

## **IASB Project *IBOR Reform and its Effects on Financial Reporting*** **AFME comments on proposed amendments to IFRS Standards aiming to** **address financial reporting issues that may arise leading up to IBOR reform**

8 March 2019

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Dear Sir / Madam,

AFME welcomes and fully supports the International Accounting Standards Board's (IASB or the Board) intent to provide certain reliefs in relation to financial reporting issues arising from IBOR (Interbank Offered Rates) reform (Reform). We note that this will be via amending IFRS Standards as outlined in the IFRS Staff paper<sup>1</sup> presented in the Board's meeting on the 8<sup>th</sup> of February 2019, taking into consideration tentative decisions made by the Board on the proposed amendments<sup>2</sup>, and the IFRS Staff paper<sup>3</sup> included in the agenda for the meeting in March 2019. AFME believes that providing such reliefs on the financial reporting requirements would be crucial to ensure a smooth and efficient market transition to new risk-free rates (RFRs). We appreciate that this project has been prioritised by the IASB and would concur that this is necessary.

AFME supports the IASB's phased approach to the project where during the first phase the proposed amendments would address accounting issues that may arise in the period leading up to IBOR reform, provided it encapsulates all the issues that could occur prior to the Reform; and the second phase will cover issues affecting financial reporting when IBOR reform is enacted, including issues going beyond hedge accounting.

AFME is supportive of the Board's tentative decision regarding the 'highly probable' requirement whereby the amendments are aimed at providing a relief solely from the effects of the uncertainties arising from the Reform around the 'highly probable' hedge accounting requirement. We would concur that it is appropriate that any prospective effectiveness assessment should not be impacted adversely due to uncertainty arising from the fact that the Reform will take place. As such, AFME also welcomes the Board's tentative decision on the relief allowing entities to consider only the existing contractual terms of the hedging instrument and hedged item, either to demonstrate compliance with hedge accounting requirements where a hedging relationship must be proven as highly effective (under IAS 39) or to demonstrate that there is an economic relationship between the hedged item and hedging instrument (under IFRS 9).

We also understand and support that the reliefs are aimed at addressing accounting issues for both cash flow and fair value hedges, where similar issues around the Reform could impact the hedge accounting requirements.

As noted above, we strongly support the initiative to provide transitional reliefs. However, we would also like to highlight some matters we believe should be considered by the Board to ensure any relief is appropriately targeted and practical for preparers to implement.

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<sup>1</sup> <https://www.ifrs.org/-/media/feature/meetings/2019/february/iasb/ibor/ap14-ibor.pdf>

<sup>2</sup> <https://www.ifrs.org/news-and-events/updates/iasb-updates/february-2019/>

<sup>3</sup> <https://www.ifrs.org/-/media/feature/meetings/2019/march/iasb/ap14-ibor-reform-and-the-effects-of-financial-reporting.pdf>

### **Association for Financial Markets in Europe**

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We note that currently there is significant uncertainty as to what happens when the market approaches the transition from IBORs to RFRs. Whilst we appreciate that the IASB intends to discuss financial reporting implications of the contractual amendments during Phase II of the project, we would like to note that entities might need to change their hedge designations (and maybe therefore change their hedge documentation) from IBORs to RFRs even prior to the Reform being officially enacted. We agree that financial reporting should reflect ineffectiveness between the hedged item and the hedging instrument, however we believe that discontinuation of a hedging relationship only because of RFR transition should be avoided, if the hedging relationship following the RFR transition would have been highly effective, had it been documented at the inception of the hedging relationship. We strongly believe that there should be a relief ensuring that when hedging documentation is amended to reflect the transition to RFRs before the Reform is enacted, this should not be automatically viewed as a dedesignation and redesignation event, and the same approach should be followed in Phase II.

AFME understands and supports the relief proposed that “an entity should be allowed to continue hedge accounting when an IBOR risk component meets the separately identifiable requirement at the inception of the hedging relationship” notwithstanding that its identification could be subsequently affected by uncertainties arising from the IBOR reform. This is because we believe that a relief should be available to ensure that, if a conclusion was reached that an IBOR risk component meets the separately identifiable requirement at the inception of the hedging relationship, this assumption can continue throughout the life of the hedge as it should not be affected by uncertainty outside of an entity’s control arising solely from the Reform.

Additionally, when a risk component fails the “separately identifiable” requirement, it would also generally mean that the risk component cannot be measured reliably. As a result, it raises doubts on the benefit of giving relief only to the “separately identifiable” requirement since hedge accounting would have to be stopped, at some point, because of the non-fulfilment of the “reliably measurable” requirement. AFME believes that the relief should address the two requirements together because separating them would not be effective in practice. We anticipate that there will be a period of time when IBORs and new RFRs will have to co-exist in the market as the transition is not expected to happen at a single point in time and for all instruments simultaneously. Also, we anticipate that at some point IBORs could become “level 3” benchmarks, and it is not clear yet what it would entail in terms of hedge designations. Consequently, a certain level of judgement would need to be applied to conclude on what would be deemed as “reliably measurable” during this transitional period in the context of a risk component designation. We strongly suggest that there should be a relief provided when IBORs become less liquid but are still published and used by the market to allow the conclusion that a risk component designated in terms of IBORs could still be deemed as reliably measurable.

Furthermore, the IFRS Staff Paper notes that “The effects of IBOR reform on the ‘retrospective assessment’, required by paragraph AG105(b) of IAS 39, are not considered in the staff analysis because such a retrospective assessment is based on the actual results of the hedging relationship”. AFME understands and appreciates the IASB’s significant focus on reliefs related to the ‘prospective test’ as part of hedge effectiveness assessment. We also acknowledge the fact that IFRS 9 does not require a retrospective test. However, we would like to bring to the IASB’s attention that it would be important to consider how this criterion is addressed for new RFR based hedges under IAS 39 for which there would not be historical information available. Where historical data does not exist, we would propose it would be preferable to exempt such transactions from retrospective assessment until the data becomes available over time. We note that an alternative solution could be the presumption, that in the absence of reliable historical data points, IBORs represent reasonable proxies for the past, however further consideration of this topic would be necessary to determine the usefulness and viability of such an approach. On a related point, a relaxation of the retrospective test requirements under IAS 39 for new and existing IBOR-based hedges during the period leading up to IBOR reform would be welcome, in particular for the situation where IBOR is not formally replaced but instead

continues to be quoted and has become less liquid because new hedging relationships are formed referencing the new RFRs. This relief is needed only to allow the continuation of hedge accounting and is not meant to change the actual results of the hedge which would still continue to be derived from the actual measurement of the hedged item and the hedging instrument.

Additionally, we note that the proposed amendments do not provide explicit guidance for judgments applicable to pools of hedged items, especially regarding how to assess when there is no longer an uncertainty for a pool of hedged items and how to apply the 'proportionality' test per IAS 39.83. We would thus encourage the IASB to consider this matter in further deliberations on the project.

In relation to the end of the proposed reliefs, we note that the IFRS Staff paper for the Board's meeting in March provides additional clarifications and illustrations regarding principles that should be considered by entities in determining when the relief should end, in particular "when the uncertainty regarding the timing and amount of the resulting cash flows is no longer present". We support the IASB's continued consideration to ensure any transitional relief is practical and AFME looks forward to providing comments and recommendations on these proposals in due course. It is important to note, however, that, whilst we understand the rationale for ending the relief when the hedging relationship terminates, we would welcome the ability to apply the relief, if there is a replacement or rollover of the hedge.

Regarding the optional versus mandatory application of the proposed amendments, AFME supports a view that generally transitional relief should not be mandatory for all preparers across all products. In fact, we think that for certain classes of products, applying the relief may not be operationally feasible, and entities might need to choose to discontinue the hedging relationship, if it is not possible to benefit from the relief. Therefore, we suggest that the relief should be optional, however applied consistently to classes of instruments of similar nature and accompanied by appropriate disclosure reflecting the details and extent of relief application.

We would be pleased, of course, to discuss the content of this paper or to provide any further clarity with regard to the statements made.

Yours faithfully,

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### **About AFME**

AFME (Association for Financial Markets in Europe) advocates for deep and integrated European capital markets which serve the needs of companies and investors, supporting economic growth and benefiting society. AFME is the voice of all Europe's wholesale financial markets, providing expertise across a broad range of regulatory and capital markets issues. AFME aims to act as a bridge between market participants

and policy makers across Europe, drawing on its strong and long-standing relationships, its technical knowledge and fact-based work. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. AFME participates in a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) through the GFMA (Global Financial Markets Association). For more information please visit the AFME website: [www.afme.eu](http://www.afme.eu).