Martin Boer
Director
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May 25, 2020

Mr. Hans Hoogervorst
Chairman
International Accounting Standards Board
7 Westferry Circus
Canary Wharf, London E14 4HD
United Kingdom

RE: Exposure Draft ED/2020/1 Interest Rate Benchmark Reform—Phase 2. Proposed amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16

Dear Mr. Hoogervorst:

1. The Institute of International Finance (IIF), via its IIF Senior Accounting Group (SAG), welcomes the opportunity to comment on the International Accounting Standards Board (IASB) Exposure Draft ED/2020/1 *Interest Rate Benchmark Reform—Phase 2. Proposed amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16* (the ED).
2. Interest rate benchmarks, such as interbank offered rates (IBORs), play an important role in global financial markets since they are used in large volumes and across a wide range of products and contracts. Hence, any uncertainties around those rates and the shift to alternative references rates such as reformed risk-free rates (RFRs) can pose a significant disruption of financial markets.
3. Given these substantial potential impacts it is crucial that regulators, standard setters, and market participants identify and tackle any issues that may arise from the transition to reformed RFRs. We therefore fully endorse the IASB's two-phase project on the implications of the IBOR reform on financial reporting.

4. IIF member firms are supportive of the proposals in the ED and appreciate how quickly the IASB has addressed members' concerns related to issues arising when interest rate benchmarks are replaced. In particular, members appreciate that concerns we raised in our comment letter for the IASB's Phase 1 proposals around pre-replacement issues are reflected in the Phase 2 proposals set out in the ED—e.g. to amend paragraph 102M that the hedge accounting relief for Phase 1 ends at the hedge relationship level. Members also appreciate the IASB's proposals—such as the practical expedient—that allow preparers to adjust the interest rate on debt instruments rather than take an immediate modification gain/loss as contracts are amended from IBOR to the reformed RFR.
5. There are several proposals in the ED where members would like to provide feedback and suggestions for additional considerations; but before responding to specific questions posed in the ED, we would like to highlight a few substantive issues.
6. For fair value hedges, the relief requires an immediate P&L impact as the hedged risk is amended to the reformed RFR. Members note this is inconsistent with the current requirements in IAS 39 when a hedge relationship is dedesignated and redesignated and the previous hedge adjustment is amortized into the P&L. Members would like to have the option to apply paragraph 102T or existing dedesignation guidance in IAS 39 (i.e. the basis adjustment is amortized into the P&L).
7. The benchmark rate reforms are progressing at different rates and at various scales across different jurisdictions. It is expected that a significant number of entities will be operating in multi-rate environments. Where transition to RFR is optional and voluntary in multi-rate jurisdictions, BC2 and BC11 creates some ambiguity on whether such reforms are in scope of the Amendments. Not unlike circumstances contemplated in BC12, these transitions have the same economic substance as contracts that are specifically in scope. Since development of these RFR stem from the reform, members believe that multi-rate jurisdictions should be in scope of the proposals and wish to obtain additional clarity from the IASB on whether IBOR transitions in these environments qualify for these Amendments.
8. Members are supportive of the relief allowing continuation of a hedge relationship when the hedge documentation needs to be updated for IBOR reform. However, there are concerns that the wording might be too restrictive to apply the relief for many situations that might occur in practice. One example is where centrally cleared derivatives (designated in hedging relationships and have no fallback languages) are modified for IBOR reform by unwinding the existing contract and replacing it with a new contract which is economically equivalent to the old instrument but with a change in the floating rate from IBOR to RFR. There is concern that it is not clear that an economically equivalent trade with the same counterparty is considered a modification and not a derecognition of the original contract. If it were deemed a derecognition event, then the relief for hedge continuation would not apply. We have included further examples in the Annex.

9. On the portfolio hedging and the grouping of items, members support the proposal to split items of similar risk into subgroups. However, this approach will cause significant operational complexity.
10. Regarding proposed amendments to IAS 39 to reset the cumulative fair value changes to zero for the purpose of the retrospective effectiveness testing, members agree that this amendment would avoid recognizing ineffectiveness arising from the difference between IBOR and the alternative benchmark rate. However, members recommend that the IASB makes this amendment optional instead of mandatory, since there could be situations where resetting to zero could result in the hedge relationship falling outside the 80-125% range.
11. In the Annex, we provide additional answers to the specific questions posed in the ED.
12. We hope that you will find our comments useful and constructive. If you have any questions, please feel free to contact the undersigned at mboer@iif.com or Stefan Gringel at sgringel@iif.com.

Yours sincerely,

Martin Boer
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Institute of International Finance (IIF)

ANNEX

Question 1—Modifications of financial assets and financial liabilities (paragraphs 6.9.1–6.9.6 of the [Draft] amendments to IFRS 9, paragraphs 20R–20S and 50–51 of the [Draft] amendments to IFRS 4 and paragraphs 104–106 and C1A–C1B of the [Draft] amendments to IFRS 16)

Paragraphs 6.9.2–6.9.6 of the draft amendments to IFRS 9 propose that:

a) a financial asset or financial liability would be modified if the basis for determining the contractual cash flows is changed after the initial recognition of the financial instrument. In this context, a modification can arise even if the contractual terms of the financial instrument are not amended.

b) an entity would apply paragraph B5.4.5 of IFRS 9 as a practical expedient to account for a modification of a financial asset or financial liability that is required by interest rate benchmark reform.

c) a modification is required by interest rate benchmark reform if and only if (i) it is required as a direct consequence of interest rate benchmark reform; and (ii) the new basis for determining the contractual cash flows is economically equivalent to the previous basis (ie the basis immediately preceding the modification).

d) an entity would also apply the practical expedient proposed in paragraph 6.9.3 if an existing contractual term is activated that results in a change in the basis for determining the contractual cash flows of a financial asset or a financial liability, and particular other conditions are met.

Paragraphs BC10–BC36 of the Basis for Conclusions describe the Board's reasons for these proposals.

e) The Exposure Draft proposes to make corresponding amendments to IFRS 4 that would require insurers applying the temporary exemption from IFRS 9 to apply the same practical expedient as described above.

f) The Exposure Draft proposes amendments to IFRS 16 that would require entities to apply paragraph 42 of IFRS 16 to account for a lease modification that is required by interest rate benchmark reform.

Paragraphs BC39–BC41 and paragraphs BC118–BC125 of the Basis for Conclusions describe the Board's reasons for these proposals.

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 and why.

- Members are supportive of the practical expedient and its objective.

- Members are supportive of using the principle of 'economic equivalence' to determine the scope of the practical expedient. In this regard, members have assumed that a modification that meets one of the examples set out in paragraph IFRS 9 6.9.4 of the ED is considered to result in a rate that is economically equivalent. If that is the case, it might be helpful to confirm this point in the standard or basis for conclusions.

- However, members prefer that the practical expedient is introduced without providing a definition of a modification in IFRS 9 6.9.2 which includes not only changes in contractual terms but also changes in the basis for determining the contractual cash flows. If that is required, then members agree with the IASB's limited scope as explained in BC20. Members are also not supportive of this definition or scope being changed in any future projects as proposed in BC20. Members strongly believe there is consistency in practice currently (which is in line with the remark of the IASB in BC14) and do not think an additional project is required.

- Members support the proposed relief on fallback provisions to the extent that the fallback provisions are economically equivalent at the time of activation. However, members noted that this may not always be the case at the time of IBOR transition, even though the fallback provisions were economically equivalent at the time when it was contractually entered into. Members would prefer the standard or basis of conclusion make clear that if the fallback provisions were economically equivalent when added to the contract then it can be assumed that it will be economically equivalent when it is activated (assuming all things being equal).

- With a significant number of entities operating in multi-rate environments, members would like the IASB to clarify whether financial instruments whose benchmark rate refers to an IBOR in a multi-rate jurisdiction (for example, CDOR) are in scope of these amendments given RFR will complement rather than replace IBOR. Neither fallback provisions nor modification of IBOR contracts will be triggered as there is no cessation of IBOR. As such, any effort undertaken by entities to manage the new RFR exposure created by shifts in primary markets and transition their IBOR contracts to RFR would be voluntary. It is unclear whether an entity can consider changes to these contracts as being part of a market-wide reform (eligible for the IFRS 9.B5.4.5 practical expedient) given this optionality. Since developments of these RFR stem from the reform, members believe that multi-rate jurisdictions should be in scope of the proposals and wish to obtain additional clarity from the IASB on whether IBOR transitions in these environments qualify for these Amendments.

Question 2—Amendments to hedging relationships (paragraphs 6.9.7–6.9.10 of the [Draft] amendments to IFRS 9 and paragraphs 102O–102R of the [Draft] amendments to IAS 39)

Paragraphs 6.9.7–6.9.10 of the draft amendments to IFRS 9 and paragraphs 102O–102R of the draft amendment to IAS 39 propose that an entity would amend the formal designation of the hedging relationship only to make one or more of the changes specified in paragraph 6.9.7 and paragraph 102O as and when uncertainty arising from interest rate benchmark reform is no longer present with respect to the hedged risk and/or the timing and the amount of interest rate benchmark-based cash flows of the hedged item or of the hedging instrument.

Paragraphs BC42–BC50 of the Basis for Conclusions describe the Board's reasons for these proposals.

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 and why.

- Members agree with the proposals to allow hedge continuation when the hedge documentation is amended due to IBOR reform.

- However, there are concerns that the wording might be too restrictive to apply the relief for many situations that might occur in practice. One example is where clearing houses amend derivatives for IBOR reform by unwinding the existing contract and replacing it with a new contract which is equivalent to the old instrument but with a change in the floating rate from IBOR to RFR. There is concern that the derecognition conclusion is not clear in this scenario and a risk that this would result in derecognition and then the relief for hedge continuation would not apply in this case. A solution might be to provide an example as implementation guidance in the basis of conclusion.

- Another example where it is not clear whether the relief applies is in the case of cash flow pools of IBOR-based instruments. In this hedging relationship, replenishment of new instruments may be out of scope under the relief, as currently drafted. Under current IFRS, IBOR cash flows from loans with varying terms to maturity with the same floating benchmark interest rate can form a pool of hedged items. As loans are repaid and new loans are added to the pool, the hedge relationship continues as the forecasted cash flows remain IBOR. Under the ED, contractual changes required by benchmark rate reform would be in scope of relief for hedge accounting. Since the instruments in the hedged pool are not amended but are, instead, replaced by new RFR instruments, the forecasted cash flows will be a combination of IBOR and RFR. The reliefs, as drafted, may restrict the replacement of RFR into an IBOR pool. Since this is economically similar to a modification of hedged items driven by the benchmark rate reform, members recommend it be clarified that the relief also applies in this scenario.

Question 3—Accounting for qualifying hedging relationships and groups of items (paragraphs 6.9.11–6.9.15 of the [Draft] amendments to IFRS 9 and paragraphs 102S–102X of the [Draft] amendments to IAS 39)

Paragraphs 6.9.11–6.9.15 of the draft amendments to IFRS 9 and paragraphs 102S–102X of the draft amendments to IAS 39 propose that:

a) the requirements in IFRS 9 and IAS 39 would be applied when the designation of a hedging relationship is amended to remeasure the hedging instrument and the hedged item based on the alternative benchmark rate and recognise any resulting ineffectiveness in profit or loss.

b) the amount accumulated in the cash flow hedge reserve at the date the entity amends the description of the hedged item would be deemed to be based on the alternative benchmark rate on which the hedged future cash flows are determined.

c) when there is a change in the basis for determining the contractual cash flows of a financial asset or a financial liability previously designated as a hedged item in a hedging relationship that has been discontinued, the amount accumulated in the cash flow hedge reserve for the discontinued hedging relationship would be deemed to be based on the alternative benchmark rate on which the hedged future cash flows will be based.

d) when applying paragraph 6.9.7 or paragraph 102O to groups of items designated as hedged items, the hedged items would be allocated to sub-groups within the same hedging relationship based on the benchmark rate to which they are referenced and that the proportionality test would be applied to each sub-group separately.

e) for the purpose of assessing retrospective effectiveness as required by IAS 39, the cumulative fair value changes of the hedged item and hedging instrument would be reset to zero when paragraph 102G of IAS 39 ceases to apply.

Paragraphs BC51–BC79 of the Basis for Conclusions describe the Board's reasons for these proposals.

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 and why.

- For fair value hedges 102T indicates that there can be a P&L effect when the hedged risk is amended in line with 102O. This might arise for example where the hedging instrument is amended with the floating rate moving from IBOR + spread to the reformed RFR + spread + compensation spread. If the hedging relationship is amended from hedging IBOR to the reformed RFR, then the adjustment to the carrying value of the hedged item would not be equal and offsetting to the adjustment to the carrying value of the hedging instrument. The difference would be due to the impact of the compensation spread. Members noted that IAS 39 allows dedesignation of hedge relationships and if the fair value hedge was dedesignated and a new hedging relationship designated then no immediate P&L effect would occur.

- Members are concerned about this inconsistency and also the potential P&L impact from applying paragraph 102T. Members would prefer to have an option to apply paragraph 102T or an approach that was consistent with the current approach in IAS 39 when dedesignating and redesignating a fair value hedge (i.e. to amortize the prior basis adjustment over the remaining life of the hedging instrument).

- On the portfolio hedging and the grouping of items, members are supportive of the split of items into subgroups but are concerned it may result in significant operational complexity. The concern is that there would be many subgroups which would need to be tracked.

- Members understood the guidance related to groups of items (102X) was applicable to fair value and cash flow hedge relationships. However, the BCs refer to cash flow hedges only, so it was unclear whether the relief also applied to fair value hedges (including the hedges under IAS 39.81A). Members recommend that it is clarified in the BCs that the groups of items relief relates to both fair value and cash flow hedges.

- In relation to the proposed amendment to IAS 39 to reset the cumulative fair value changes to zero for the purpose of the retrospective effectiveness testing (see paragraph 102S of the ED), members agree that this amendment could provide some relief for ineffectiveness outside the 80-125% range that occurred during Phase 1. However, some members recommend that the IASB makes this amendment optional instead of mandatory since there might be situations when resetting to zero could result in the hedge relationship falling outside the 80-125% range.

Question 4—Designation of risk components and portions (paragraphs 6.9.16–6.9.18 of the [Draft] amendments to IFRS 9 and paragraphs 102Y–102Z1 of the [Draft] amendments to IAS 39)

Paragraphs 6.9.16–6.9.18 of the draft amendments to IFRS 9 and paragraphs 102Y–102Z1 of the draft amendments to IAS 39 propose that:

a) an alternative benchmark rate designated as a non-contractually specified risk component that is not separately identifiable at the date it is designated, would be deemed to have met that requirement at that date, if and only if, the entity reasonably expects the alternative benchmark rate will be separately identifiable within a period of 24 months from the date the alternative benchmark rate is designated as a risk component.

b) if subsequently, an entity reasonably expects that the alternative benchmark rate will not be separately identifiable within 24 months from the date it was designated as a risk component, an entity would cease applying the requirement in paragraph 6.9.16 and paragraph 102Y and discontinue hedge accounting prospectively from the date of that reassessment.

Paragraphs BC87–BC97 of the Basis for Conclusions describe the Board's reasons for these proposals.

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 and why.

- Members agree with and are supportive of the IASB's proposal. However, members are concerned with the proposed wording in BC87 and BC89 which seem to create a higher threshold for identifying a benchmark interest rate than is currently applied in practice. The wording seems to suggest that an available term structure of zero coupon interest rates or that the volume and liquidity of debt instruments referenced to an alternative benchmark rate is required for a benchmark to be considered separately identifiable in a particular market or jurisdiction. Whilst that is an example in IFRS 9, it was written in the context of identifying an inflation component of a fixed rate bond, this is not included in IAS 39, and is not aligned to the market practice. Members recommend that the IASB reconsiders the wording in these paragraphs to avoid unintended implications to current practice outside the scope of IBOR reform.

Question 5—Effective date and transition (paragraphs 7.1.9 and 7.2.36–7.2.38 of the [Draft] amendments to IFRS 9 and paragraphs 108H–108J of the [Draft] amendments to IAS 39)

a) The Exposure Draft proposes that the amendments would have an effective date of annual periods beginning on or after 1 January 2021. Earlier application would be permitted.

b) The Exposure Draft proposes that the amendments would be applied retrospectively in accordance with IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors, except as specified in (ii) below. An entity would:

   i. reinstate a discontinued hedging relationship if and only if the entity discontinued that hedging relationship solely due to changes required by interest rate benchmark reform and, therefore, the entity would not have been required to discontinue that hedging relationship if the amendments had been applied at that time.

   ii. not be required to restate prior periods to reflect the application of these amendments. However, the entity may restate prior periods if, and only if, it is possible without the use of hindsight.

Paragraphs BC110–BC115 of the Basis for Conclusions describe the Board's reasons for these proposals.

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 and why.

- Members are supportive of the retrospective application and the ability to reinstate hedge relationships which failed due to IBOR reform. Members note that there might be situations where the retrospective reinstatement of hedge accounting maybe impracticable. An example would be if the hedging derivative in the original hedge relationship, which failed due to IBOR reform, has been utilized in a new hedging relationship. In this situation members would assume that the relief from retrospective application due to impracticability in IAS 8 would apply, but it is not clear in the current ED.

Question 6—Disclosures (paragraphs 24I–24J and paragraphs 44HH–44II of [Draft] amendments to IFRS 7)

The Exposure Draft proposes that entities provide specific disclosures in order to provide information about:

a) the nature and extent of risks arising from interest rate benchmark 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 that transition.

Paragraphs BC105–BC109 of the Basis for Conclusions describe the Board's reasons for this proposal.

Do you agree with this proposal? Why or why not? If you disagree with the proposal, please explain what you propose and why.

- Members thought the disclosure requirements in IFRS 7.24J (b) would take considerable operational effort and cost to compile. Members also question whether the information required would capture the risks or effect that IBOR reform will have on its financial instruments. Therefore members suggest the standard be amended to allow other forms of quantitative disclosures (e.g. notional values) that preparers believe best capture the risks or effects of IBOR reform.

- In addition, due to the cost/benefits of providing comparative disclosures in the first year of adoption, members ask that the disclosures only be required on a prospective basis. However, if this is not possible, then at a minimum members ask that where members early adopt the standard in their 2020 financial statements that 2019 comparatives would not be required.

- Consistent with the disclosure principle in IFRS 7.24I to disclose information about the impact of interest rate benchmark reform, members would like to clarify that the disclosures required by IFRS 7.24J(b) only apply to financial instruments that will be in existence at the date of IBOR reform. Specifically, entities <u>will not</u> be required to include information about financial instruments that will mature prior to the required reform date.

- Members believe that a clarification or a definition of the 'base rate' as stated in IFRS 7.24J (c) is needed.