International Accounting Standards Board
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Stockholm 8 June 2020

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

FAR, the Institute for the Accountancy Profession in Sweden, is responding to your invitation to comment on the above Exposure Draft.

Attached is FAR´s comments to certain questions. FAR comments are related to specific areas identified.

Yours sincerely,

Pernilla Lundqvist
Chairman Accounting Practices Committee

Question 1 – Modifications of financial assets and financial liabilities (paragraphs 6.9.1–6.9.6 of the [Draft] amendments):

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

Question 1(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.

The practical expedient described in 6.9.3 to apply paragraph B5.4.5 of IFRS 9 is applicable to both financial assets and liabilities that are modified as a result of interest benchmark reform. Paragraph 6.9.2 includes in the concept of a modification any changes in cash flows due to changes in how an interest benchmark is calculated, also in situations when the terms of the financial instruments have not been modified. FAR agrees that as these changes in cash flows are a result of interest benchmark reform and should thus be covered by the practical expedient to apply B5.4.5. However FAR believes that labelling changes to the calculation of the benchmark index as a modification of the financial assets and liabilities that are not a result of modification of the terms of the contract, is to expand the concept of modification that may have unintended consequences. FAR therefore suggests that the last sentence of 6.9.2 is deleted and that the basis for conclusions are amended to clearly state that "for the avoidance of doubt" changes in cash flows due to how benchmarks are calculated and which do not require changes to the contractual terms of financial instruments are eligible for the application of B5.4.5.

Question 1(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.

FAR agrees with the proposed amendment

Question 1(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 (i.e. the basis immediately preceding the modification).

FAR agrees with the proposed amendment but suggests that in 6.9.3 (a) the words "is required as a direct consequence" is replaced with "is required to be made as a consequence of". It will be difficult to demonstrate a direct consequence in situations where for example regulators may be applying pressure to move to other benchmarks, but no formal requirement is issued, or if the market allows a choice between different alternative benchmarks. This may for instance be the case when there is no formal requirement, but there are commercial reasons to change the applied benchmark rate in a certain type of contract.

Question 1(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.

FAR agrees with the proposed amendment

Question 1(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.

FAR agrees with the proposed amendment

Question 1(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.

FAR agrees with the proposed amendment

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 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 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.

FAR agrees with the proposed amendment allowing hedge designation to be amended once the uncertainty from the interest rate benchmark reform is no longer present. We believe however that requiring the amendment to be done "as and when" the uncertainty disappears is too restrictive and put undue operational burden on the preparers. There is otherwise a risk for a too literary interpretation which may result in irrelevant outcome, seen from the perspective of the objective of hedge accounting as expressed in IFRS 9.6.1.1. It should be sufficient if the hedge documentation is updated before the next financial report prepared under IFRS is issued.

We also believe that there may situations where other changes than those described in 6.9.7 (a-c) will be made as a consequence of an interest rate benchmark reform (for instance changes to reset dates, spreads or hedge ratios). We therefore suggest that 6.9.7 (a-c) are described as being examples rather than a comprehensive list.

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 propose that:

Question 3(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.

If the terms of the hedging instrument are amended so that the terms are equivalent, this should practically mean that the fair value of the derivative is the same as before the modification of the cash-flows of the derivative. Alternatively, the derivative has a different value, but one of the parties had to compensate the other party by for instance a partial cash-settlement to ensure the equivalence. Either way there should be no net impact to profit or loss resulting from the modification of the derivative.

If no amendments were to be made in IFRS 9 and IAS 39 with regards to fair value hedges, the fair value hedge would need to be discontinued and an adjustment to be made of the effective interest rate of the hedged item. Also, the hedge relationship would be re-designated. Neither of these two activities would mean a "day one effect" created by the de-designation and re-designation exercise. Paragraph 6.9.11 may in practice potentially mean that there is a "day-one" effect from the introduction of the new or revised benchmark rate when both (a) the hedging instrument as well as (b) the carrying amount of the hedged item is remeasured. FAR believes spreading this potential impact over the remaining life of the instrument in the same manner as for a discontinued hedge relationship would be more consistent with how de-designations of fair value hedge relations otherwise are accounted for.

Question 3(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.

FAR agrees with the proposed amendment

Question 3(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 is continued hedging relationship would be deemed to be based on the alternative benchmark rate on which the hedged future cash flows will be based.

FAR agrees with the proposed amendment

Question 3(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.

FAR agrees with the proposed amendment

Question 3(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.

FAR believes that it may be operationally complex for many entities to reset the cumulative fair value changes to zero and would thus propose that an entity is not required but may reset the cumulative fair value changes to zero.

Question 4 – Designation of risk components and portions

Question 4(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.

FAR agrees with the proposed amendment

Question 4(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.

FAR agrees with the proposed amendment

Question 5 – Effective date and transition

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 application would be permitted.

FAR agrees with the proposed amendment

Question 5 (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.

FAR agrees with the proposed amendment