reliefs provided by the IASB.

EFRAG Secretariat's recommendations to EFRAG TEG on EFRAG's proposed final position

- 21 Based on the comments received to Appendix II, see paragraphs 75 to 94 below, the EFRAG Secretariat proposes to add retrospective assessments as a pre-replacement issue. Also, the application of the relief to the portfolio fair value hedge of interest rate risk is proposed to be added.

Question 2 [paragraph 6.8.7 of IFRS 9 and paragraph 102G of IAS 39]

Designating a component of an item as the hedged item

- 22 For the reasons set out in paragraphs BC24-BC27, the IASB proposes amendments to the hedge accounting requirements in IFRS 9 and IAS 39 for hedges of the benchmark component of interest rate risk that is not contractually specified and that are affected by interest rate benchmark reform. Specifically, for such hedges, the Exposure Draft proposes that an entity applies the requirement – that the designated risk component or designated portion be separately identifiable – only at the inception of the hedging relationship.
- 23 Do you agree with this proposal? Why or why not? If you disagree with the proposals, please explain what you propose instead and why.

Proposals in the ED

- 24 *An entity may designate an item in its entirety or a component of an item as the hedged item in a hedging relationship. Both IFRS 9 and IAS 39 require that the risk component be separately identifiable and reliably measurable in order to be eligible for hedge accounting.*
- 25 *The IASB observed that the interest rate benchmark 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. The IASB noted that the same issue does not arise for risk components that are contractually specified.*
- 26 *Because a discontinuation of hedging relationships resulting from the uncertainty relating to the interest benchmark reform would not provide useful information, the IASB decided to propose amendments to IFRS 9 and IAS 39 so that entities do not discontinue hedge accounting solely because the hedged item is no longer separately identifiable as interest rate benchmark 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.*
- 27 *The IASB did not allow entities to designate the benchmark component of interest rate risk as the hedged item in a new hedging relationship if the risk component is not separately identifiable at inception of the hedging relationship as this would go beyond the objective of the proposed exception.*
- 28 *Finally, the IASB is not proposing any exception from the requirement relating to reliable measurement.*

EFRAG's tentative position

EFRAG agrees that the hedged risk component or risk portion should only be separately identifiable at inception of the hedging relationship.

Summary of constituents' comments

29 ESBG supported the relief proposed on the separately identifiable requirement that would permit to perform this assessment only at inception of the hedging relationship. However, ESBG expressed concern that when IBORs become less liquid, it might no longer fulfil the “reliably measurable” criterion. ESBG proposed that the IASB should at least discuss in the BCs how the “reliably measurable” criterion should be understood in the context of the relief provided for the “separately identifiable” criterion.

EFRAG Secretariat's recommendations to EFRAG TEG on EFRAG's proposed final position

30 The EFRAG Secretariat recalls that BC22 of the Amendments explicitly states that “If the yields on instruments that are linked to the existing interest rate benchmark are affected by the reform, for example, due to decreased liquidity, then the entity cannot ignore such a change in the yields in its measurement of hedge effectiveness. In the Board's view, disregarding the effects of interest rate benchmark reform in measuring the outcome of a hedging relationship could conceal the effect of actual changes in the economics of a financial instrument and would go beyond the objectives of the proposed exceptions.”

31 No change proposed.

Question 3 [paragraphs 6.8.8 – 6.8.10 of IFRS 9 and paragraphs 102H – 102J of IAS 39]

Mandatory application and end of application

32 For the reasons set out in paragraphs BC28 – BC31, the IASB proposes that the exceptions are mandatory. As a result, entities would be required to apply the proposed exceptions to all hedging relationships that are affected by interest rate benchmark reform.

33 For the reasons set out in paragraphs BC32 – BC42, the IASB proposes that the exceptions would apply for a limited period. Specifically, an entity would prospectively cease to apply the proposed amendments at the earlier of:

(a) 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; and

(b) When the hedging relationship is discontinued, or if paragraph 6.8.9 of IFRS 9 or paragraph 102I of IAS 39 applies, when the entire amount accumulated in the cash flow hedge reserve with respect to that hedging relationship is reclassified to profit or loss.

34 For the reasons set out in paragraph BC43, the IASB is not proposing an end of application in relation to the separate identification requirement.

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

Proposals in the ED

- 36 The IASB proposed that entities must apply the exceptions in the ED to all hedging relationships to which the exceptions are applicable. Voluntary application is not allowed as it could give rise to selective discontinuation of hedge accounting and selective reclassification of the amounts recorded in other comprehensive income related to previously discontinued hedging relationships.
- 37 The IASB also proposed that an entity ceases applying the proposed exceptions at the earlier of (a) when the uncertainty regarding the timing and the amount of interest rate benchmark-based cash flows is no longer present and (b) the discontinuation of the hedging relationship.
- 38 The IASB observed that there could be circumstances in which the exceptions in this ED are not applicable for example if a particular interest rate benchmark is not subject to a replacement with an alternative interest rate. Also, there could be circumstances where the exceptions are only partly applicable.

EFRAG's tentative position

EFRAG agrees with mandatory application of the Amendments to all hedge accounting relationships as this avoids the potential for selective application of hedge accounting requirements. EFRAG also agrees with the temporary nature of the relief as the relief is not needed once the uncertainties about the reform have been lifted. Finally, EFRAG agrees with not proposing an end of application in relation to the separately identifiable requirement as this would be inconsistent with the aim of the relief provided.

Summary of constituents' comments

- 39 ESBG agreed that the exceptions proposed in the ED must be applied to all hedging relationships that are affected by the uncertainties arising from interest rate reform, without permitting voluntary application that might lead to a selective discontinuation of hedging relationships.

EFRAG Secretariat's recommendations to EFRAG TEG on EFRAG's proposed final position

- 40 No change proposed.

Question to constituents

- 41 The Amendments require entities to cease applying the relief when the uncertainty arising from interest rate benchmark reform is no longer present with respect to the timing and amount of the interest rate benchmark-based cash flows. The assessment of when uncertainty ceases to exist requires the exercise of judgement.
- 42 Do constituents believe that the level of judgement involved in this assessment would deserve additional discipline? For example, should the IASB add a clarification that this assessment has to be done by management using all the available information applicable to the specific facts and circumstances?

Summary of constituents' comments

- 43 ESBG stated that currently BC propose several examples of when the uncertainties related to the reform would end. However, ESBG considers that under certain circumstances, a deeper analysis may be necessary beyond the amended terms of the contract to determine the economic link between the hedge item and the hedging instrument, in which case management should apply judgement to determine whether or not uncertainties have ceased. ESBG suggests the IASB to add further clarification regarding the assessment that should be performed by management in the specific circumstances.

- 44 Erste Group agreed that the IASB should clarify that the assessment of when to cease applying the relief has to be done by management using all the available information applicable to the specific facts and circumstances. Different scenarios of IBOR transition can be applicable for each entity and as result, the determination of whether the uncertainty is no longer present may involve exercising adequate professional judgement.

EFRAG Secretariat's recommendations to EFRAG TEG on EFRAG's proposed final position

- 45 The EFRAG Secretariat suggests adding a sentence noting that the end of the relief requires the exercise of judgement using all the available information applicable to the specific facts and circumstances.

Question 4 [paragraph 6.8.11 of IFRS 9 and paragraph 102K of IAS 39]

Disclosures

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| 46 | For the reasons set out in paragraph BC44, the IASB proposes that entities provide specific disclosures about the extent to which their hedging relationships are affected by the proposed amendments. |
| 47 | Do you agree with these proposed disclosures? Why or why not? If not, what disclosures would you propose instead and why? |

Proposals in the ED

- 48 *The IASB proposes that entities applying the reliefs in this Exposure Draft provide disclosure about the magnitude of the hedging relationships to which the reliefs apply. The IASB noted that IFRS 7 Financial Instruments: Disclosures already requires specific disclosures about hedge accounting and, for some specifically identified disclosures, information provided separately for hedging relationships to which the proposed exceptions apply, would provide useful information to users of financial statements. The IASB expects that the cost of this disclosure proposal would not be onerous because it only requires disaggregating information that is already required to be disclosed by IFRS 7.*

EFRAG's tentative position

EFRAG agrees with the IASB's proposal to require specific disclosures about the extent to which the hedging relationships are affected by the proposed amendments.

Summary of constituents' comments

- 49 FBF and BNP Paribas noted that the proposed disclosures were burdensome and would generate undue costs. These costs would be generated by the disaggregation of carrying amounts and gains and losses arising from IBOR hedges that are not naturally disaggregated. FBF questioned the relevance of the information and its usefulness for users of financial information. They also noted that under the IAS 39 amendments "Novation of derivatives and continuation of hedge accounting" additional disclosures were not required. As a result, FBF argued the disclosures should remain qualitative only.
- 50 BNP Paribas also considered that the proposed disclosures would have little benefit for users and would require significant modification in the systems of preparers. In their view, users would be more interested about the qualitative information regarding the transition implementation paths.

EFRAG Secretariat's recommendations to EFRAG TEG on EFRAG's proposed final position

- 51 The EFRAG Secretariat questions the benefits of the proposed disclosures to users. As currently proposed, the disclosures seek to provide information on hedges applying the regular hedge accounting conditions separately from hedges that are accounted for using the exceptions. It should be clarified whether the intent of this separation is to enable users to assess the impact on the financial statements should the reliefs cease and the hedging relationships are discontinued. Should this not be the intention of the IASB, then it is difficult to see a reason for the separate disclosures.
- 52 The EFRAG Secretariat notes that the Amendments are narrow mandatory exceptions from the hedge accounting requirements. As a result, the disclosures related to the amendments should therefore also be narrow and designed to explain the consequences of these exceptions. The EFRAG Secretariat notes the disclosures should address wider reporting needs relating to the benchmark rate reforms. To identify such needs, it is asked that the IASB do further work in collaboration with users as part of Phase II of this project. This workstream should start as soon as possible to address users' needs appropriately and timely.
- 53 The IASB may also consider hedging relationships where only the hedging instrument or hedged item qualify for the relief and the impact this may have on the proposed disclosures.

Question 5 [paragraphs 7.1.9 and 7.2.26(d) of IFRS 9 and paragraph 108G of IAS 39]

Effective date and transition

- 54 For the reasons set out in paragraphs BC45–BC47, the IASB proposes that the amendments would have an effective date of annual periods beginning on or after 1 January 2020. Earlier application would be permitted. The IASB proposes that the amendments would be applied retrospectively. No specific transition provisions are proposed.
- 55 Do you agree with these proposals? Why or why not? If you disagree with the proposals, please explain what you propose instead and why.

Proposals in the ED

- 56 *Acknowledging the urgency of the matter, the IASB proposes that the effective date of these amendments is annual periods beginning on or after 1 January 2020, with earlier application permitted.*
- 57 *In addition, the IASB proposes the amendments apply retrospectively.*

EFRAG's tentative position

EFRAG supports the IASB proposals on the date of application with earlier application permitted and the retrospective application of the amendments.

Summary of constituents' comments

- 58 Two respondents (FBF and BNP Paribas) highlighted the importance of the early application of the amendments and swift European endorsement process to be launched this year to avoid the discontinuation of hedge accounting in 2019.
- 59 Two respondents (Insurance Europe and BNP Paribas) called on the IASB to start with the second phase of the project as soon as possible to have clarity about the accounting treatment before the IBOR reform takes effect.

EFRAG Secretariat's recommendations to EFRAG TEG on EFRAG's proposed final position

- 60 The EFRAG Secretariat supports retrospective application of the exceptions as proposed in the ED. However, the EFRAG Secretariat does not think retrospective application of the Amendments should always be prohibited for hedges that were discontinued in a prior period (BC46). Retrospective reinstatement should be permitted for previously discontinued hedges that failed the hedge accounting requirements because the proposed reliefs in the ED were not (yet) available.

Preparation for phase II (replacement issues)

- 61 *EFRAG has summarised the transition patterns of the main benchmarks affecting the European Economic Area, i.e. EURIBOR, EONIA and LIBOR as general fact patterns. EFRAG has relied on these fact patterns in analysing the potential accounting effects that may arise.*

Question to Constituents

- 62 In addition to the fact patterns [listed in the draft comment letter] are there different patterns of IBOR transition that the IASB should consider when dealing with the replacement issues? Please describe.

Summary of constituents' comments

- 63 ESBG and Erste Group suggested to add to fact patterns described by EFRAG the transition from CHF LIBOR to SARON rate since Switzerland participates in the European single market.
- 64 ESBG also emphasised the particular situation of EURIBOR which is not being replaced but undergoing an evolution in its estimation methodology. ESBG considered that a change in calculation methodology is not a change in the benchmark, and therefore amendments to IFRS 9 and IAS 39 would not be applicable. ESBG suggests that the amendments should clearly state that proposed reliefs are not applicable in cases of modification of methodology and hence, preparers would maintain their current accounting.

EFRAG Secretariat's recommendations to EFRAG TEG on EFRAG's proposed final position

- 65 The EFRAG Secretariat notes that Appendix II of the draft comment letter listed three transition paths of IBORs in order to demonstrate the differences between them as each transition may require different accounting solutions. The transition from CHF LIBOR to SARON could be considered as an example of the LIBOR-family transition path and hence the EFRAG Secretariat is of the view there is no need to include this transition path separately.
- 66 The EFRAG Secretariat concurs with the analysis of ESBG that a change in calculation methodology is not a change in the benchmark (EURIBOR). Hence, there is no change in the accounting requirements and no reliefs are needed.
- 67 No change proposed.

Question to Constituents

- 68 EFRAG has been informed that, during the period while the relief is ongoing, it will be necessary to have clarity on the outcome of not only the prospective assessment of a cash flow hedge relationship under IAS 39, but also of the retrospective assessment. This in order to determine, at the end of each reporting period, how much of the value difference between the hedged item and the hedging instrument is assigned to other comprehensive income and which amount is assigned to profit or loss. As such, the retrospective assessment at the beginning of the cash flow

hedge relationship should be able to be carried forward during the period of the relief solely for the purpose of determining the cash flow hedge reserve.

69 In your view, are there particular circumstances in which a relief of the retrospective test is needed applying IAS 39? If so, please describe the reasons why as well as the specific fact patterns it would apply to.

70 Four respondents (FBF, ESG, Erste Group and BNP Paribas) raised concerns that during the transition period, a relief of the retrospective test under IAS 39 would be needed to avoid that certain hedges fail the hedge accounting only because they are temporarily outside the 80-125% range due to the different timing of transition of hedged item and hedging instruments and discounting effects. The above concerned the prospective and retrospective hedge effectiveness assessments under IAS 39. FBF considered that this topic should be included in the scope of the first phase. ESG provided several examples of potential ineffectiveness.

71 Erste Group noted that the IASB should consider providing a relief that one-off valuation effects resulting from the transition to the new benchmark rates should not disqualify hedging relationships from meeting the hedge effectiveness requirements. I.e. they should not lead to discontinuation of hedges.

72 ESG supported the introduction of the relief on the prospective but also on the retrospective assessment to avoid that preparers applying IAS 39 would be penalised compared to ones applying IFRS 9.

73 ESG and Erste Group noted that retrospective assessment and the 'lower of test' determining how much of the hedging derivative revaluation is recognised in the cash flow hedge reserve in paragraph 6.5.11(a) of IFRS 9 refers to present value of the cumulative change in the hedged expected future cash flows. Similar wording is used in paragraph 96(a) of IAS 39. The values determined in this test are often also used for measuring the retrospective hedge effectiveness for hedges under IAS 39.

74 These two respondents (ESG and Erste Group) highlighted that, in their view, the retrospective assessment and the 'lower of test' are based on the actual results and proposed that the IASB clarifies how future expected cash flows should be understood in the context of the proposed amendments. In their view, similarly to other areas addressed in the exposure draft, the future expected cash flows should be analysed assuming that the interest rate benchmark on which the hedged cash flows are based is not altered. They highlighted that this particular clarification should be part of the phase one of the project.

EFRAG Secretariat's recommendations to EFRAG TEG on EFRAG's proposed final position

75 The EFRAG Secretariat understands the reasons why the IASB excluded the retrospective assessment from the reliefs proposed. However, that measure is considered to be too broad as it does not allow to consider how much of the value difference between the hedged item and the hedging instrument is assigned to other comprehensive income and which amount is assigned to profit or loss. Therefore, the EFRAG Secretariat proposes to provide an additional relief for that purpose and that relief should already be considered during phase I.

76 The EFRAG Secretariat notes that valuation effects will be dealt with by the IASB as part of phase II.

Question to Constituents

77 In your view which of the above topics should be addressed by the IASB when dealing with the replacement issues? Please explain the reasons why and your suggested accounting treatment.

78 In addition to the topics listed above, do you have any other matters that the IASB should consider when dealing with the replacement issues? Please describe.

79 The respondents supported the topics raised by EFRAG to be addressed in phase two of the IASB project and highlighted that this phase should start as soon as possible.

80 The following topics were considered the most important by majority of the respondents:

(a) Topic 3: retrospective assessment: hedge accounting ineffectiveness. This topic was raised by all the respondents replied to the question (FBF, ESG, Erste Group and BNP Paribas) and proposed to be addressed in phase one by one respondent and as soon as possible by others;

(b) Topics 1 and 2: derecognition and modification. Most of the respondents (FBF, ESG, BNP Paribas) considered that the relief from the accounting for modification and derecognition should be provided and/or that the continuity of the existing contracts and accounting treatments should be granted by the IASB.

(c) Topics 4 and 6: hedge accounting discontinuation and hedge documentation. The respondents (FBF and ESG) highlighted the importance to be able to continue hedge accounting and that the change of hedge documentation due to reform should not result in hedge accounting discontinuation.

(d) Topic 8: IFRS 9 – SPPI-criterion. Two respondents (ESG and Erste Group) highlighted that due to the “backward looking” calculation methodology of the new risk-free rates such as ESTER, SONIA, SARON these rates might have features which are not SPPI compliant because of the time value of money consideration. These respondents suggested the IASB to discuss the SPPI treatment within the interest rate benchmark reform context.

For example, a 6-month Euro interest rate would be determined as a compounded €STR rate over the 6-month interest cash flow period. As a result, such an interest would be known only at the end of the interest period (the backward-looking aspects). Erste Group considered that in such a case the instrument could be viewed as bearing current overnight interest rates which are technically paid, including interest on the ‘deferred interest’, every 6 months in arrears. In their view, such an instrument would not have non-SPPI features.

(e) The respondents (FBF, ESG, Erste Group and BNP Paribas) considered other topics as less important or as a subset of the major topics described above.

EFRAG Secretariat’s recommendations to EFRAG TEG on EFRAG’s proposed final position

81 The EFRAG Secretariat proposes to include topic 3 regarding the retrospective assessment of the hedge ineffectiveness to the phase one of the project to avoid that the hedges temporarily falling out of the range 80%-125% (due to different timings of the transition to RFR of hedged item and hedging instrument) have to be discontinued in accordance with IAS 39. This will ensure the consistent treatment of hedge accounting between the constituents applying IAS 39 and IFRS 9 and will not undermine the reliefs given for the prospective assessments of hedge effectiveness.

82 Based upon the inputs received from constituents, the EFRAG Secretariat suggests to re-arrange the topics from Appendix II and to remove topic 8 on IAS 8 – Change in estimates and topic 12 on collateralised derivatives discounting using €STR.

Inputs received through meetings with constituents

- 83 During the consultation period the EFRAG Secretariat had meetings with a number of constituents who did subsequently not submit a comment letter (yet). Their inputs can be found below.
- 84 One constituent [Anonymous] noted the following:
- (a) For phase I, the IASB should clarify that it addresses overnight rates [in addition to interbank offered rates];
 - (b) For phase II, the IASB should consider whether or not a change from IBOR or overnight rates to RFR would impact:
 - (i) The valuation of financial instruments and the impact on hedge effectiveness;
 - (ii) The fair value measurement of a financial instrument in accordance with IFRS 13;
 - (iii) Other IFRS standards such as IFRS 16 *Leases* and IAS 19 *Employee Benefits*;
 - (iv) Modification of financial instruments and hedging documentation.
- 85 One constituent (EBF) noted the following early inputs¹:
- (a) It is unclear whether the reliefs that are provided are also applicable to situations where cross-currency swaps are being used for hedging purposes;
 - (b) In applying a portfolio fair value hedge for interest rate risk, continuous designation and de-designation of hedges is being applied. It is unclear how the reliefs would work in such a case.
 - (c) The relief should also be provided for the retrospective hedge ineffectiveness assessment under IAS 39 to avoid that the hedges temporarily falling out of the range 80%-125% (due to different timings of the transition to RFR of hedged item and hedging instrument) have to be discontinued, especially taking into account that the majority of banks continue applying IAS 39 and not IFRS 9. The impact on the profit and loss should continue to be calculated and booked.
 - (d) The clarification is needed whether the relief ends at the moment the new rate has been communicated by a rate administrator or when the contract is amended to reflect this rate.
 - (e) Appendix I of EFRAG's DCL could clarify whether "reinstatements of previously designated hedging relationships" refer to previous hedging relationships in general or only those that have been de-designated as a result of the IBOR reform.
 - (f) The retrospective application of the disclosure requirements (comparatives) is found to be highly burdensome.

EFRAG Secretariat's recommendations to EFRAG TEG on EFRAG's proposed final position

- 86 The EFRAG Secretariat notes that valuation effects will be dealt with by the IASB as part of phase II.

¹ As the official EBF-position is not determined at the moment of writing, only technical points are being listed.

- 87 IAS 19 *Employee Benefits*, paragraph 83 notes that the rate to discount post-employment benefit obligations is determined by reference to market yields on high quality corporate bond. Or in absence of a deep market, the market yields on government bonds in that particular currency. In accordance with paragraph 86 current market rates of the appropriate term may be extrapolated.
- 88 In accordance with paragraph 11 of IAS 19, short-term employee benefits are recognised undiscounted either as a liability (accrued expense) or as an expense.
- 89 IFRS 16 *Leases*, paragraph 26 notes that a lessee measures the lease liability at the present value of the lease payments that are not paid at that date, using the interest rate implicit in the lease (if it can be readily determined). Otherwise, an incremental borrowing rate is to be used.
- 90 The EFRAG Secretariat proposes to include a general invitation to the IASB to screen all IFRSs on potential impacts of the IBOR reform.
- 91 Further, the EFRAG Secretariat proposes including the portfolio fair value hedge of interest rate risk as a specific application issue for the reliefs. Further the EFRAG Secretariat agrees that retrospective reinstatement of previously discontinued hedges should be allowed if these hedges failed the hedging requirements only because the proposed reliefs were not (yet) available.
- 92 The extension of the relief for the retrospective test is addressed in paragraph 81 above.
- 93 On the end of the relief, no further changes are proposed to the DCL except the addition of judgement as discussed in paragraph 45 above.
- 94 The EFRAG Secretariat proposes to add the use of cross-currency swaps as an additional phase II issue because of the valuation issues that could arise out of the IBOR-transition.

Appendix 2 – List of respondents

1 The following respondents replied to EFRAG’s Invitation to Comment:

Name of the respondent	Type of the respondent	Country
Fédération Bancaire Française	Preparer’s organisation	France
ESBG	Preparer’s organisation	Europe
Erste Group	Preparer	Austria
Insurance Europe	Preparer’s organisation	Europe
BNP Paribas	Preparer	France