

Comment Letters
IASB
Colombus Building
7 Westferry Circus
Canary Wharf
London E14 4HD
United Kingdom
La Défense, 17th June 2019

Exposure Draft ED/2019/1: Interest Rate Benchmark Reform

Dear Hans,

Mazars welcomes the opportunity to comment on the International Accounting Standards Board's Exposure Draft (hereafter ED) Interest Rate Benchmark Reform, issued in May 2019.

The ongoing Interest Rate Benchmark Reform (hereafter IRBR) increases the uncertainty on some interest rate benchmarks such as IBOR and the related future contractual cash flows. It is going to have a significant impact all around the world. We welcome the IASB initiative to propose reliefs given this specific context and the numerous and significant potential accounting consequences. We are convinced that such reliefs are useful and needed to provide users with a faithful representation of the actual effects of risk management by entities.

We welcome the intent of the Board to address the issue in the very short term. We note the two steps approach conducted by the Board. Splitting this global issue in two parts raises some questions as there are obviously interactions between both. However, at this stage of the process, we are convinced that the best way forward is to finalise this first phase as soon as possible and start working at the same time and without waiting further on the second phase as it may be needed in 2020 at the latest, and even in 2019 in some jurisdictions.

We agree on most of the proposed reliefs. We would however like to draw the attention of the Board on 3 matters:

- The impact of the IRBR reform is not limited to interest rate derivatives but may also impact other types of derivatives such as cross currency swaps. We encourage the Board to clarify that such derivative instruments and the hedging relationships in which they are involved can also benefit from the proposed reliefs.
- The amendment proposes a relief for prospective effectiveness test. We consider that such a relief is also needed for retrospective effectiveness assessment. We agree with the Board that any actual ineffectiveness measured shall be recorded in profit or loss.

However, ineffectiveness could arise due to a difference in the timing of the modification of the hedging and the hedged instruments. In such a situation we consider that a relief is needed

61, RUE HENRI REGNAULT - 92400 COURBEVOIE - PARIS (92) FRANCE
TEL: +33 (0)1 49 97 60 00 - FAX: +33 (0)1 49 97 60 01 - www.mazars.fr

However, ineffectiveness could arise due to a difference in the timing of the modification of the hedging and the hedged instruments. In such a situation we consider that a relief is needed to allow entities to maintain hedging relationships even if, during this interim period, the actual effectiveness breaches the [80:125] threshold.

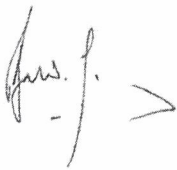
- The relevance and usefulness for users of the proposed disclosure has not been clearly demonstrated in the draft basis for conclusions. Given the IT development costs needed to fulfil temporary disclosure requirements we are not convinced by the cost benefit ratio of such a proposal.

We also draw the Board's attention on several topics to be addressed in the second phase of the project. Referring to the topics identified by EFRAG, we selected those that, in our opinion, should be prioritised.

Our detailed comments to the questions raised in the ED are set out in the Appendix.

Please do not hesitate to contact us should you want to discuss any aspect of our comment letter.

Yours sincerely,



Michel Barbet-Massin
Head of Financial Reporting Technical Support

Appendix

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.

We agree with the proposed amendments of both IAS 39 and IFRS 9 regarding the highly probable requirement and prospective assessments criteria. We consider the proposed relief of not considering the ongoing Interest Rate Benchmark Reform when assessing the prospective effectiveness of a hedge is a proper solution to ensure the continuity of hedging relationships in this transition period.

We also agree with paragraph BC22 not to change the measurement of hedge effectiveness and to maintain any hedge ineffectiveness in the statement of profit or loss, including the ineffectiveness due to the reform. This requirement combined with appropriate relief on hedge accounting eligibility criterion seems to us the best way to provide relevant and faithful information to users.

However, we draw the attention of the Board on the fact that a relief may be needed on retrospective effectiveness test as well to avoid the discontinuation of hedging relationships. We agree with the Board that any actual ineffectiveness measured shall be recorded in profit or loss. However, ineffectiveness could arise due to a difference in the timing of the contractual modification of the hedging and the hedged instruments.

We disagree with the Board assumption in paragraph BC40 that such situation is unlikely to occur. For example, one could envisage that hedging derivatives move to a new RFR index in the context of a global ISDA guidance by the end of 2019, whereas the contractual terms of the hedged loan will remain unchanged until an agreement is reached with the counterparty one or two years later. In such a situation we consider that a relief is needed to allow entities to maintain hedging relationships even if, during this interim period, the actual effectiveness breaches the [80:125] threshold. In any case, all the measured ineffectiveness will be recorded in profit or loss to avoid hiding any actual effect of the reform on the entity's cash flows but the hedging relationship should be allowed to be maintained.

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.

We agree with the proposed amendment to separately identify a designated benchmark component of interest rate risk that is not contractually specified at the inception of the hedging relationship and is affected by the reform. We think it is an efficient way to prevent immediate discontinuation of existing fair value hedges of fixed-rate financial instruments, in situations where it is known that the underlying benchmark index will disappear in the future and will not be separately identifiable throughout the duration of the hedging relationship.

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.

We agree with the proposed amendments.

We consider that a mandatory application is the appropriate solution to avoid arbitrage opportunities, as expressed in paragraph BC29. An optional application would also have been possible if used as an accounting policy choice for all hedging relationships. But we share the Board's view that the mandatory application is not expected to raise significant additional costs for preparers and will ensure comparability between entities.

We agree on the temporary nature of the proposed amendments until the uncertainty on contractual cash flows arising from interest rate benchmark reform is no longer present.

However, we would like to draw the attention of the Board on:

- the fact that this uncertainty may not disappear at the same time for the hedging instrument and the hedged item, due to the time differences that could arise in the renegotiation of those instruments (a derivative instrument may be modified earlier than a loan for example);
- the need of a transition at the end of the relief period to ensure that no unintended consequences could occur when the usual IAS 39 and IFRS 9 requirements apply again.

We encourage the Board to address explicitly such situations in the second phase of the project.

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?

We agree that specific disclosures may be relevant for entities that are concerned by the Interest Rate Benchmark Reform to point out the arising uncertainty on the hedging relationships related to IBOR components.

However, we do not share the Board's view expressed in paragraph BC44 stating that "*the cost of this disclosure proposal would not be onerous because it requires only disaggregating information that is already required to be disclosed by IFRS 7*", for the following reasons:

- the basis for conclusions of the amendment does not provide evidence of the usefulness of such split for the users;
- the disaggregation required by the amendment would be made upon a new criterion (i.e. hedging relationships for which the proposed reliefs apply) that does not currently exist under IFRS 7: such a disaggregation would cause significant modifications of the IT tools for preparers with significant costs and implementation timing;
- these disclosures would be required only temporarily, as long as there are uncertainties on hedging relationships. Hence the expected benefits from this disaggregation would be limited.

For the reasons exposed above, we would rather suggest disclosing qualitative information to explain what the main benchmark interest rates used by the entity are, the consequences of the reform on the risk management policy of the entity and if, and to which extent, the reliefs have been applied.

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.

We agree with the proposed amendment and draw the Board's attention that in some jurisdictions, the timetable for the reform could already raise issues in 2019 and lead many entities to adopt an earlier application of the amendments, which will need to be prior endorsed by local authorities when this is required by local laws. We therefore strongly support the given possibility of an earlier application and ask the Board to issue the amendments as soon as possible to make this early application possible in due time.

Issues to be addressed in phase II

We encourage the Board to identify and analyse as soon as possible the potential issues that could arise and need to be addressed in the phase II of its project ("*replacement issues*").

EFRAG has proposed a preliminary list of potential issues that could be addressed during the phase II in annex 2 of their Draft Comment Letter. We share concerns of EFRAG on the following topics and think they should be analysed in priority by the Board:

1. derecognition versus modification when the contracts will be amended to reflect the replacement of the current benchmark interest rates by the new RFR (topic 1 of the letter);
2. in case of a modification that would not lead to derecognition, the possibility to assess whether this modification could be considered as a prospective change of the effective interest rate rather than a modification gain or loss (topic 2 of the letter);
3. retrospective assessment: hedge accounting effectiveness: if not addressed in Phase I, assessing how to relieve the retrospective test (see above) (topic 3 of the letter)
4. recalibration of hedging relationships and hedge documentation: the replacement of benchmark interest rates may lead to recalibrate hedging relationships (through for example the hypothetical derivative) and generate hedge ineffectiveness, and may also require a burdensome and time-consuming update of the hedge documentation; a relief on these requirements may be needed to avoid a discontinuation of numerous hedging relationships (topics 5 and 6 of the letter);
5. accounting treatment of OCI balances at the end of relief: it will be necessary to clarify if the hedge can be continued because all or a part of the initial hedged cash flows still exist to prevent an immediate recycling of the OCI reserve in profit or loss (topic 11 of the letter).