



Basel Committee on Banking Supervision

BANK FOR INTERNATIONAL SETTLEMENTS

Chairman

Via email: commentletters@ifrs.org

Mr Hans Hoogervorst
Chairman
International Accounting Standards Board
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17 June 2019

Exposure Draft: Interest Rate Benchmark Reform

Dear Mr Hoogervorst

The Basel Committee on Banking Supervision (the Committee) welcomes the opportunity to comment on the International Accounting Standards Board's (IASB) Exposure Draft (ED) *Interest Rate Benchmark Reform*.

The Committee supports the development of high-quality accounting standards, as accounting information generally forms the starting point for the Committee's prudential capital framework. Financial information that is relevant and faithfully represents the substance of transactions or other events helps to promote the safety and soundness of the financial system. Accounting treatments regarding issues that may arise from benchmark reform are important for most banks, given that the interest rates subject to reform are widely used in a large volume and broad range of financial products and contracts. Thus, the reform may impact not only individual banks but also the financial system as a whole. The Committee comments on the ED from that perspective.

We support the proposals in the ED, which relate to "pre-replacement" issues. We agree with the Board that, if a position in which hedging relationships currently subject to hedge accounting were to become ineligible for that treatment solely because of the uncertainties regarding benchmark reform, this would not provide useful information to users of financial statements. Accordingly, we urge the Board to finalise the proposals in the ED swiftly once the comment period has ended. Jurisdictions need time to bring the amendments to IAS 39 and IFRS 9 into effect for the 2019 year-end. The annex to this letter sets out our responses to the specific questions in the ED.

The ED states that the Board intends to monitor developments relevant to identifying "replacement issues" – arising from the actual replacement of a benchmark interest rate with an alternative benchmark – in order to assess the potential implications for financial reporting and determine what action, if any, would be appropriate. We strongly believe that these Phase II efforts must be accelerated, as it is vitally important that the IASB promptly responds to "actual" replacement issues. We acknowledge that, at present, there is a range of uncertainties regarding how benchmark reform will be implemented. However, in our view enough is already known about actual or possible fact patterns to allow the IASB to start working

immediately on replacement issues – although this work should not slow down finalisation of the IASB's work on pre-replacement issues.

In that regard, we note that the relevant regulator has stated that it will not require panel banks to submit LIBOR quotes beyond year-end 2021. This means that clarity as to the financial reporting implications of benchmark reform is needed as early as possible.

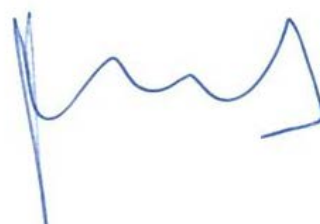
While we have not at this stage sought to identify a comprehensive list of replacement issues, in our view many of these accounting issues are likely to prove complex and require time to resolve, for example:

- **Hedge accounting.** The issue is whether a change in the benchmark rate for the hedged item or hedging instrument leads to discontinuation of a hedge-accounted relationship.
- **Fair value.** As replacement proceeds, some benchmark rates may become less liquid and less observable, and this could affect reporting of assets under the fair value hierarchy.
- **Modification and derecognition.** Particularly in view of the very large number of contracts which will be affected by benchmark reform, additional guidance may be needed regarding the interaction of benchmark reform and the accounting standard requirements for modification and derecognition. We note that, amongst other things, derecognition of a financial asset followed by recognition of a new financial asset in its place would entail the reperformance of the Solely Payments of Principal and Interest (SPPI) test.

Benchmark reform is a global issue, which is being coordinated by the Financial Stability Board's Official Sector Steering Group. In that context, we encourage standard setters to work in a coordinated way to develop solutions to issues associated with benchmark reform to the extent that doing so is compatible with the need for standard setters to respond promptly to any accounting issues benchmark reform might create. We further emphasise the importance of the IASB conducting outreach on replacement issues to national accounting standard setters, relevant regulators and market participants. Such outreach would provide the IASB with a full picture of how benchmark reform is being taken forward in different markets, and therefore of the full set of financial reporting implications which may arise.

We hope you find our comments constructive and helpful. This letter has been prepared by the Committee's Accounting Experts Group, chaired by Fernando Vargas Bahamonde, Associate Director General of the Bank of Spain. If you have any questions regarding these comments, please contact Mr Vargas (+34 913 38 61 04), Ian Michael, Chair of the IBOR Drafting Team (+44 20 3461 8795) or Ruby Garg at the Basel Committee Secretariat (+41 61 280 8463).

Yours sincerely

A handwritten signature in blue ink, consisting of a series of connected loops and a vertical line on the left, representing the name Pablo Hernández de Cos.

Pablo Hernández de Cos

Annex

Responses to questions in the ED

1. **Highly probable requirement and prospective assessments**

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 proposals. Given the current uncertainties about how benchmark rates will change, the proposed amendments to IAS 39 and IFRS 9 would reduce the potential for hedge de-designation resulting solely from benchmark interest rate (IBOR) reforms.

We believe that it would be helpful to include Application Guidance which, for the avoidance of doubt, addresses timing issues if rates applicable to the hedged item and the hedging instrument in a hedging relationship change in different periods. This guidance could be drawn from the discussion in *Basis for Conclusions* paragraph BC31.

2. **Designating a component of an item as the hedged item**

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 proposal. However, we are concerned that the language used in paragraphs 6.8.7 (IFRS 9) and 102G (IAS 39) could be read to include the inception of new hedges once the uncertainties due to benchmark reform are no longer present. We recommend that the clarification that this is not the case currently included in paragraph BC27 be included in paragraphs 6.8.7 and 102G (or put in Application Guidance). As noted for our response to question 1, we believe guidance should address hedging relationships in which replacement rate adoption occurs in different periods for the hedged item and the hedging instrument.

3. **Mandatory application and end of application**

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 mandatory approach for the reasons identified by the Board.

We believe that, for the avoidance of doubt, the Board should clarify explicitly that:

- The proposal must be applied to new hedge accounting relationships entered into after the effective date of the amendment, but before uncertainty is no longer present, and not just to legacy positions created prior to the effective date; and
- Other than in respect of benchmark reform, nothing in the proposal amends the existing rules in IAS 39 and IFRS 9 relating to revocation of hedge accounting.

In our view, the discussion of End of Application in the *Basis for Conclusions* contains useful guidance, and we recommend placing some of this material (especially paragraphs BC34–BC41) in Application Guidance. However, we urge the Board to consider whether removal of uncertainties regarding the timing and amount of cash flows should be closely linked to actual amendment of contracts. It is possible to envisage situations in which uncertainty is substantively removed ahead of the

amendment of contracts. For example, if a market consensus has clearly arisen regarding how benchmark reform should be implemented for a particular class of financial instrument, uncertainty is removed whether or not the contracts affected have been amended. We recommend clarifying that the scenarios in paragraphs BC35–BC39 are intended to illustrate the principles underlying end of application, and to analyse the most common fact patterns, but they are not intended to be an exhaustive description of all the circumstances in which uncertainties arising from benchmark reform regarding the timing and amount of cash flows would no longer be present.

4. **Disclosures**

Do you agree with these proposed disclosures? Why or why not? If not, what disclosures would you propose and why?

We broadly agree with the proposal. However, we recommend that the applicable scope of the proposed disclosure be clarified. The proposal requires separate disclosures for hedging relationships to which any aspect of the proposal applies. However, it may not be fully clear which hedging relationships fall within that scope as benchmark reforms are implemented.

For instance, in the case of a hedging relationship involving a LIBOR rate which matures before the end of 2021, some preparers may argue that there is no uncertainty prior to year-end 2021 and deem the relationship to be outside the scope of the proposal. Alternatively, other preparers might assert that there is uncertainty about the timing and amount of the LIBOR-related cash flows even before the end of 2021, albeit perhaps limited, and therefore deem the relationship to be covered by the proposal. Thus, it may be appropriate to require an entity to disclose the criteria and any key judgments applied in determining to which hedging relationships they have applied the proposal.

5. **Effective date and transition**

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 these proposals. An early effective date is necessary to provide certainty for the 2019 year-end. We support an effective date of 1 January 2020 accompanied by permission to adopt earlier, for application in annual accounts for year-end 2019.