Martin Boer
Director
Regulatory Affairs

June 17, 2019

Mr. Hans Hoogervorst
Chairman
International Accounting Standards Board
30 Cannon Street, First Floor
London, EC4M 6XH
United Kingdom

RE: IASB ED/2019/1 Interest Rate Benchmark Reform - Proposed amendments to IFRS 9 and IAS 39

Dear Mr. Hoogervorst:

1. The Institute of International Finance (IIF), via its Senior Accounting Group (SAG), welcomes the opportunity to comment on the Exposure draft ED/2019/1 Interest Rate Benchmark Reform – Proposed amendments to IFRS 9 and IAS 39 (the ED).
2. Interest rate benchmarks such as interbank offer rates (IBORs) are extensively used in large volumes and across a wide range of products and contracts such that any cessations of or uncertainties around those rates may pose significant disruption of financial markets. Further, references to IBORs pervade many processes within entities so that the shift to alternative references rates such as risk-free rates (RFRs) has broad ramifications for organizations, which would represent significant operational challenges.
3. In light of the substantial potential impacts, it is crucial that regulators, standard setters and market participants identify any issues that may arise from the transition to RFRs, gauge the breadth of impact, and outline any proper actions that need to be taken to ensure an orderly adoption. This is all the more important because any issues not properly addressed may impede the creation of the necessary liquidity in contracts referencing new RFRs, which, in turn, may impact the markets desire to move to the new RFR and would increase uncertainty.

4. Against that background, we fully endorse the IASB's initiative to consider the financial reporting implications of IBOR reform. We believe the ED tackles important accounting issues that may arise in the period before the replacement of an existing interest rate benchmark with an alternative interest rate (pre-replacement issues or Phase 1).
5. However, we have certain clarifications/drafting amendments which we suggest for Phase 1. Additionally, we have some broader issues which if possible we would like to be addressed in Phase 1, but we understand the timeline restrictions and due process which needs to be followed. If these cannot be addressed whilst ensuring Phase 1 is delivered in 2019, we would like them quickly be addressed in Phase 2.
6. First, while we believe that the proposed amendments should not be restricted to only hedges of interest rate risk, so we urge the IASB, for the sake of clarity, to explicitly state that proposed relief is applicable whenever IBOR index cash flows are a component of either the hedging instrument or the hedged item, which include hedges where interest rate and foreign currency risks are the designated risks. This is a drafting amendment which could be dealt with in Phase 1.
7. Further, we urge the IASB to consider relief for separately identifiable for dynamic hedges under IAS 39. We are concerned that the current proposals would provide little relief for entities under IAS 39 where the hedge programme involves rebalancing and de-designating and re-designating hedging instruments on a regular basis. Before transition to the new RFR, entities could experience significant difficulties to assess at each re-designation point the separately identifiable requirement for the designated hedged IBOR risk.
8. We urge the IASB to consider relief in regard to the retrospective test and specifically the 80-125% effectiveness thresholds under IAS 39. During Phase 1 the IBOR reform could result in the fair value of the hedged item for the hedged IBOR risk and the hedging instrument moving in slightly different ways which could push an effective hedge across the thresholds. This issue becomes more significant when either the hedged item or the hedging instrument is amended when ineffectiveness could jump significantly. We request relief to be provided whereby if the ineffectiveness is above or below the range is due to IBOR reform that this does not fail the hedge accounting. However, we agree the increase in ineffectiveness should be reported in the P&L. This relief is important as hedging relationships under IFRS 9 do not have this issue and we are only looking for alignment as it relates to the impact of IBOR reform.
9. We do not think it is clear when the relief ends in macro hedge relationships. It is unclear when uncertainty ends where there are multiple hedged items being hedged

with a single or multiple hedging instruments. The same issue arises where multiple hedging instruments hedge a single hedged item. It is unclear whether the uncertainty test is analyzed on a collective or individual basis. This point should be clarified as part of Phase 1 without re-exposure, since it is application of an agreed principle.

10. In terms of other priority Phase 2 issues we would flag the following.

11. Regarding hedge accounting, preparers will have to modify their hedge documentation to take into account the move to the new RFR. In order to ensure there is a smooth transition to the new RFR's, it is imperative that the IASB allow continuation of the hedge accounting relationship when entities update existing hedge documentation solely to reflect changes due to the IBOR reform. We are particularly concerned regarding cash flow hedges of forecast IBOR cash flows. We would not want a transition of the hedged item from IBOR to alternative RFR to immediately result in recycling of OCI to P&L.

12. Further, it is especially important that market participants have clarity sooner rather than later as to the effects of IBOR reform on ineffectiveness testing. On transition, it might be challenging to demonstrate that new hedges will be highly effective from inception because of the lack of historic information and different pricing curves between cash and derivative instruments.

13. In addition to hedge accounting, there are other issues that we believe the IASB should consider whether and how to take proper actions to address them. We have outlined some of them as well as those already mentioned above in Annex 2.

14. We recommend the IASB to start considering Phase 2 issues as soon as possible, in parallel to the finalization of the Phase 1. Indeed, issues identified as part of Phase 2 may arise sooner than expected as IBOR reforms are carried out at different speed across jurisdictions and entities will need to factor in lead times to develop systems monitoring and controls.

15. Market participants are encouraged by regulators to transition to the new RFRs before IBORs stop, however, entities may be reticent to enter into some RFR transactions if they deem the accounting treatment uncertain. Early guidance would then contribute to facilitating the adoption of new RFRs as well as help entities deal with the widespread accounting implications of IBOR reform.

16. Finally, we note that IBOR transition is not a joint project between FASB and IASB so any relief under the two standards may introduce complexities in complying with both GAAPs for dual reporting global entities. Consequently, we recommend IASB coordinate with FASB to provide consistent relief where relevant.

17. 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 Hassan Haddou at hhaddou@iif.com.

Yours sincerely,

Martin Boer
Director, Regulatory Affairs
Institute of International Finance (IIF)

Annex I - Responses to the questions raised in the ED

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

For hedges of interest rate risk that are affected by interest rate benchmark reform, the Board proposes amendments to IFRS 9 and IAS 39 as described below.

a) For the reasons set out in paragraphs BC8–BC15, the Board 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 is not altered as a result of interest rate benchmark reform.

b) For the reasons set out in paragraphs BC16–BC23, the Board 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 instrument are based, are not altered as a result of interest rate benchmark reform when the entity determines whether:

(i) there is an economic relationship between the hedged item and the hedging instrument applying IFRS 9; or

(ii) the hedge is expected to be highly effective in achieving offsetting applying IAS 39.

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.

18. We support proposed amendments regarding the highly probable requirements and prospective assessment.

19. However, as mentioned in the cover letter, we are concerned that the IASB does not propose relief for the effects of IBOR reform on the retrospective test under IAS 39. We believe that a relief to the retrospective 80-125% test requirements under IAS 39 is needed for the following hedges:

    - Existing IBOR-based hedges during the period leading up to IBOR reform, for example for the situation where IBOR is not formally replaced but instead continues

to be quoted but there is a small increase in ineffectiveness due to IBOR reform impacting the hedged item differently from the hedging instrument.

- Mismatch in cash flows between the hedged item (either single instrument or group of instruments) and hedging item can occur if IBOR is replaced with a new RFR at different times (Phase 2 issue).
- Hedges based on new RFR undertaken by an entity, during the early stage of the new RFR where it is developing its liquidity, there would be insufficient historical information based on the new RFR to perform the retrospective test (Phase 2 issue.)

20. We suggest the IASB temporarily permit the entity under IAS 39 hedge accounting to apply paragraph B6.4.2 of IFRS 9; that is, to base the assessment of the hedge effectiveness on an analysis of the sources of hedge ineffectiveness that are expected to affect the hedging relationship during its term.
21. Such relief would only allow the continuation of hedge accounting and would not allow changing the actual results of the hedge ineffectiveness reflected in the P&L which would continue to be derived from the actual measurement of the hedged item and the hedging instrument based on the market conditions prevailing on reporting date.

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

For the reasons set out in paragraphs BC24–BC27, the Board 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 is 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 is separately identifiable—only at the inception of the hedging relationship.

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

22. We share the IASB's view that discontinuation of hedging relationship solely due to increased uncertainty stemming from IBOR is not desirable as it would not provide users with useful information of entities' performance. We are supportive of the relief for "separately identifiable".

23. As mentioned in the covering letter we urge the IASB to consider relief for separately identifiable for dynamic hedges under IAS 39. We are concerned that proposals would provide little relief for entities under IAS 39 where the hedge programme involves de-designating and re-designating hedging instruments on a regular basis.

24. In addition, as a Phase 2 issue the IASB should consider permitting designation of new RFRs as a risk component under IFRS 9 and IAS 39 during the IBOR transition period even if the new RFR is illiquid, as it will take a bit of time to create liquidity and to have the historical data needed for effectiveness testing.

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

(a) For the reasons set out in paragraphs BC28–BC31, the Board 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.

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

(i) 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

(ii) 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.

(c) For the reasons set out in paragraph BC43, the Board is not proposing an end of application in relation to the separate identification requirement.

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.

25. We agree that the exceptions should be mandatory until there is uncertainty arising from the IBOR reforms.

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

Disclosures

For the reasons set out in paragraph BC44, the Board proposes that entities provide specific disclosures about the extent to which their hedging relationships are affected by the proposed amendments.

Do you agree with these proposed disclosures? Why or why not? If not, what disclosures would you propose instead and why?

26. We agree that entities should disclose information about the extent to which their hedging relationships are affected by the proposed amendments.

27. However, the specific disclosure should not impose undue cost and effort on entities. Disclosures should be meaningful and relevant, which should include qualitative information and an appropriate level of granularity.

28. To disclose the effects of the proposed amendments, entities should be able to leverage as much as possible existing 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

For the reasons set out in paragraphs BC45–BC47, the Board 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 Board proposes that the amendments would be applied retrospectively. No specific transition provisions are proposed.

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

29. We agree with these proposals.

Annex 2. Issues pertaining to Phase 2 (replacement issues)

30. We urge the IASB to start considering issues relating to Phase 2 as soon as possible, in parallel to the finalization of the Phase 1, without waiting for full clarity. We have laid out in the table below some key issues that we believe the IASB should take proper actions to address them.

Accounting Theme	Possible Issues/Questions
Modification of Financial Instruments	• When contractual amendments of financial instruments represent a modification or a derecognition event? In this context, it is not clear whether the contractual amendments include the insertion of permanent fallback provisions or just the actual transition to replacement benchmarks? • For financial instruments which are modified but not de-recognized, how entities should measure the effective interest rate? We believe there should be no P&L impact and only a change in the effective interest rate.
Classification & Measurement	• For financial instruments measured at amortized cost under IFRS 9, would expected de-recognition of financial assets on transition give rise to inconsistency with a hold to collect business model?
Hedge Effectiveness	• On transition, how to deal with the lack of historic information and different pricing curves between cash and derivative instruments? In some circumstances, it might be challenging to demonstrate that new hedges will be highly effective from inception.
Hedge Documentation	• What are the hedge accounting implications if an entity alters their hedge documentation or re-defines the hedged risk to accommodate IBOR reform? Guidance would be helpful how to differentiate between necessary changes and other changes
Macro Hedges	• How to assess when IBOR transition uncertainty is no longer present for a pool of items and how to assess in the run up to transition, the proportionality test when grouping items into pools?