Submitted electronically via **www.ifrs.org** website

17 June 2019

Dear Sir / Madam,

Response to the International Accounting Standards Board's Exposure Draft *ED/2019/1 Interest Rate Benchmark Reform - Proposed amendments to IFRS 9 and IAS 39*

The Association for Financial Markets in Europe (AFME) welcomes the opportunity to comment on the **Exposure Draft *ED/2019/1 Interest Rate Benchmark Reform - Proposed amendments to IFRS 9 and IAS 39 ("ED")*** issued as part of the International Accounting Standards Board's (IASB or the Board) project *IBOR Reform and its Effects on Financial Reporting*. Consistent with our letters to the IASB as of 8 March 2019[1] and 2 April 2019[2], AFME welcomes and fully supports the IASB's proposal to provide reliefs in relation to some of the financial reporting issues arising from the Interbank Offered Rates (IBOR) reform. AFME believes that providing such reliefs would be important to ensure a smooth and efficient market transition to new risk-free rates (RFRs), and thus we believe it would be necessary for the IASB to proceed with finalising and issuing the respective amendments to IFRS as soon as possible.

AFME thus welcomes the proposed relief with regard to highly probable requirement and prospective assessments to ensure the continuation of hedge accounting for cash flow hedges. We note, however, that the scope of the relief should be clarified that it applies broadly across all hedge accounting relationships affected by the uncertainty from IBOR transition (e.g. including derivatives such as cross-currency swaps).

We also agree with the IASB's proposal that the assumption of separately identifiable risk component or risk portion, if met at the inception of the hedging relationship, should 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.

AFME is generally supportive of the Board's proposed approach on the cessation of the relief, however, we do have some concerns, that without clarification to the language, the relief can terminate prematurely. Our concern relates to the wording "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*".* We believe that it should be clarified that the relief continues to be available until all fundamental contractual terms and parameters are agreed allowing entities to conclude that the uncertainly has indeed been eliminated. Furthermore, as a matter of clarification, our view is that it should clearly state that the relief should be applied until uncertainly stops for the hedging relationship as a whole and not just for its separate components (i.e. hedged item and hedging instrument) as hedging is also conducted as a relationship between both of these components.

Additionally, AFME acknowledges the need for additional disclosures about the extent to which the hedging relationships are affected by the Board's proposed amendments. However, we cannot stress enough the importance of such disclosures not being too prescriptive or burdensome to produce particularly given the information already prepared under IFRS 7. We would also request that the IASB clarify how the retrospective application of the proposed amendments would work in practice, because, as currently worded, it does not appear to be in line with IAS 8.22. We believe that the relief should be available from the date of application

[1] https://www.afme.eu/globalassets/downloads/consultation-responses/afme-position-paper---ibor-reform-and-its-effects-on-fin-reporting.pdf
[2] https://www.afme.eu/globalassets/downloads/consultation-responses/afme---effects-of-ibor-reform-on-fin-reporting-phase-ii-letter-to-iasb-final.pdf

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for all hedge relationships existing at the date of application and for all hedge relationships being put in place subsequent to the date of application. This should be clarified in the final amendments to IFRS preferably avoiding the use of the term "retrospective" unless there is greater clarification of how this particular aspect applies retrospectively.

The detailed responses to the questions raised in the ED are outlined in Appendix A to this letter.

Notwithstanding the above, we note that there are important matters that may arise during the period leading up to the reform, which have not been addressed by the Exposure Draft. In particular, those relate to contractual modifications of hedging documentation, guidance for macro hedges and two issues under IAS 39 – retrospective assessment in measuring hedge accounting effectiveness and separately identifiable requirement in dynamic macro-hedging. In the event the IASB is not able to address these issues in the current phase, they as well as some other most critical, in our view, issues should be addressed by the IASB as a matter of urgency and priority as the next step of the Board's discussions and standard-setting activity within the project. In Appendix B to this letter, we have described these most critical issues. In this context and with full appreciation of the rigidity and time commitment required for the IASB due process, we urge the Board to accelerate its work on these issues and commence deliberations and public consultation process in 2019.

We would be pleased, of course, to discuss the content of this letter and/or of the Appendices 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.

Exposure Draft – *Interest Rate Benchmark Reform – Proposed Amendments to IFRS 9 and IAS 39*

Appendix A

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.

AFME response:

AFME welcomes the proposed amendments to IFRS 9 and IAS 39 providing reliefs to the highly probable requirement and prospective assessments as described and for the reasons stated in BC8–BC15 and BC16–BC23 of the Exposure Draft. We agree that, as set out in paragraphs BC4 and BC12 of the ED, discontinuing all hedging relationships affected by the reform solely due to uncertainty arising from the reform would not provide useful information to users of financial statements. Furthermore, ensuring the continuation of hedge accounting would be necessary to avoid or at least minimise any unintended consequences and market disruptions during the period of transition to alternative risk-free rates. We, however, would like to point out that the scope of the relief should be broadly applicable to all hedge relationships affected by the uncertainty from IBOR transition (e.g. foreign currency hedges such as cross-currency swaps, inflation hedges, etc.). We trust this is simply a clarification of the wording rather than a change in the intent. Additionally, in Appendix B, AFME expressed its considerations with regard to other aspects necessary to ensure the continuation of hedge accounting, such as, among others, retrospective assessment in measuring hedge accounting ineffectiveness.

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.

AFME response:

AFME generally agrees with the ED's proposal 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.

As noted in our letter to the IASB as of 8 March 2019[1], the assumption of separately identifiable risk component or risk portion, if met at the inception of the hedging relationship, should 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. This would be critical in ensuring the continuation of hedging relationships that would otherwise meet the hedge accounting requirements and thus would prevent any artificial volatility in financial reporting that would not be useful to users of financial statements.

Additionally, in Appendix B, AFME expressed its considerations with regard to the other aspect necessary to ensure the continuation of hedge accounting, i.e. the separately identifiable requirement under IAS 39 in dynamic macro hedges as a result of the need to de-designate and re-designate the hedging relationships in the portfolio in order to re-balance the portfolio for its dynamic nature.

[1] https://www.afme.eu/globalassets/downloads/consultation-responses/afme-position-paper---ibor-reform-and-its-effects-on-fin-reporting.pdf

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.

AFME response:

Regarding question 3(b), AFME is generally supportive of the proposed approach whereby an entity would prospectively cease to apply the proposed amendments at the earlier of:

(a) 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

(b) 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.

However, we would like to raise some concerns in relation to the application of paragraph (a), specifically in relation to circumstances that can be considered as indicative of the end of uncertainties from the reform. Although we find the illustrative scenarios and accompanying explanations provided in BC35-40 helpful, we believe that determining when uncertainly would no longer be present should not be confined to the fact patterns illustrated in the noted BC as those can be prone to different interpretations. For example, Scenario A per BC35, states that uncertainty regarding the timing and the amount of cash flows for a contract is eliminated (and thus the relief should stop) when the contract is amended to include a clause that specifies both (a) the date the existing interest rate benchmark will be replaced by an alternative interest rate and (b) the alternative interest rate on which the cash flows will be based. It could be argued that even with such contractual amendments in place, the uncertainly might not be eliminated (e.g. alternative RFRs can be known but the spread not) resulting in the relief being terminated prematurely. AFME believes that the relief should continue to be available until all fundamental contractual terms and parameters are agreed allowing entities to conclude that the uncertainty has been eliminated. Additionally, the application of Scenario A as currently worded can potentially incentivise firms not to amend their hedging documentation with RFR fall-back provisions at the earliest stage possible resulting in outcomes counterproductive to what regulatory bodies are trying to achieve. We therefore believe that determining whether uncertainty has been eliminated should be governed by the use of professional judgement relative to the particular circumstances of each relationship. In line with existing standards, preparers will of course disclose all material policies and judgements as necessary in the notes. Furthermore, we request the Board to clarify that the relief should be applied until uncertainly stops for the hedging relationship as a whole and not just for its separate components (i.e. hedged item and hedging instrument).

Regarding question 3(c), for the reasons set out in paragraph BC43, AFME agrees with not proposing an end of application regarding the proposed exception on the separately identifiable requirement as this would contradict the intended effects of the proposed relief.

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?

AFME response:

AFME acknowledges the need for specific disclosures about the extent to which the hedging relationships are affected by the proposed amendments, and therefore generally supports the IASB's proposal. We support the disclosures in the annual financial statements and believe that the disclosure requirements should not be overly prescriptive and should be applied in a proportionate manner, including as well that the disclosures for macro hedge accounting should not be overly burdensome to provide. We also note that IFRS 7 already requires very granular and prescriptive disclosures on hedging and hedge accounting, thus we think it is important for entities to exercise professional judgement with regard to the form and extent of any additional disclosures about the impact of the Board's proposed amendments. This would allow entities of different types and sizes to explain in qualitative and, where necessary, quantitative terms the impact of the amendments to the users of their financial statements covering the extent of relevance and magnitude of such an impact. AFME, however, urges the IASB to clarify the application of IAS 8.28 (f)[2] in the context of the proposed amendments as we are concerned that the requirements of IAS 8.28 (f) may be too onerous.

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.

AFME response:

AFME supports the IASB proposal on the date of application of the amendments with earlier application permitted. We believe that it is important to allow early application as preparers across various jurisdictions might operate under different reporting periods and likely different timelines for RFR transition.

[2] When initial application of an IFRS has an effect on the current period or any prior period, would have such an effect except that it is impracticable to determine the amount of the adjustment, or might have an effect on future periods, an entity shall disclose:
(f) for the current period and each prior period presented, to the extent practicable, the amount of the adjustment: (i) for each financial statement line item affected; and (ii) if IAS 33 Earnings per Share applies to the entity, for basic and diluted earnings per share.

Regarding the proposal to apply the amendments retrospectively, AFME believes that the concept of retrospective application is not used in its generally accepted sense, as defined under IAS 8.22[3]. For example, BC46 of the ED states that the amendments should not be applied to allow either hindsight designations or reinstatements of previously discontinued hedging relationships. Given the fact that the amendments would not allow the reinstatement of previously discontinued hedging relationships, it is not clear how the retrospective approach as currently stated in the ED should be applied. This suggests that the use of the word "retrospective" might not be correct in the context of the amendments and can be confusing or even misleading to both preparers and users of financial statements. We agree that the application of the proposed amendments should enable entities to continue applying hedge accounting for those hedging relationships that the entity had designated and that qualified for hedge accounting applying IFRS 9 and IAS 39 in the absence the uncertainty arising from the IBOR reform. In other words, if the hedging relationship qualified for hedge accounting in the past reporting periods before any uncertainty from IBOR reform becomes an issue, the assumption of the hedge accounting being able to continue should not change for future reporting periods. We thus urge the IASB to clarify that the relief should be applicable from the date of application for all hedge relationships existing at the date of application and for all hedge relationships being put in place subsequent to the date of application.

[3] IAS 8.22 Retrospective application means adjusting the opening balance of each affected component of equity for the earliest prior period presented and the other comparative amounts disclosed for each prior period presented as if the new accounting policy had always been applied.

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Appendix B

AFME notes that the first four points raised represent the most critical issues and each of them should be treated by the Board as being equally important. We stress that the issues can be viewed as current rather than "Phase 2" and thus require the most urgent consideration and response.

Separately identifiable requirement in dynamic macro-hedging

AFME notes that, according to BC27 of the ED, the Board has decided not to allow entities to designate the benchmark component of interest rate risk as the hedged item in a new hedging relationship if the risk component is not separately identifiable at the inception of the hedging relationship. This is because "in the Board's view, allowing hedge accounting for risk components in these circumstances would go beyond the objective of the proposed exception". However, we believe a situation exists under IAS 39 that warrants the Board to provide a relief to the separately identifiable requirement at the inception of new hedging relationships which would meet the "objective of the proposed exception". This situation arises when an entity undertakes dynamic hedging strategies. In order to apply the hedge accounting requirements under IAS 39 to these dynamic hedging strategies, including when it comes to operationalising the Portfolio Fair Value Hedge of Interest Rate Risk Model in IAS 39, it is necessary for the entity to de-designate and re-designate the hedging relationships within the portfolio at regular intervals to re-balance the portfolio for its dynamic nature. Because of this need to de-designate and re-designate at regular intervals, there is a concern that there could be a point in time when the portfolio is required to be newly re-designated for IBOR that it would not meet the separately identifiable requirement, such as in the run-up period where IBORs lose their liquidity as the market transitions to the new RFRs. The same concern is also relevant for macro cash flow hedging where a risk component or portion is hedged. Therefore, a relief would be necessary throughout the transition process to ensure the continuation of the hedging relationships for such dynamic hedging strategies.

Modification of hedge documentation

AFME notes that entities might need to change their hedge designations (and maybe therefore change their hedge documentation) from IBORs to RFRs prior to the actual replacement of IBORs. 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 it is critical that there is relief ensuring that when hedging documentation is amended to reflect the transition to RFRs, this will not be automatically viewed as a de-designation and re-designation event.

Retrospective assessment in measuring hedge accounting effectiveness

AFME notes that, per paragraph BC23 of the ED, the IASB decided not to propose any exception for the effects of the IBOR reform on 'retrospective assessments' required by IAS 39. Nevertheless, we would like to request the IASB to provide relief, in the form of a temporary suspension of the "80-125% test", in the context of the retrospective test requirements under IAS 39 for new and existing IBOR-based hedges during the period leading up to IBOR reform. This is in particular to situations where the results of effectiveness testing fall outside the 80-125% range such as where IBOR is not formally replaced but instead continues to be quoted and has become less liquid because new transactions referencing the new RFRs are picking up in volume or where either the hedged item or the hedging instrument is replaced with a new RFR at different times. This temporary relief is needed only to allow the continuation of hedge accounting (i.e. to avoid hedge accounting failures) 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.

Furthermore, we would also strongly encourage the IASB to consider how the retrospective effectiveness test should be addressed for new hedging relationships that are based on new RFRs. We note that a quantitative assessment based on the 80-125% range would be a challenge to perform during the early stage of the new RFRs due to lack of availability of historical information. 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 a presumption, that in the absence of reliable historical data points, IBORs could represent reasonable proxies for the past, however we would welcome flexibility in applying approaches to define such proxies.

Guidance for existing macro-hedges referencing IBORs

We note it is important to preparers to obtain guidance from the IASB on 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, which states that the change in fair value attributable to the hedged risk for each individual item in the group shall be expected to be approximately proportional to the overall change in fair value attributable to the hedged risk of the group of items.

Modification and derecognition of financial instruments

The contractual terms of existing financial assets and liabilities will have to be amended to reflect the alternative risk-free rates. Entities will have to assess whether such an amendment would be substantial enough to trigger derecognition of the old financial instrument and recognition of a new one (IFRS 9 3.2.3). We note that some entities have very low tolerance thresholds to define a substantial modification and other strict qualitative criteria that could trigger derecognition. It would be preferable if clarified by the IASB that any modification that is purely a move from IBOR to RFR should not constitute a derecognition event. Alternatively, it would be important to leave it to entities professional judgement and policy choice to conclude on whether the modification would trigger derecognition.

Where modification does not result in derecognition, a modification gain or loss may need to be recognised in profit or loss as the difference between the carrying amount and the present value of the revised contractual cash flows, discounted using the original effective interest rate (EIR) (IFRS 9 5.4.3). In this case it is unclear what EIR would have to be applied given the fact that he original EIR would be based on IBOR and might not be available and that IFRS 9 does not envision the change in benchmark rates. We suggest that in this case IFRS 9 B5.4.5[1] can be applied to prevent any P&L fluctuations due to recording the modification gains and losses, and we request the IASB to clarify this position.

[1] IFRS 9 B5.4.5 For floating rate financial assets and floating rate financial liabilities, periodic re-estimation of cash flows to reflect movements in market rates of interest alters the effective interest rate. If a floating rate financial asset or floating rate financial liability is recognised initially at an amount equal to the principal receivable or payable on maturity, re-estimating the future interest payments normally has no significant effect on the carrying amount of the asset or liability.