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Association pour la participation des entreprises françaises à l'harmonisation comptable internationale

The Chairman of the IASB

IASB
Columbus Building
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London
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Dear Mr. Hoogervorst,

Comment letter on ED/2019/1 amendments to IFRS 9 and IAS 39 related to interest rate benchmark reform (IRBR)

We are pleased to have the opportunity to comment on this exposure draft since we fully support the initiative to provide a quick and pragmatic solution to avoid any undesirable accounting effects caused solely by the IRBR.

We agree that maintaining the hedge relationship in this initial period, is crucial. While we accept the Board's proposals, we believe that the IASB's approach could have been even more pragmatic if it were to provide a general temporary relief focused on the presumed continuity of the hedge effectiveness. Such a solution would be efficient and less burdensome than the contract-by-contract basis approach proposed.

Concerning the proposed effective date of application and the possible early application, we encourage the Board to issue the final amendment as soon as possible in order to allow their adoption in our jurisdiction, thus allowing us to implement these provisions in a timely manner.

Finally, our members have been fully involved in the dedicated working group of our national standard setter (ANC), and we therefore also support the comments it has made, and which are reproduced hereafter.

Should you require any further comment or explanation, please do not hesitate to contact us.

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Patrice MARTEAU
Chairman

Comments on the proposed amendments in phase I (as discussed in the ED)

ANC agrees that the relief provided by the suggested amendments will address the issues raised in phase I except for the following topics detailed hereunder.

Hedging relationship assessment (Question 1)

We share the Board's view when it states that "discontinuation of hedge accounting solely due to such uncertainties [about the timing and the amount of future cash flows] before the reform's economic effects are known would not provide useful information to users of financial statements.", but we also consider that such uncertainties remain opened until the new benchmark rate are applied to a financial instrument, which is not always expected to occur on a fixed date when transition periods are provided by the relevant authorities (which is the case for the transition from EONIA to ESTER, for instance).

When differences in the changes of cash flows of the hedged item and of the hedging instrument arise from the reform (including different timing in the benchmark rate replacement), the additional ineffectiveness shall be recorded into P&L as any other ineffectiveness but shall not preclude the continuation of the hedge accounting.

We do not share the Board's view expressed in BC 23 and consider that a relief shall also be provided for retrospective test without waiting for additional consideration under phase II. Discontinuing the hedge accounting before the replacement of benchmark interest rate because of a temporary higher ineffectiveness (leading to breach the 80%-125% test) would be inconsistent with the entity's interest rate risk management and would not provide a useful information to users of financial statements.

Conditions to the end of the relief (Question 3)

In ANC's view, conditions set in determining the end of the relief need to be adjusted. In fact, BC 40 of the ED deals with uncertainties on both hedged and hedging instruments, but not with uncertainties on either hedged or hedging instruments.

For instance, there can be cases arising before the end of 2019 where a hedging relationship would be set-up with a derivative, such as an Interest Rate Swap, and a non-derivative instrument, such as a loan granted to a corporate or an individual, and for which:

- The derivative, with fall-back clauses set-up by market setter (e.g., ISDA), is required to migrate to an RFR benchmark (before the end of the IBOR quotation); and
- The non-derivative instrument, requiring a bilateral negotiation to be amended, has not yet migrated to an RFR benchmark rate.

We are aware that such issues are expected to be addressed in the second phase of the IASB project. We therefore urge IASB to undertake the phase II as soon as possible.

Disclosures (Question 4)

Since the purpose of the relief is to reflect in the financial statements the continuity of the hedge relationship, and that any possible inefficacity will be recognised in the P&L, we question the relevance and the usefulness of further disclosure about the "magnitude of the hedging relationships to which the exception applies". The Basis for Conclusions do not provide any details about the nature and extent of users' need. We rather suggest providing qualitative information about the transition to the new benchmark rates, the absence (or not) of consequences on the risk management and the related hedging transactions, and whether the entity has applied the reliefs proposed through these amendments.

Unlike expected by the Board (BC 44), disaggregating information already required to be disclosed by IFRS 7 according to a new criterion (whether the exceptions have been applied or not) will be costly. It would require from preparers the implementation in the IT tools of this new criterion, the modification of the reporting tools used by groups to consolidate the contributions of their subsidiaries and affiliates, and the adaptation of the consolidation tool to be able to provide the new disaggregated figures in the notes to consolidated financial statements. All tasks that also require enough time to ensure a proper implementation.

We also note that the Board did not require new disclosure when issuing IAS 39 amendments "Novation of derivatives and continuation of hedge accounting" in 2013.

Effective date and transition: early application

The Board proposes an effective date on 1 January 2020 with a possible early application of the amendments. To be able to early apply the amendments, they should have been issued before the end of 2020 and then endorsed by local authorities when such endorsement is required (which is the case within the European union). We then ask to the Board to consider all what is possible to be able to issue the amendments at a date that would allow such an early application.

Issues to be addressed in phase II (as addressed in Appendix II of the EFRAG's comment letter)

The Board has organised its works into two successive phases assessing separately pre-replacement issues and replacement issues. As far as replacement issues could arise before the end of 2019 for some benchmark rates, we warmly encourage the Board to address these issues as soon as possible with the objective to provide the appropriate reliefs on a timely basis for a possible early application since 2019.

ANC has still identified some issues that would need to be preferentially addressed in phase II:

- Modification versus derecognition: assessing how an amendment of contractual interest rate to reflect the new benchmark rate, as it is required by external regulation, should not result in the derecognition of the instrument.
- Prospective change of the effective interest rate versus recognition of a modification gain or loss: assessing whether it should be allowed to prospectively adjust the EIR when this

adjustment is a consequence of the sole IBOR reform. ANC especially supports a solution proposed by the EFRAG which deals with expected decrease of benchmark rates[1] ;

- Hedge accounting effectiveness: if not addressed in Phase I, assessing how to relieve the retrospective test (see here-before).
- Hedge documentation: to avoid burdensome updates of each hedging documentation affected by the reform, assessing whether a relief should be granted to the extent that discontinuation of the hedge accounting relationship would solely be due to the need of such an update of the documentation.
- Cross currency swaps: assessing whether changes in the currency basis spread due to the application of the IBOR reform could have unintended consequences for which a relief should be granted.

ANC also stresses the point that the practicability of the solutions to be proposed will also have to be assessed in order to ensure a level playing field.

[1] It has been observed that new-RFRs will be lower than the old IBORs. When IBOR-based financial instruments are modified to be based on the new RFR they may include a higher fixed spread. To the extent the present value of the increase in the spread is offset by lower forecast floating rate cash flows, at the date of the modification the relationship between the lender and borrower is unchanged. Accordingly, the modification should not result in a gain or loss for either borrower or lender and instead they should be allowed to apply IAS 39, AG8 or IFRS 9, paragraph B5.4.5.