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25 May 2020

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Ref: **2020/O/C1/IASB/MS/60**

RE: ED/2020/1 – Interest Rate Benchmark Reform – Phase 2

Dear International Accounting Standards Board Members:

The International Organization of Securities Commissions (IOSCO) Committee on Issuer Accounting, Auditing, and Disclosure (Committee 1) thanks you for the opportunity to provide our comments regarding the International Accounting Standards Board's (IASB or the Board) Exposure Draft: *Interest Rate Benchmark Reform – Phase 2* (the Exposure Draft).

IOSCO is committed to promoting the integrity of the international markets through promotion of high quality accounting standards, including rigorous application and enforcement. Members of Committee 1 seek to further IOSCO's mission through thoughtful consideration of accounting and disclosure concerns and pursuit of improved transparency of global financial reporting. The comments we have provided herein reflect the general consensus among the members of Committee 1 and are not intended to include all of the comments that might be provided by individual securities regulator members on behalf of their respective jurisdictions.

General Observations

We fully support the IASB's initiative to provide a timely response to the potential financial reporting impacts of interest rate benchmark reform, thereby facilitating entities' modification of financial instruments and hedging instruments as existing interest rate benchmarks near their respective sunset dates.

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Particularly, we support the mandatory application of the proposed amendments. This should result in greater consistency in reporting the impacts of interest rate benchmark reform and increased comparability across entities. Furthermore, mandatory application obviates the need for the Board to establish a sunset date for the expedients. We also agree with the Board's proposed effective date and believe application in annual periods beginning on or after 1 January 2021 is consistent with the Board's objective to support preparers in applying IFRS standards as they make changes to contractual cash flows or hedging relationships as a result of changes made in response to interest rate benchmark reform.

We agree with the Board's expectation that alternative reference rate markets may not develop uniformly across different jurisdictions. As such, different entities will likely make changes to contractual cash flows or hedging relationships at different times throughout the transition period. Because of this, we agree with the Board's decision to allow entities to early adopt the amendments, but, as described in our response to Question 5, we believe additional clarity is needed to ensure early application is reflected consistently in accordance with the Board's intent.

We agree with the Board's decision to limit the scope of the proposed amendments to changes made as a result of interest rate benchmark reform. However, we have some concerns with the clarity and operability of the two conditions set forth in paragraph 6.9.3 that must be met for a modification to be considered required by the reform, and thus eligible for the practical expedient. More specifically, we believe the concept of economic equivalence may be difficult to apply in practice. Applying the guidance as proposed will require entities to make certain judgments. Without further clarification, we believe entities could reach different conclusions in their evaluation of changes to contractual cash flows resulting in reduced consistency and comparability of financial reporting (see our response to Question 1).

Finally, we agree with the Board that discontinuation of hedge accounting solely due to the effects of interest rate benchmark reform would not always provide useful information to users of the financial statements. While we agree with the proposed accommodations for changes to hedging relationships, we acknowledge that there continues to be uncertainty around the development of alternative rate markets, which could impact an entity's assessment of whether certain components are separately identifiable. As such, we encourage the Board to continue to monitor the transition to alternative rates across various markets and be prepared and willing to adjust the proposed 24-month sunset period for this assessment as necessary.

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Our detailed feedback on each section of the Exposure Draft is provided below.

Responses to the Board's Questions

Question 1

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 is 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.

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Question 1 ***(continued)***

(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 to make 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.

Response:

Committee members generally agree with the proposals, specifically with the Board's intent to limit the scope of the proposed amendments to changes in the basis for determining the contractual cash flows of financial assets and financial liabilities as a result of the reform, to lease modifications required by the reform, and to hedging relationships as specified in paragraphs 6.9.7, 6.9.18, 102O or 102Z1 of the Exposure Draft. Members also agree with the Board's view that the same accounting would be applied to a change in the basis for determining the contractual cash flows even when the contractual terms of the financial instrument are not amended (such as when existing fallback language is triggered). Members agree with the Board that doing so would reflect the economic substance of the change and provide useful information to financial statement users.

While members agree with the proposed scope of the amendments, some members believe the structure of paragraphs 6.9.2 through 6.9.6 is unnecessarily complex, and they encourage the Board to simplify the structure so that the scope of the amendments is more easily understood. Specifically, these members note that the description of a modification spans several paragraphs (6.9.2, 6.9.3, 6.9.5), certain of which also include the explanation of the practical expedient. Members also highlight that while paragraph 6.9.2 states that "a modification can arise even if

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the contractual terms of the financial instrument are not amended," paragraph 6.9.5 subsequently discusses activation of an existing contractual term and clearly states this type of change does not meet the description of a modification for purposes of applying the proposed amendments. Paragraph 6.9.5 goes on to indicate that notwithstanding the fact that these changes are not considered modifications, they are nevertheless eligible for the practical expedient provided they are required by interest rate benchmark reform. For some members, the proposed language within these paragraphs appears inconsistent and the Board's intention for making this distinction is not clear, particularly since we understand that the scope of the practical expedient ultimately does apply to these changes, as discussed in paragraph BC118.

While members support the overall approach in limiting the scope of the amendments, some members suggest the Board strengthen the language in paragraph BC9 to specifically state that the amendments cannot be applied by analogy to any other facts and circumstances. These members believe this is especially important given the current circumstances related to the COVID-19 global pandemic, which has prompted entities to consider making changes to existing contracts, unrelated to interest rate benchmark reform.

Committee members understand the Board's desire to limit the scope of the relief provided by paragraph 6.9.3 of the proposed amendments to IFRS 9. The Exposure Draft describes this scope as "modifications required by interest rate benchmark reform" which is defined by two conditions: (1) the modification is required as a direct consequence of interest rate benchmark reform and (2) the new basis for determining the contractual cash flows is economically equivalent to the previous basis (i.e., the basis immediately preceding the modification). Some committee members believe that application of the proposed language in the qualifying conditions is unclear, which could result in different interpretations as to whether certain changes qualify for the practical expedient proposed in paragraph 6.9.3.

The Board has included examples of modifications required by interest rate benchmark reform in paragraph 6.9.4 of the proposed amendments, and members believe these will be helpful for entities in evaluating whether changes meet the required conditions. However, some members believe it would also be helpful to include examples of modifications that would not meet the required conditions, particularly if there are specific changes the Board does not believe should qualify for the practical expedient. These examples could provide further clarity for reporting entities and help avoid potential diversity in practice. Absent additional guidance or further clarification, members believe diversity in application could arise.

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Some members also question the extent of evidence or support entities would be expected to provide in order to assert that certain modifications meet the conditions outlined in paragraph 6.9.3. These members believe it is not clear whether the Board has a presumption that certain changes would meet the conditions or whether entities will need to explicitly support this assertion in each situation. Specifically as it relates to the concept of economic equivalence, the language in paragraph BC29 indicates that this means the contractual cash flows of the financial instrument are "substantially similar" before and after the modification. It is not clear, however, whether (a) the Board intends for entities to prepare an assessment to demonstrate cash flows are economically equivalent and (b) if so, whether the assessment should be qualitative or quantitative. Some members believe that if the Board expects such an assessment, it should provide additional guidance regarding acceptable approaches for management to support this assertion. Furthermore, some members questioned how effectively entities will be able to perform the economic equivalence evaluation, particularly for changes that occur during the early stages of transition to alternative rates when relevant markets have not yet sufficiently developed. In paragraph BC95, the Board acknowledges diversity in both approach and timing for expected replacement of interest rate benchmark rates across various jurisdictions. If the Board expects entities will need to explicitly support that modifications are economically equivalent, this assessment could be particularly challenging in the early stages of reference rate transition.

We note that paragraph BC29 explains that a modification would be economically equivalent if an existing rate is replaced with a new benchmark rate plus a fixed spread. In the absence of a developed market for the replacement rate, entities will be required to make judgments in determining an appropriate spread, and different entities may make different judgments regarding economic equivalence. To further illustrate this point, assume the benchmark rate in an existing contract is IBOR plus 200 basis points. When replacing the benchmark rate, one entity may use an alternative rate plus a spread of 300 basis points, while another may use the same alternative rate plus a spread of 400 basis points. Some members do not believe the proposed language provides a sufficient basis to evaluate the appropriateness of each of these fact patterns. Some may take a view that both are acceptable because they each represent an alternative benchmark rate plus a fixed spread, consistent with the example in paragraph 6.9.4(b) and BC29 of the proposed amendments. Others, considering the differing information in the marketplace, may conclude that it would not be possible for the contractual cash flows before and after the modification to be substantially similar in both fact patterns; thus, neither (or perhaps only one but not both) of the changes would be economically equivalent.

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Question 2

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 of 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.

Response:

Committee members generally agree with the proposals related to hedge documentation changes when uncertainty from interest rate benchmark reform is no longer present with respect to the hedged risk and/or the timing and amount of cash flows of the hedged item or the hedging instrument.

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Question 3

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 proposed 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 recognize any resulting ineffectiveness in profit or loss.

(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 items 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 of 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.

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Response:

Committee members generally agree with the proposals related to remeasurement of the hedged item and hedging instrument at the time the hedge documentation is amended as a result of amendments to the hedging relationship.

Some members, however, question whether the accounting described in paragraphs 6.9.11 and 6.9.12 is consistent with the principles described in paragraphs 6.9.7 and 6.9.10. Paragraph 6.9.7 lists possible hedge documentation amendments that could be required as a result of interest rate benchmark reform, including changes to the hedged risk, description of the hedged item or description of the hedging instrument. The Board acknowledges that changes to the hedged item and the hedging instrument may not always occur simultaneously, such that there could be instances in which one instrument may be updated to reflect an alternative benchmark rate while the other instrument continues to reference the original benchmark rate for some period of time. This is seen in paragraph 6.9.10 which states "an entity may amend the formal designation of different hedging relationships at different times or may amend the formal designation of a particular hedging relationship more than once." Paragraphs 6.9.11 and 6.9.12, however, seem to require an entity to remeasure both the hedging instrument and the hedged item upon any amendment to hedge designation (i.e., even if only one of the items in the hedging relationship has been changed). As such, it is not clear how an entity should apply the proposals in paragraphs 6.9.11 and 6.9.12 (as applicable) when only one item in a hedging relationship is amended. Members encourage the Board to resolve this inconsistency or to provide further clarity with respect to how the hedge accounting proposals should be applied together when the hedging instrument and hedged item are amended at different points in time.

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Question 4

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 if 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.

Response:

Committee members generally agree with the proposals related to the designation of risk components. Specifically, members agree that a clearly defined end point for the assessment of whether an alternative benchmark rate will be separately identifiable is necessary given the temporary nature of the proposed amendment. Members understand the Board's reasons for determining the proposed 24-month period to be appropriate for this relief (as discussed in paragraph BC94), particularly during the early stages of the transition to alternative benchmark rates.

However, Committee members acknowledge that there continues to be a high level of uncertainty related to when sufficiently liquid alternative rate markets will be established, particularly in light of market disruption caused by the COVID-19 global pandemic. As such, it may be helpful for the Board to continue to monitor the ongoing development of alternative rate markets and to be prepared to adjust the sunset period for the separately identifiable assessment as necessary, particularly if markets develop more slowly than currently is expected.

Question 5

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

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Response:

Committee members generally agree with the proposed effective date of the amendments and believe it is important to provide timely guidance that can be applied as interest rate benchmark reform begins to impact existing contracts. We continue to highlight the importance of finalizing the proposed amendments as quickly as possible so that entities will have sufficient time to implement the proposals.

While the proposed amendments would have an effective date of annual periods beginning on or after 1 January 2021, earlier application would be permitted. Certain members believe that further clarification is needed for entities that choose to adopt the amendments earlier. Entities that have already begun to modify financial assets and financial liabilities that are within the scope of the proposed amendments, may want to early adopt the amendments during an interim period. Guidance on early adoption of the proposed amendments is limited in the Exposure Draft and currently only requires an entity to disclose the fact it is applying the amendments for an earlier period. Further, the proposals do not require an entity to restate prior periods to reflect application of the amendments.

The Board's expectations of how an entity should apply the requirements of IAS 8 and the proposed amendments in an earlier period are currently unclear. For example, assume a calendar-year entity elects to apply the amendments in the period in which they are issued (e.g., 2020) but that entity has issued interim financial information prior to the issuance and adoption of the practical expedient. How does the Board expect the entity to present the impacts of the amendments? Would the Board expect the amendments to be reflected as of the beginning of the first period in which the entity applies the guidance (likely this would be at the beginning of an interim period)? Alternatively, should the amendments be reflected as of the beginning of the annual period in which the entity adopts the new guidance, which could be prior to when the final amendments were issued and could require changes to the entity's previous accounting? If the Board has a specific view on transition for early application, it would be helpful to include as part of the transition guidance to limit diversity in practice and ensure early application is reflected consistently in accordance with the Board's intent.

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Question 6

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.

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

Response:

Committee members generally agree with the proposed disclosures related to interest rate benchmark reform. Some members, however, question whether the proposed disclosures required by paragraph 24J(c) of IFRS 7 will be sufficiently specific for each entity. As such, the Board may want to consider adding a disclosure objective for situations where an entity is making use of the expedient(s) available in this proposal.

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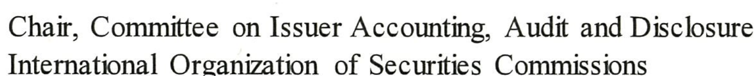
We appreciate your thoughtful consideration of the responses provided in this letter. If you have any questions or need additional information, please do not hesitate to contact Cameron McInnis, Chairman of the Accounting Subcommittee of Committee 1, at +1 416-593-3675 or myself. In case of any written communication, please mark a copy to me.

Sincerely,



Makoto Sonoda

Chair, Committee on Issuer Accounting, Audit and Disclosure
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