German Banking Industry Committee

Die Deutsche
Kreditwirtschaft

Comments

IASB Exposure Draft ED/2020/1 "Interest Rate Benchmark Reform – Phase 2 Proposed amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16"

Register of Interest Representatives
Identification number in the register: 52646912360-95

Berlin, 20-05-22

The **German Banking Industry Committee** is the joint committee operated by the central associations of the German banking industry. These associations are the Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR), for the cooperative banks, the Bundesverband deutscher Banken (BdB), for the private commercial banks, the Bundesverband Öffentlicher Banken Deutschlands (VÖB), for the public-sector banks, the Deutscher Sparkassen- und Giroverband (DSGV), for the savings banks finance group, and the Verband deutscher Pfandbriefbanken (vdp), for the Pfandbrief banks. Collectively, they represent approximately 1,700 banks.

Coordinator:
National Association of German
Cooperative Banks
Schellingstraße 4 | 10785 Berlin | Germany
Telephone: +49 30 2021-0
Telefax: +49 30 2021-1900
www.die-dk.de

Comments IASB Exposure Draft ED/2020/1 "Interest Rate Benchmark Reform – Phase 2 Proposed amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16"

Question 1—Modifications of financial assets and financial liabilities (paragraphs 6.9.1–6.9.6 of the [Draft] amendments to IFRS 9, paragraphs 20R–20S and 50–51 of the [Draft] amendments to IFRS 4 and paragraphs 104–106 and C1A–C1B of the [Draft] amendments to IFRS 16)

Paragraphs 6.9.2–6.9.6 of the draft amendments to IFRS 9 propose that:

(a) a financial asset or financial liability would be modified if the basis for determining the contractual cash flows is changed after the initial recognition of the financial instrument. In this context, a modification can arise even if the contractual terms of the financial instrument are not amended.

(b) an entity would apply paragraph B5.4.5 of IFRS 9 as a practical expedient to account for a modification of a financial asset or financial liability that is required by interest rate benchmark reform.

(c) a modification is required by interest rate benchmark reform if and only if (i) it is required as a direct consequence of interest rate benchmark reform; and (ii) the new basis for determining the contractual cash flows is economically equivalent to the previous basis (ie the basis immediately preceding the modification).

(d) an entity would also apply the practical expedient proposed in paragraph 6.9.3 if an existing contractual term is activated that results in a change in the basis for determining the contractual cash flows of a financial asset or a financial liability, and particular other conditions are met.

Paragraphs BC10–BC36 of the Basis for Conclusions describe the Board's reasons for these proposals.

(e) The Exposure Draft proposes to make corresponding amendments to IFRS 4 that would require insurers applying the temporary exemption from IFRS 9 to apply the same practical expedient as described above.

(f) The Exposure Draft proposes amendments to IFRS 16 that would require entities to apply paragraph 42 of IFRS 16 to account for a lease modification that is required by interest rate benchmark reform.

Paragraphs BC39–BC41 and paragraphs BC118–BC125 of the Basis for Conclusions describe the Board's reasons for these proposals.

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 and why.

We agree with providing a practical expedient requiring an entity to apply paragraph B5.4.5 of IFRS 9 to account for modifications related to the IBOR reform. We also agree that this practical expedient should apply only when the modification is required as a direct consequence of interest rate benchmark reform and the new basis for determining the contractual cash flows is economically equivalent to the previous basis (i.e. the basis immediately preceding the modification).

However, we disagree with the Board's view to redefine, within the remit of the IBOR Project, the principle underlying 'what constitutes a modification of a financial asset or financial liability'. This relates to the extension in paragraph 6.9.2 of the ED, in particular to the last sentence of that paragraph that "a modification can arise even if the contractual terms of the financial instrument are not amended". The common understanding of what "constitutes a modification of a financial asset or financial liability' within

Comments IASB Exposure Draft ED/2020/1 "Interest Rate Benchmark Reform – Phase 2 Proposed amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16"

the IFRS systematics is well-understood and is consistently applied in practice within the banking industry. It is, therefore, our view that the IASB should not introduce the extension in paragraph 6.9.2 into IFRS 9, even if the Board intends it to limit its scope to changes made as a result of the IBOR reform as per paragraph BC20 of the ED.

The identification of a modification within the framework of the applicable IFRS regulations is based on the examination of the contractual level of a financial instrument. The starting point here is an assessment of whether the contractual terms between the parties to the contract have been changed compared with the recognition at the time of inception. In this context, we do not consider it appropriate to extend the definition of modification excessively to include changes that no longer affect the individual contractual level, but that generally concern calculation methods prescribed by law. It fundamentally calls into question the previous understanding of the concept of modification within the framework of IFRS, also with regard to further future statutory adjustments.

In the example described in paragraph 6.9.4(a) of the ED, the Board has included the situation where an IBOR reform is affected "by changing the method used to calculate the interest rate benchmark". We think the Board has achieved its intention in paragraph BC20 for the IBOR Project by this example. Therefore, we think that paragraph 6.9.2 is not necessary and should be deleted. As paragraph 6.9.2 is deleted, we note that there is a corresponding minor amendment to be made for paragraph 6.9.5 as follows:

> *6.9.5 An entity shall also apply the practical expedient in paragraph 6.9.3 if the following conditions are met even though these changes do not meet the description of a modification ~~in paragraph 6.9.2~~ (see also paragraph 6.9.6):*

Moreover, we note that deleting paragraph 6.9.2 of the ED would create consistency to paragraph 6.9.5 as the latter explicitly states that the activation of an existing contractual term that changes the bases for determining the contractual cash flows does "not meet the description of a modification".

Furthermore, we would like to add that in the example given by the IASB under IFRS 9.6.9.4 (b), we believe that the term "fixed spread" should be replaced by "market-based" spread. This gives users more scope to reflect the practices in their specific markets. A very static interpretation of the term "fixed spread" could result in disproportionate effort, which would not lead to a significant improvement in financial reporting.

Apart from that, we agree with the proposed amendments to IFRS 16 as this will increase comparability of the effects from IBOR reform since the proposed amendments to IFRS 16 will enable entities to arrive at an accounting outcome for lease liabilities of a lessee similar to the proposed amendment to apply paragraph B5.4.5 of IFRS 9 to financial instruments.

Comments IASB Exposure Draft ED/2020/1 "Interest Rate Benchmark Reform – Phase 2 Proposed amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16"

Question 2—Amendments to hedging relationships (paragraphs 6.9.7–6.9.10 of the [Draft] amendments to IFRS 9 and paragraphs 102O–102R of the [Draft] amendments to IAS 39)

Paragraphs 6.9.7–6.9.10 of the draft amendments to IFRS 9 and paragraphs 102O–102R of the draft amendment to IAS 39 propose that an entity would amend the formal designation of the hedging relationship only to make one or more of the changes specified in paragraph 6.9.7 and paragraph 102O as and when uncertainty arising from interest rate benchmark reform is no longer present with respect to the hedged risk and/or the timing and the amount of interest rate benchmark-based cash flows of the hedged item or of the hedging instrument.

Paragraphs BC42–BC50 of the Basis for Conclusions describe the Board's reasons for these proposals.

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 and why.

We agree with the Board's proposals as they would permit an entity to amend the hedge documentation to reflect the alternative benchmark rate, when the hedged items and hedging instruments are modified as a direct consequence of the IBOR reform, without requiring an entity to discontinue hedge accounting for the underlying hedging relationships.

However, we note that the permitted changes to the hedge documentation in paragraph 6.9.7 and paragraph 102O(a)–(c) of the ED are limited to the alternative benchmark rate that replaced the existing benchmark rate as described in the example of paragraph 6.9.4(a) of the ED. As the other examples in paragraph 6.9.4(b)-(d) are equally relevant, we recommend that they are also included in paragraph 6.9.7 and paragraph 102O as permitted changes to the hedge documentation to enable hedge accounting to be continued.

Furthermore, we note that when the hedging derivative designated is amended from IBOR to the new RFR plus a spread (e.g. £ LIBOR to Sonia), the hedge ineffectiveness will increase when the designated hedged risk is changed in the hedge documentation to reflect the new RFR only (i.e. without a corresponding spread). In order to mitigate this hedge ineffectiveness so that it does not lead to the hedging relationship being discontinued, we ask the Board to permit, as an exception for such hedges, the ability to designate a new RFR plus a spread as a hedged risk. This exception would apply for hedging relationships that are hedge accounted as fair value or cash flow hedges.

Question 3—Accounting for qualifying hedging relationships and groups of items (paragraphs 6.9.11–6.9.15 of the [Draft] amendments to IFRS 9 and paragraphs 102S–102X of the [Draft] amendments to IAS 39)

Paragraphs 6.9.11–6.9.15 of the draft amendments to IFRS 9 and paragraphs 102S–102X of the draft amendments to IAS 39 propose that:

(a) the requirements in IFRS 9 and IAS 39 would be applied when the designation of a hedging relationship is amended to remeasure the hedging instrument and the hedged item based on the alternative benchmark rate and recognise any resulting ineffectiveness in profit or loss.

Comments IASB Exposure Draft ED/2020/1 "Interest Rate Benchmark Reform – Phase 2 Proposed amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16"

(b) the amount accumulated in the cash flow hedge reserve at the date the entity amends the description of the hedged item would be deemed to be based on the alternative benchmark rate on which the hedged future cash flows are determined.

(c) when there is a change in the basis for determining the contractual cash flows of a financial asset or a financial liability previously designated as a hedged item in a hedging relationship that has been discontinued, the amount accumulated in the cash flow hedge reserve for the discontinued hedging relationship would be deemed to be based on the alternative benchmark rate on which the hedged future cash flows will be based.

(d) when applying paragraph 6.9.7 or paragraph 102O to groups of items designated as hedged items, the hedged items would be allocated to sub-groups within the same hedging relationship based on the benchmark rate to which they are referenced and that the proportionality test would be applied to each sub-group separately.

(e) for the purpose of assessing retrospective effectiveness as required by IAS 39, the cumulative fair value changes of the hedged item and hedging instrument would be reset to zero when paragraph 102G of IAS 39 ceases to apply.

Paragraphs BC51–BC79 of the Basis for Conclusions describe the Board's reasons for these proposals.

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 and why.

Overall, we agree with the proposed amendments. Nevertheless, we have the following concerns:

- In the case of fair value hedges, we agree that the re-measurement of both the hedging instrument and the hedged item are required at the time the hedge documentation is amended. However, in the case of cash flow hedges, we note that this might not possible as the floating rate hedged item and the hedging derivative could be amended at different points in time. As a consequence, the re-measurement would be required as and when the hedged item or the hedging instrument changes. We note in paragraph 6.9.10 of the ED that the Board has acknowledged this and as a consequence has specified that "when, and only when, such a change is made to the hedge designation, an entity shall apply paragraphs 6.9.11–6.9.17 to the extent relevant". Having this in mind, we think the IASB should clarify how paragraphs 6.9.12 and 102U of the ED should be applied for the case when the hedged item and the hedging instrument do not change at the same time.

- We agree with the Board's proposal to amend IAS 39, for the purpose of the retrospective assessment only, to reset to zero the cumulative fair value changes of the hedged item and hedging instrument when paragraph 102G of IAS 39 ceases to apply. However, we recommend that an entity should have the option to apply this 'zeroing provision' instead of making it mandatory. We point out that there are various methods for retrospective measurement, e.g. regression analysis, for which "reset to zero" is relevant and would be helpful. However, "reset to zero" may, under certain circumstances, lead to the 80%-125% threshold being exceeded, as outliers may occur in the early phase of determining the new hedged risk, while the new RFR only gains momentum over time to maintain liquidity in the market.

Comments IASB Exposure Draft ED/2020/1 "Interest Rate Benchmark Reform – Phase 2 Proposed amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16"

Question 4—Designation of risk components and portions (paragraphs 6.9.16–6.9.18 of the [Draft] amendments to IFRS 9 and paragraphs 102Y–102Z1 of the [Draft] amendments to IAS 39)

Paragraphs 6.9.16–6.9.18 of the draft amendments to IFRS 9 and paragraphs 102Y–102Z1 of the draft amendments to IAS 39 propose that:

(a) an alternative benchmark rate designated as a non-contractually specified risk component that is not separately identifiable at the date it is designated, would be deemed to have met that requirement at that date, if and only if, the entity reasonably expects the alternative benchmark rate will be separately identifiable within a period of 24 months from the date the alternative benchmark rate is designated as a risk component.

(b) if subsequently, an entity reasonably expects that the alternative benchmark rate will not be separately identifiable within 24 months from the date it was designated as a risk component, an entity would cease applying the requirement in paragraph 6.9.16 and paragraph 102Y and discontinue hedge accounting prospectively from the date of that reassessment.

Paragraphs BC87–BC97 of the Basis for Conclusions describe the Board's reasons for these proposals.

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 and why.

We support the IASB's proposal to provide temporary relief in the context of non-contractually specified risk components on the "separately identifiable" criterion as specified in paragraphs 6.9.16–6.9.18 and paragraphs 102Y–102Z1 of the ED.

Nevertheless, we are concerned with the way BC87 and BC89 were drafted in the ED. As noted by the Board in BC88, although the concepts and principles for the separately identifiable requirement are very similar between IFRS 9 and IAS 39, there are differences in wordings in IFRS 9 and IAS 39. Furthermore, the guidance in IFRS 9 is more detailed compared with IAS 39. However, by introducing guidance from IFRS 9 into the ED, we are concerned that this could have unintended consequences for the current practice under IAS 39. We therefore ask the Board to reconsider the drafting in these 2 paragraphs. For example, in BC87, the part referring to the availability of the term structure of zero coupon interest rates could be deleted as follows:

> *BC87 In developing the proposals in this Exposure Draft, the Board noted that considerations similar to those discussed in paragraphs BC80–BC82 apply to the designation of an alternative benchmark rate as a non-contractually specified risk component in either a cash flow hedge or a fair value hedge. This is because an entity's ability to conclude that the alternative benchmark rate meets the requirements in paragraphs 6.3.7(a) and B6.3.8 of IFRS 9 and paragraphs 81 and AG99F of IAS 39 that a risk component must be separately identifiable and reliably measurable could be affected in the early stages of the reform~~, when a particular market might not yet be sufficiently developed for a term structure of zero coupon interest rates to be available~~.*

Comments IASB Exposure Draft ED/2020/1 "Interest Rate Benchmark Reform – Phase 2 Proposed amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16"

Question 5—Effective date and transition (paragraphs 7.1.9 and 7.2.36–7.2.38 of the [Draft] amendments to IFRS 9 and paragraphs 108H–108J of the [Draft] amendments to IAS 39)

(a) The Exposure Draft proposes that the amendments would have an effective date of annual periods beginning on or after 1 January 2021. Earlier application would be permitted.

(b) The Exposure Draft proposes that the amendments would be applied retrospectively in accordance with IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors, except as specified in (ii) below. An entity would:

(i) reinstate a discontinued hedging relationship if and only if the entity discontinued that hedging relationship solely due to changes required by interest rate benchmark reform and, therefore, the entity would not have been required to discontinue that hedging relationship if the amendments had been applied at that time.

(ii) not be required to restate prior periods to reflect the application of these amendments. However, the entity may restate prior periods if, and only if, it is possible without the use of hindsight.

Paragraphs BC110–BC115 of the Basis for Conclusions describe the Board's reasons for these proposals.

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. However, with regards to the proposed requirement to reinstate a discontinued hedging relationship in paragraph 7.2.37 and paragraph 108I of the ED, we recommend that the Board explicitly states in the requirement that a discontinued hedging relationship is reinstated only if it is practicable to do so. This impracticability to reinstate a discontinued hedging relationship could arise when:

- the hedging derivative or the hedged item from the discontinued hedging relationship is re-designated in another new hedging relationship, or
- the hedging derivative may be terminated upon discontinuation as part of the entity's on-going Asset-Liability-Management activities.

Question 6—Disclosures (paragraphs 24I–24J and paragraphs 44HH–44II of [Draft] amendments to IFRS 7)

The Exposure Draft proposes that entities provide specific disclosures in order to provide information about:

(a) the nature and extent of risks arising from interest rate benchmark reform to which the entity is exposed, and how it manages those risks; and

(b) the entity's progress in completing the transition from interest rate benchmarks to alternative benchmark rates, and how the entity is managing that transition.

Paragraphs BC105–BC109 of the Basis for Conclusions describe the Board's reasons for this proposal.

Comments IASB Exposure Draft ED/2020/1 "Interest Rate Benchmark Reform – Phase 2 Proposed amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16"

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

We agree that additional disclosures on the IBOR reform would be needed to assist users of financial statements in understanding the effects of the IBOR reform. However, we also believe that the disclosures to be provided should be proportionate and not extensive.

It should be clarified that the population of financial instruments referred to in the proposed disclosures in paragraph 24J(b) of IFRS 7 are only on those instruments where its contracts are still not yet amended to replace the existing IBOR with the new RFR as of the reporting date. In this context, we understand that financial instrument contracts referencing EURIBOR, which has been successfully transitioned in 2019, are out of scope.

It is not clear in the proposed disclosures in paragraph 24J(c), what is meant by the term "base rate" and hence how to do the assessment required in the proposed disclosures. We also note that providing the proposed disclosures could lead to boiler-plate disclosures. As these proposed disclosures are not entity-specific, we question their usefulness to users of financial statements.