This paper provides the technical advice from EFRAG TEG to the EFRAG Board, following EFRAG TEG's public discussion. The paper does not represent the official views of EFRAG or any individual member of the EFRAG Board. This paper is made available to enable the public to follow the EFRAG's due process. Tentative decisions are reported in EFRAG Update. EFRAG positions as approved by the EFRAG Board are published as comment letters, discussion or position papers or in any other form considered appropriate in the circumstances.

Summary and analysis of the comment letters received on the EFRAG draft comment letter on the 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*

1 Based on the comments received, the EFRAG Secretariat has developed a revised draft EFRAG final comment letter that is presented as agenda paper 10-03.

2 This paper also incorporates input from the EFRAG FIWG discussion of the comment letters received.

Structure of the paper

3 This comment letter analysis contains:

(a) Background;

(b) Summary of respondents;

(c) Summary of respondents' views;

(d) Main positions in EFRAG's proposed final comment letter;

(e) Appendix 1 - detailed analysis of responses to questions in EFRAG's draft comment letter, the EFRAG Secretariat's recommendations and questions to EFRAG TEG. Please note that the description of the requirements of the ED and of the EFRAG draft comment letter is a repetition of contents of the DCL. Accordingly, members may focus on the sections where views of the constituents and EFRAG analysis are presented;

(f) Appendix 2 – list of respondents; and

(g) The comment letters can be found using the following link.

Background

4 The IASB has split its work on the Interest Rate Benchmark Reform project in two phases. The first phase addressed issues affecting financial reporting in the period before the replacement of an existing interest rate benchmark with an alternative interest rate and was completed in September 2019. EFRAG has issued its endorsement advice on Phase 1 of the project on 16 October 2019.

5 The second phase deals with issues that might affect financial reporting when an existing interest rate benchmark is replaced with an alternative interest rate.

6 This Exposure Draft ('the ED') addresses the second phase of the IASB project and covers the following topics:

(a) modifications of financial assets and financial liabilities, including lease liabilities;

(b) hedge accounting; and

(c) disclosures.

7 The aim of the IASB proposals is to allow continuation of the existing hedging relationships which otherwise would have been discontinued only due to the effects of the IBOR reform.

8 EFRAG published a draft comment letter on the IASB proposals on 23 April 2020. In the draft comment letter, EFRAG generally supports the proposed amendments, as they 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 the IASB proposal to clarify that a change in the basis on which the contractual cash flows are determined after initial recognition of financial instrument constitutes a modification even if the contractual terms of that financial instrument are not amended. As an assessment of the impact of this clarification is not possible within the limited timeframe available for this urgent project, EFRAG agrees with this proposal provided that this new definition is limited to the changes directly related to the IBOR reform. EFRAG also suggests that the IASB carries forward to the final Standard its tentative decision to amend IAS 39 to require an entity changing the hedged risk in the hedge documentation for a portfolio hedge of interest rate risk to assume that all items included in the portfolio of financial assets or financial liabilities share the risk being hedged. In addition, EFRAG proposes some drafting and clarification suggestions to the final standard.

Summary of respondents

9 At the time of writing, 8 comment letters have been received. The letters are summarised in the Appendix 1.

Summary of respondents' views

Question 1

10 Constituents generally supported the proposed amendments and EFRAG's position in the draft comment letter.

11 Three constituents noted that their agreement to the proposed definition of a modification is based on ringfencing it to IBOR-related modifications and should not be taken as silent consent also for modifications that are not related to the IBOR reform.

12 One constituent suggested that the IASB may clarify how the proposed practical expedient to apply paragraph B5.4.5 of IFRS 9 should be applied to financial instruments not measured at amortised cost, i.e. measured at fair value either through other comprehensive income or through profit or loss or alternatively review the scope of the relief.

13 One constituent suggested changes to the wording used in the exposure draft on whether a modification or activation of fallback clauses has to be "required" because entities may also modify contractual cash flows on a voluntary basis.

14 One constituent suggested to align the wording used in the basis for conclusions with the requirements in the main body of the standard regarding the order in which requirements should be applied in case the contractual cash flows of a financial instruments is modified not only as a direct consequence of the IBOR reform. This topic is already addressed by EFRAG draft comment letter.

15 Two constituents raised the issue of assessing the criterion of solely payments of principal and interest (SPPI) when an alternative benchmark rate is not a forward-looking rate but is compounded. The example of term rates based on SARON using averages of the overnight SARON rates over certain periods was given.

Constituents expressed concern about the potential need to apply the so-called benchmark test due to interest mismatches because there is a time lag between the time the rate effectively relates to and the start of the interest period. The constituents ask for a relief from application of the so-called benchmark test to avoid failure of SPPI test and instead developing an exception similar to paragraph B4.1.9E of IFRS 9 on regulated rates.

Question 2

16 Constituents generally supported the proposed amendments as allowing to continue hedging relationship while hedged item or hedging instrument is modified as a result of the reform.

17 Two constituents considered that the IASB should allow more flexibility by adding derivatives (basis swaps) in existing hedging relationships which address solely the differences between alternative benchmark rates used for the hedging instrument and the hedged item arising directly as a result of the reform. This would allow complications due to mismatches that may exist between the exact timing of the repricing of the new benchmark rates for the two legs of the hedging relationship.

Question 3

18 Constituents supported the ED proposals on cash flow hedges and groups of items.

19 Constituents had different views about the impact for fair value hedges in particular the remeasurement of hedged items at the moment the underlying benchmark rate of the hedging instrument is modified. Some noted that the proposed amendments allow for the remeasurement of the hedged items leading to day one gain or loss which does not represent hedging ineffectiveness, while others looked at both legs of the hedge separately and were of the view that each leg of the hedge is only remeasured when that leg is modified. In the former view, the usefulness of the day one gain or loss is questioned, and it is suggested to remeasure the credit risk margin of the hedged item to avoid the impact. In the latter view, insofar any ineffectiveness occurs, it is to be recorded in profit or loss.

20 Two constituents suggested that the requirement in paragraph 102S of IAS 39 of resetting the cumulative fair value changes to zero be made optional; and/or it could be clarified that it is applicable for entities using the cumulative dollar offset method. In fact, they report that setting to zero in all cases may create unintended consequences.

Question 4

21 Constituents noted that assessing separately the measurement criterion may prove to be difficult, as the two criteria are closely related.

22 One constituent noted that adverse consequences affecting the implementation of the reform cannot be excluded due to uncertainty that arises from the current COVID-19 pandemic situation. It was alternatively suggested that the identification criterion could be presumed to be met, provided measurement is performed on a reliable basis. The entity would subsequently have to check whether this presumption is not negatively challenged within the following 24 months.

Question 5

23 Constituents generally supported the proposals in the exposure draft and EFRAG's position in the draft comment letter.

24 One constituent suggested allowing a choice not to respectively reinstate hedging relationships that had to be discontinued because the proposed amendments were

not yet available. Another constituent explicitly appreciated mandatory reinstatement because this increased comparability.

Question 6

25 Constituents generally supported the ED proposals on providing entity-specific disclosures.

26 Two constituents mentioned that some disclosures requirements seem of limited relevance to users, whereas costly and challenging for preparers.

Main positions in EFRAG's proposed final comment letter

Question 1

27 The EFRAG Secretariat **proposes to include a suggestion** to the IASB to reconsider the term "required" for modifications or activation of fallback provisions activated as a direct consequence of the IBOR reform. This is to clarify that the practical expedient would also apply even if an entity was not required to modify the contractual cash flows but transitions to an alternative benchmark rate on a voluntary basis, in particular in case of a modification done before the end of the transitional period, when the entity choose to do so before the benchmark is legally discontinued. This could be clarified if the term "required" in paragraph 6.9.3 (a) was deleted so that is reads "the modification is a direct consequence of interest rate benchmark reform."

28 During the EFRAG FIWG discussion, a further potential issue with fallback rates was discussed. Some members were concerned that not all historical fallback terms would have been amended before transition takes place, and that these historical fallbacks might not qualify for the practical expedient since the new cash flows may not be economically equivalent when the fallback rate is triggered but were economically equivalent when it was included in the underlying contract.

29 EFRAG FIWG members suggested raising with EFRAG TEG and EFRAG Board whether it would be helpful if the IASB clarified in the Basis for Conclusions of the final amendments that economic equivalence can be assessed when the fallback clause is included in the contract and not at the time when it is triggered.

30 This could be included as an additional paragraph on Question 1 in the final comment letter as follows: "*EFRAG has been informed that not all historical fallback terms would have been amended before transition takes place, and that these historical fallbacks might not qualify for the practical expedient since the new cash flows may not be economically equivalent when the fallback rate is triggered but were economically equivalent when it was included in the underlying contract. EFRAG therefore suggests to the IASB to clarify in the Basis for Conclusions that there may be instances where the economic equivalence can be assessed at the date when the fallback clauses were included.*"

Question to EFRAG TEG and EFRAG Board

31 Do you agree with including in the final comment letter the wording proposed in paragraph 30?

32 The EFRAG Secretariat proposes to address the concerns on application of the practical expedient to financial instruments not measured at amortised cost by a suggestion to **relocate the proposed amendments on modifications to section 5.4 instead of section 6 of IFRS 9.** This will also increase clarity for entities that apply the requirements on hedge accounting in IAS 39 and hence do not apply the requirements of section 6 of IFRS 9.

Question 2

33 The EFRAG FIWG discussed whether the following additional issue should be supported in the comment letter: the IASB should allow adding derivatives (basis swaps) in existing hedging relationships provided they address solely the differences between alternative benchmark rates used for the hedging instrument and the hedged item arising directly as a result of the reform. Following the EFRAG FIWG advice, the EFRAG Secretariat considers that enlarging the scope of changes permitted to the hedge documentation by addressing particular hedging methodologies would go beyond the scope of the IASB amendments and might create unintended consequences.

34 In addition, it is not possible to assess the magnitude of impact and prevalence of the issue due to the time constraints imposed by the reform.

35 Based on the considerations above, EFRAG Secretariat **does not propose any changes** to the EFRAG response to Question 2 in the final comment letter.

Question 3

36 EFRAG FIWG discussed the issue of remeasurement of the hedged items for fair value hedges. Following that discussion, the EFRAG Secretariat **proposes to include** the issue of remeasurement of hedged items for fair value hedges in the EFRAG comment letter. The EFRAG Secretariat is sympathetic with the constituent's proposals to recommend that the IASB clarifies the possibility to remeasure the cash flows on the hedged item at the date of the hedging instrument's remeasurement using adequate parameters, and especially an adjusted credit margin, consistent with the alternative benchmark rate. This would avoid showing in P&L gain or losses that do not represent real hedge ineffectiveness. However, suggesting that the IASB includes in a standard such a granular level of detail seems not ideal, as it is also not aligned with the current principles-based nature of the requirements. The EFRAG Secretariat observes that the amendments refer already to the process of updating the hedge documentation. The EFRAG Secretariat understands that the remeasurement specified above could be treated as an adjustment of the hedge documentation as allowed by the amendments.

37 The EFRAG Secretariat agrees to remove the reference to the regression analysis in paragraph 49 of the draft comment letter as this is a mere example and constituents have expressed concerns in this regard when applying the proposed amendment of resetting the cumulative fair value changes to zero.

Question 4

38 The EFRAG Secretariat **proposes to incorporate** in the EFRAG comment letter a suggestion to analyse the time frame prior to the final ballot when more information would be available due to the uncertainty that arises from the current COVID-19 pandemic situation. EFRAG FIWG members suggested to include the conclusion of the analysis in the Basis for Conclusions.

Question 5

39 The EFRAG Secretariat initially proposed no changes to the EFRAG comment letter based on the feedback received from EFRAG TEG at the meeting on 26 March 2020 that the current requirements on impracticability in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* are sufficiently clear.

40 When this issue was discussed at EFRAG FIWG meeting, it was noted that in some jurisdictions the applicable prudential regulations may prevent an entity from accounting for derivatives as freestanding for the period until the retrospective reinstatement is applied. More specifically, there may be regulatory requirements

on the risk management of the banking and the trading book with a requirement that only the trading book is permitted to carry open risk positions. In a situation where a hedging relationship relating to the banking book had to be discontinued, this could then constitute an open risk position in the banking book if no actions were taken by the entity.

41 Against this background, EFRAG FIWG suggested raising this issue with EFRAG TEG and EFRAG Board for considering whether to note to the IASB in the EFRAG comment letter that the retrospective reinstatement of hedging relationships might in some cases be impracticable.

42 This could be included as the last paragraph of Question 5 in the final comment letter as follows: "*EFRAG has been informed that the requirement to retrospectively reinstate hedging relationships in accordance with paragraph 7.2.37 of IFRS 9 or paragraph 108I of IAS 39 may be impracticable for entities, such as when due to prudential requirements the derivatives after the discontinuation were either closed out or designated to another hedging relationship due to a valid risk management objective. EFRAG understands that these circumstances could qualify to be exempted from the retrospective reinstatement when doing so would be impracticable as defined in IAS 8.5. The IASB could consider adding a clarification along these lines*.

Question to EFRAG TEG and EFRAG Board

43 Do you agree with including in the final comment letter the wording proposed in paragraph 42?

Question 6

44 The EFRAG Secretariat **proposes to incorporate** in the EFRAG comment letter a suggestion to alternatively disclose quantitative information used by entities in managing the reform when information based on carrying amounts as otherwise required by paragraph 24J(b) is not available without undue cost or effort.

Questions to EFRAG TEG and EFRAG Board

45 Do you agree with the EFRAG Secretariat's recommendations summarised above?

46 For further details on the proposals refer to *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 6.9.1–6.9.6 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)

EFRAG's tentative position

EFRAG notes the proposed amendment that a financial asset or a financial liability would be modified if the basis for determining the contractual cash flows is changed after the initial recognition of the financial instrument, even if the contractual terms of the financial instrument are not amended.

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 the IBOR reform. This is because EFRAG considers 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.

The proposed amendments would also apply to fallback provisions. EFRAG agrees with this proposal.

EFRAG agrees with the clarification that an entity should first apply paragraph B5.4.5 of IFRS 9 to account for modifications related to the 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 the IBOR reform are substantial; if those modifications are not substantial, the entity should apply paragraphs 5.4.3 or B5.4.6 of IFRS 9.

EFRAG agrees with the proposed amendments to IFRS 16 and IFRS 4, EFRAG also agrees that no amendments to other IFRS Standards are necessary.

EFRAG suggests to reconsider the wording in paragraph BC35 (as it may be interpreted as contradicting the order of the application of the requirements in paragraph 6.9.6) and of paragraphs BC24 and BC25 (as it seems to provide guidance for modification that may have unintended consequences).

Summary of constituents' comments

47 All constituents were generally supportive of the IASB's proposals and EFRAG's position in the draft comment letter.

48 Three constituents expressed that the proposed definition of modifications in the context of the IBOR reform shall not preclude in any way the possibility of a different outcome for the IASB's due process expected to take place on the issues raised by financial instruments' modifications outside the realm of the IBOR reform. The IASB is encouraged to allow more time for a wider debate and stakeholder input and not to assume that agreement with these proposals is tacit support from stakeholders for broader amendments.

49 Another constituent observed that the proposed practical expedient applies to all financial instruments regardless of their classification and the ED does not provide guidance on how this relief should be applied to financial instruments not measured at amortised cost. The constituent noted it was not obvious how the requirements would be applied to financial instruments measured at fair value through other

comprehensive income or financial instruments measured at fair value through profit or loss, especially derivatives. The constituent would therefore welcome some clarification in the Basis for Conclusion, or alternatively for the IASB to review the scope of this relief.

50 One constituent suggested drafting changes in that the modification should not be described as being *required* by the IBOR reform in paragraph 6.9.3 but rather *necessary* or even to delete the term *required*. The same relates to paragraph 6.9.5 (b) where it is also suggested to replace *required* by *triggered*. Both constituents observe that although the reform of benchmark indices is a requirement, a modification or activation of fallback clauses in contracts to affect the new benchmarks, may not always be required under law, regulation or existing contractual terms but sometimes entities just feel (economically) compelled to do so, or even do so voluntarily.

51 One constituent observed that paragraph BC35 seems to suggest that the financial instrument is assessed for derecognition first, if there are changes other than those required as a direct consequence of the reform. Paragraph 6.9.6, however, requires this step to be performed last. The constituent does not necessarily believe the sequence would result in a different accounting outcome, but for ease of application, suggests the IASB redrafts paragraph BC35 so it is clearly consistent with paragraph 6.9.6.

52 Two constituents raised the issue of assessing the criterion of solely payments of principal and interest (SPPI) when an alternative benchmark rate is not a forward-looking rate but is compounded. The example of term rates based on SARON using averages of the overnight SARON rates over certain periods was given. Constituents expressed concern about the potential need to apply the so-called benchmark test due to interest mismatches because there is a time lag between the time the rate effectively relates to and the start of the interest period. The constituents ask for a relief from application of the so-called benchmark test to avoid failure of SPPI test and instead developing an exception similar to paragraph B4.1.9E of IFRS 9 on regulated rates.

The EFRAG Secretariat's recommendations to EFRAG Board and EFRAG TEG on EFRAG's proposed final position

53 The EFRAG Secretariat observes that the previous discussions in EFRAG FIWG and EFRAG TEG on ringfencing the definition of a modification to IBOR-related issues lead to the wording used in the draft comment letter in a purposefully neutral language. The EFRAG Secretariat is of the view that the current wording should be sufficiently clear in that EFRAG expresses a view only on IBOR-related modifications and that this view cannot be extended to broader modification fact patterns. Hence, the EFRAG Secretariat recommends no change to the current wording.

54 On the application of the proposed practical expedient, the EFRAG Secretariat concludes that it would equally apply to financial assets measured at fair value through other comprehensive income in accordance with paragraph 4.1.2A of IFRS 9. This is because paragraphs 9.5.7.10 and IFRS 9.5.7.11 require application of the effective interest method to these items, and the practical expedient would require application of paragraph B5.4.5 which relates to the application of the effective interest rate method. However, the EFRAG Secretariat shares the view that the IASB should clarify that the practical expedient should not be applied to financial instruments measured at fair value through profit or loss. Hence, the EFRAG Secretariat recommends including this issue to the final comment letter.

55 The EFRAG Secretariat became aware of concerns on entities that apply the requirements on hedge accounting in IAS 39 and hence are not applying the requirements of section 6 of IFRS 9 in accordance with IFRS 9.7.2.21. For those entities, the proposed requirements on modifications of financial assets and financial liabilities may not be applicable if they were included in section 6 as proposed in the ED. However, because those requirements do not relate to hedge accounting but provide guidance on how to account for modifications in the context of applying the effective interest rate method, a relocation of the proposed requirements (proposed paragraphs 6.9.1 to 6.9.6 of IFRS 9 in the ED) to section 5.4 on amortised cost measurement would be more appropriate.

56 With the support from EFRAG FIWG, the EFRAG Secretariat proposes to address the concerns on application of the practical expedient to financial instruments not measured at amortised cost by a suggestion to relocate the proposed amendments on modifications to section 5.4 instead of section 6 of IFRS 9. This will also increase clarity for entities that apply the requirements on hedge accounting in IAS 39 and hence are not applying the requirements of section 6 of IFRS 9.

57 On the suggested replacement or deletion of the word *required* in paragraphs 6.9.3 and 6.9.5(b), the EFRAG Secretariat shares the analysis that an entity may indeed replace IBOR for various reasons even if it is not required to do so. While the term "required" may also be interpreted in a way that there is a requirement to modify financial instruments in order to change the reference rate (be it on a mandatory or voluntary basis), the EFRAG Secretariat recommends including a recommendation to delete the term "required" in paragraphs 6.9.3 (a) and 6.9.5 (b) so that is reads "the modification is a direct consequence of interest rate benchmark reform."

58 During the EFRAG FIWG discussion, a further potential issue with fallback rates was discussed. Some were concerned that not all historical fallback terms would have been amended before transition takes place, and that these historical fallbacks might not qualify for the practical expedient since the new cash flows may not be economically equivalent when the fallback rate is triggered but were economically equivalent when it was included in the underlying contract.

59 EFRAG FIWG members suggested raising this issue to EFRAG TEG and EFRAG Board whether it should be proposed in the EFRAG comment letter that the IASB should clarify in the Basis for Conclusions of the final amendments that economic equivalence can be assessed when the fallback clause is included in the contract and not at the time when it is triggered.

60 This could be included as an additional paragraph on question 1 in the final comment letter as follows: "*EFRAG observes that not all historical fallback terms would have been amended before transition takes place, and that these historical fallbacks might not qualify for the practical expedient since the new cash flows may not be economically equivalent when the fallback rate is triggered but were economically equivalent when it was included in the underlying contract. EFRAG therefore suggests to the IASB to clarify in the Basis for Conclusions that there may be instances where the economic equivalence can be assessed at the date when the fallback clauses were included.*"

61 On the application of the SPPI criterion, the EFRAG Secretariat notes that this issue with Swiss rates was discussed by EFRAG FIWG (15 November 2019) and concluded that a) with regards to the regulated rate, the examples within IFRS could be applicable, and b) SPPI was meant to reflect the time value of money and benchmark interest rates, hence there should be no issue in moving to a different benchmark interest rates. The EFRAG Secretariat therefore recommends not to include this issue to the final comment letter.

EFRAG FIWG comments:

62 EFRAG FIWG members agreed with the EFRAG Secretariat proposal to not change the wording in the comment letter on ringfencing the proposed definition of a modification.

63 EFRAG FIWG suggested to clarify both the scope of the proposed requirements on modifications of financial assets and financial instruments and the applicability of those requirements to entities that apply the hedge accounting requirements in IAS 39 rather than those in section 6 of IFRS 9 by relocating the proposed requirements on modifications to section 5.4 of IFRS 9 on amortised cost measurement.

64 EFRAG FIWG agreed with the EFRAG Secretariat proposal to delete the term "required" from paragraph 6.9.3(a).

65 EFRAG FIWG members suggested raising the issue of historical fallback rates to EFRAG TEG and EFRAG Board whether it should be proposed in the EFRAG comment letter that the IASB should clarify in the Basis for Conclusions of the final amendments that economic equivalence should be assessed when the fallback clause is included in the contract and not at the time when it is triggered.

66 EFRAG FIWG members agreed with the EFRAG Secretariat proposal not to include the issue of application of the SPPI criterion in the context of particular compounded rates because this issue is not primarily related to the IBOR reform but to the application of the SPPI criterion to compounded rates in general.

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)

EFRAG's tentative position

EFRAG observes that the proposed amendments to 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.

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. EFRAG observes that the IASB's tentative decision to amend IAS 39 to require an entity changing the hedged risk in the hedge documentation for a portfolio hedge of interest rate risk to assume that all items included in the portfolio of financial assets or financial liabilities share the risk being hedged is not reflected in the ED. EFRAG suggests including such amendment to the final standard.

Summary of constituents' comments

67 All seven constituents who commented on this question, generally agreed with the proposed amendments as they will avoid the discontinuation of hedging relationship due to modification of hedged item and hedging instrument solely caused by IBOR reform.

68 One constituent expressed concerns that the scope of changes is limited to only adjustments to interest rate. This constituent suggested to consider whether more flexibility could be granted, for example by including adjustments to proportions being hedged, and the adjustments to the interest of the fixed rate leg resulting from changes to the floating rate leg, provided these changes are made as a direct consequence of referencing to a new benchmark rate.

69 Two constituents also suggested to enlarge the scope of amendments permitted to the hedge documentation by allowing adding derivatives (basis swaps) to existing

hedging relationships which would address solely the differences between alternative benchmark rates used for the hedging instrument and the hedged item arising directly as a result of the reform.

70 This is because the calculation methodology of the rates (change from forward- to backward-looking rates) used for hedged item and hedging instrument might be different. For example, for a hedge of a floating mortgage loan containing the backward-looking term structure methodology that is hedged by an ISDA derivative containing the payment delay backward-looking term structure methodology, a basis swap offsetting the difference between the two methodologies could be included in the hedge documentation.

The EFRAG Secretariat's recommendations to EFRAG Board and EFRAG TEG on EFRAG's proposed final position

71 The EFRAG Secretariat considers that enlarging the scope of changes permitted to the hedge documentation by addressing particular hedging methodologies would go beyond the scope of the IASB amendments and might create unintended consequences. EFRAG Secretariat notes that the IASB does not currently provide any detailed guidance on the hedging methodologies and thus asking for one might result in a very prescriptive guidance and delay the timely issuance and endorsement of the amendments as a whole.

72 The EFRAG Secretariat also highlights that due to the time constraints it is not possible to asses the magnitude of impact and prevalence of the issue.

73 Therefore, the EFRAG Secretariat does not recommend any changes to the EFRAG response to Question 2 in the final comment letter.

EFRAG FIWG comments:

74 EFRAG FIWG members agreed with the EFRAG Secretariat proposal not to make any changes to the EFRAG response to Question 2 in the final comment letter.

75 EFRAG FIWG members commented that it would be difficult to distinguish the changes due to risk management practices from the changes directly required by IBOR reform, highlighted potential unintended consequences that might have and limited time available to properly analyse them.

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)

EFRAG's tentative position

EFRAG agrees that 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 hedged item based on the alternative benchmark rate and recognise any resulting ineffectiveness in profit or loss. This should take place when each underlying financial instrument is modified. However, EFRAG observes that the current wording used in the ED could imply that remeasurement of both the hedging instrument and the hedged item is required at the time the hedge documentation is amended.

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.

Summary of constituents' comments

Cash flow hedges – groups of items

76 Two constituents agreed with the proposed amendments to cash flow hedges.

77 Three constituents agreed with the proposed amendments for groups of items.

Fair value hedges

78 Two constituents questioned the need and the usefulness of recognising a day-one profit or loss on the day the underlying benchmark rate of the hedging instrument is modified, when such modification is compensated for adequately (either a flat payment or a spread adjustment).

79 It remains unclear to them whether the proposed amendments allow for the remeasurement of the hedged items by adjusting its parameters (and especially the credit margin for a fixed-rate instrument) to take into account the alternative benchmark rate used to remeasure the fair value of the hedging instrument. To allow for such an adjustment of the credit margin at the date of the derivative's remeasurement seems the only satisfactory approach to avoid the recognition of a day one profit or loss of little relevance to the users.

80 Prohibiting the remeasurement using an amended credit margin of the hedged item (as could be inferred from paragraph BC61) or requesting that such a remeasurement should take place at the date of the hedge's inception (as could be inferred from paragraph BC63) would both lead to recognizing a gain or loss with no links to the hedge's effectiveness, and hence of no relevance.

81 In their view, the amendment should lay out more clearly the consequences of IFRS 9.6.9.11 (b) and IAS 39.102 (b), and their interplay with paragraphs BC61 and BC63. The possibility to remeasure the cash flows on the hedged item at the date of the hedging instrument's remeasurement using adequate parameters, and especially an adjusted credit margin, consistent with the alternative benchmark rate, should be more readily expressed.

82 This view was opposed by another constituent who concurred with the IASB that ineffectiveness should be recorded in profit or loss and therefore recommend that the final requirements and Basis of Conclusion are clarified. Such a clarification might focus, in part, on the wording in paragraph 6.9.10 of the ED and in particular, the following clause from the second sentence: "an entity shall apply paragraphs 6.9.11 to 6.9.17 to the extent relevant" [underlining added]. They interpret this as stating that each leg of, for example, a fair value hedge is only remeasured using an alternative benchmark rate when that leg has been modified. If this is correct, then clarification could be provided by, for example, inserting explanatory parentheses such as, "to the extent relevant (i.e. to the extent hedged items and hedging instruments have been individually modified)."

Assessing effectiveness

83 Two constituents commented on the requirement in IAS 39 paragraph 102S to reset to zero the cumulative fair value changes of the hedged item and hedging instrument when the benchmark rates are replaced. The constituent noted that this requirement does not favour entities that are using regression analysis for assessing hedge effectiveness compared to the cumulative dollar offset method.

84 The constituents propose that the requirement in paragraph 102S of IAS 39 of resetting the cumulative fair value changes to zero:

(a) could be made optional; and/or

(b) it could be clarified that it is applicable for entities using the cumulative dollar offset method.

85 One of the above constituents further notes that paragraph 49 in the EFRAG DCL refers to the regression analysis as a method where the available historical information for the alternative benchmark rate might not be sufficient to perform the analysis.

86 The constituent notes that the issue of mixed data combining the old and new benchmark rates until sufficient data series for the new benchmark rate environment develop could be addressed in practice. For example, the data reflecting the old benchmark rates could be reconstructed by adjusting the old benchmark curves for the spread between the old and new benchmark rates. As a result, they would appreciate if the regression analysis was not used in the EFRAG letter as an example where the change in the effectiveness method may be necessary. Otherwise the paragraph could lead to unnecessary questions towards entities which will continue using the regression.

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Cash flow hedges – groups of items

87 No change proposed.

Fair value hedges

88 In case of fair value hedges of fixed rate financial instruments, EFRAG has been made aware of the need to remeasure the hedged items by adjusting its parameters (in particular the credit margin defined at the inception of the hedge) to take into account the alternative benchmark rate used to remeasure the fair value of the hedging instrument. In absence of such a remeasurement, there would be an impact in profit or loss which relevance is questionable, as it does not represent real ineffectiveness. EFRAG notes that the amendments require (paragraph 6.9.7) that the entity amend the formal designation of the hedging relationship as previously documented. EFRAG understands that the remeasurement of the credit margin as described above is one of the adjustments that would be considered when amending the formal designation. EFRAG suggests that the IASB clarifies that this is the case.

Assessing effectiveness

89 The EFRAG Secretariat disagrees with the requirement of resetting the cumulative fair value changes to zero as optional, as entities might have difficulty to avoid hindsight in applying the requirement. Further, the EFRAG Secretariat does not agree that IFRSs should distinguish between different methods that are used in determining ineffectiveness.

90 The EFRAG Secretariat agrees to remove the reference to the regression analysis in paragraph 49 of the comment letter as this is a mere example.

EFRAG FIWG comments:

91 EFRAG FIWG members agreed with the EFRAG Secretariat proposal.

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)

EFRAG's tentative position

EFRAG agrees with the IASB's proposal to provide temporary relief in the context of non-contractually specified risk components on the "separately identifiable" criterion. However, EFRAG is concerned about paragraphs BC87 and BC89, as they seem to introduce application guidance of the current hedge accounting requirements inconsistent with some practices that exist in European jurisdictions.

EFRAG observes that the IASB might consider clarifying the wording used in paragraph BC92 of the ED, that the expectation should always relate to the end of 24-month period, regardless of whether this expectation is made either during or at the end of the 24-month period.

Summary of constituents' comments

92 All constituents generally agreed with the proposed amendments to provide a relief on the separately identifiable criterion. However, some of those constituents noted that assessing separately the measurement criterion may prove to be difficult, as the two criteria are closely related.

93 One constituent mentioned that the 24-months period for the alternative benchmark rate to be separately identifiable appears to be adequate. However, given the rapidly evolving context of the COVID-19 pandemic, adverse consequences affecting the implementation of the reform cannot be excluded, and it is therefore proposed to assess the time frame prior to the final ballot on the proposed amendments.

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94 The EFRAG Secretariat acknowledges the uncertainty that arises from the current COVID-19 pandemic situation and proposes to analyse the time frame prior to the final ballot when more information will be available.

95 The EFRAG Secretariat acknowledges that assessing separately the measurement criterion may prove to be difficult, as the two criteria are closely related. The EFRAG Secretariat has already incorporated the issue in EFRAG's comment letter and has proposed to clarify the wording in the Basis for Conclusion.

EFRAG FIWG comments:

96 EFRAG FIWG members agreed with the EFRAG Secretariat proposal to incorporate in EFRAG final comment letter a suggestion to analyse the time frame prior to the final ballot when more information will be available due to the uncertainty that arises from the current COVID-19 pandemic situation and include the conclusion of the analysis in the in the Basis for Conclusion.

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)

EFRAG's tentative position

EFRAG agrees with the IASB's proposal on effective date and transition requirements.

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 the IBOR reforms.

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.

Summary of constituents' comments

97 Constituents agreed with the proposed effective date and transition requirements.

98 One constituent noted that, in practice, once a hedge is discontinued the derivatives may have been closed out or designated in an alternative hedging relationship. In this situation an entity would have to restate the hedge, but immediately discontinue again. The constituent suggests to the IASB to consider whether the relief could be amended to avoid this situation. Another constituent however noted that the proposed amendments should be mandatory in order to increase comparability across entities.

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99 The EFRAG Secretariat does not recommend any changes to the draft comment letter. The issue raised by the constituent was discussed with EFRAG TEG (26th March 2020, AP 06-03) and it was concluded that the current requirements on impracticability in IAS 8 were sufficiently clear.

100 When this issue was discussed at EFRAG FIWG meeting on 19th May 2020, it was noted that in some jurisdictions the applicable prudential regulations may prevent an entity from accounting for derivatives as freestanding for the limited period until the retrospective reinstatement is applied. More specifically, there may be regulatory requirements on the risk management of the banking and the trading book with a requirement that only the trading book is permitted to carry open risk positions. In a situation where a hedging relationship relating to the banking book had to be discontinued, this could then constitute an open risk position in the banking book if no actions were taken by the entity.

101 Against this background, EFRAG FIWG suggested raising this issue with EFRAG TEG and EFRAG Board for considering whether to suggest to the IASB in the EFRAG comment letter that the retrospective reinstatement of hedging relationships might in some cases be impracticable.

102 This could be included as the last paragraph of Question 5 in the final comment letter as follows: *"EFRAG has been informed that that the requirement to retrospectively reinstate hedging relationships in accordance with paragraph 7.2.37 of IFRS 9 or 108I of IAS 39 may be impracticable for entities, such as when due to prudential requirements the derivatives after the discontinuation were either closed*

out or designated to another hedging relationship under to a valid risk management objective. EFRAG understands that these circumstances could qualify to be exempted from the retrospective reinstatement when doing so would be impracticable as defined by IAS 8.5. The IASB could consider adding a clarification along these lines."

EFRAG FIWG comments:

103 EFRAG FIWG members suggested raising this issue with EFRAG TEG and EFRAG Board and whether it should be addressed in the EFRAG comment letter as outlined in paragraph 103.

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

EFRAG's tentative position

EFRAG agrees that the proposed disclosures will assist users of financial statements in understanding the effects of the 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 24J(c) of IFRS 7 may be less helpful to users of financial statements because the disclosures are expected to be less entity specific.

As the new disclosure requirements refer not only to hedge accounting, the IASB should consider a cross-reference to the risk disclosures section of IFRS 7.

Summary of constituents' comments

104 Most constituents generally agreed with the proposed amendments to provide entity-specific disclosures.

105 One constituent agreed with EFRAG's tentative position as observed that the proposed disclosures in paragraph 24J(c) of IFRS 7 may be less helpful to users of financial statements because the disclosures are expected to be less entity specific. They support to include a cross-reference to the risk disclosures section of IFRS 7 as new disclosure requirements refer not only to hedge accounting.

106 One constituent added that the information about the carrying amount of non-derivative financial asset, non-derivative financial liabilities and the nominal amount of derivatives, disaggregated by significant interest rate benchmark, that continue to reference interest rate benchmarks subject to the reform would be feasible to prepare by them.

107 Two constituents mentioned that some disclosure requirements seem of limited relevance for users, whereas potentially extremely costly and challenging to prepare. More specifically, the requirement to disaggregate the carrying amounts of assets, liabilities, and the nominal amounts of derivatives by interest rate benchmark could be exceedingly difficult to fulfil, as this level of detail may not generally be available in the accounting systems.

108 Those constituents suggested that the disclosure of information used by entities in managing the reform, which could differ from the financial instruments' carrying amounts, would allow for a better cost/benefit trade-off, as information extracted from the management systems would provide a relevant proxy of the magnitude of the reform's impacts.

109 One constituent noted that the focus should be on qualitative disclosures to provide explanation on how the entity manages the transition to the benchmark interest rate reform.

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110 The EFRAG Secretariat observes that some constituents expressed concerns that the disclosure requirements in paragraph 24J(b) may be perceived as unbalanced in terms of cost/benefit in practice, while other constituents reported they were able to prepare such information. Against the background of such mixed feedback, the EFRAG Secretariat considers incorporating in the EFRAG comment letter a suggestion to alternatively disclose quantitative information used by entities in managing the reform when information based on carrying amounts as otherwise required by paragraph 24J(b) is not available without undue cost or effort.

EFRAG FIWG comments:

111 EFRAG FIWG members agreed with the EFRAG Secretariat proposal to incorporate in the EFRAG final comment letter a suggestion to alternatively disclose quantitative information used by entities in managing the reform when information based on carrying amounts as otherwise required by paragraph 24J(b) of IFRS 7 is not available without undue cost or effort.

Appendix 2 – List of respondents

Name	Type of respondent	Country
Autorité des Normes Comptables (ANC)	National Standard Setter	France
Danish Accounting Standards Committee (DASC)	National Standard Setter	Denmark
Erste Group	Preparer	Austria
European Savings and Retail Banking Group (ESBG)	Business Association	Europe
Fédération Bancaire Française (FBF)	Business Association	France
Financial Reporting Council (FRC)	National Standard Setter	UK
Instituto de Contabilidad y Auditoria de Cuentas (ICAC)	National Standard Setter	Spain
Organismo Italiano di Contabilità (OIC)	National Standard Setter	Italy