



Basel Committee on Banking Supervision

BANK FOR INTERNATIONAL SETTLEMENTS

Chairman

Via email: commentletters@ifrs.org

Mr Hans Hoogervorst
Chairman
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Exposure Draft: Interest Rate Benchmark Reform – Phase 2

Dear Mr Hogervorst

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 – Phase 2*.

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 on a large scale and for a 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's comments on the ED are from this perspective.

We strongly support the proposals in the ED, which relate to the "replacement" issues that arise as legacy benchmark interest rates are replaced by alternative rates. The Committee agrees with the IASB's objective of seeking to ensure that entities are enabled to continue to provide useful information during the period of transition to alternative benchmark rates and, overall, considers that the proposals in the ED will achieve that objective. We agree that the amendments to IFRS should apply only temporarily, during the period of benchmark reform, and relate only to changes which are a direct consequence of the reform, and implemented on an economically equivalent basis. We have identified only four, limited aspects of the proposal, listed below, which we believe would benefit from further consideration.

In view of the very large number of outstanding contracts which will need to be amended, the Committee agrees with the IASB that it is appropriate to provide the proposed practical expedient for accounting for modifications of financial assets and liabilities required by the reform. We share the Board's view (at BC30) that the practical expedient will deliver similar accounting outcomes compared to applying

the normal principles for accounting for re-estimating cash flows for floating-rate financial instruments set out in IFRS 9. Our response to the proposals in this ED does not prejudice any view the Committee may have on a future IASB proposal on modifications (as mentioned in BC20).

The Committee also agrees with the Board that discontinuing hedge accounting solely due to the effects of benchmark reform would not always reflect the economics of the changes and so would not always provide useful information to users of financial statements (BC46). We support the changes to the hedge accounting requirements in IAS 39 and IFRS 9 which the IASB is proposing in order to address that issue.

Finally, we agree that users are likely to find the disclosures about the impact of benchmark reform on an entity useful and support the intent behind the proposed amendments to IFRS 7.

As noted above, we have identified four, limited areas of the proposals where we believe some reconsideration would be beneficial:

- **Separately identifiable risk components.** Our understanding of the analysis presented in BC87-BC97 (especially BC93) is that early in the life of a new benchmark a risk component may not be separately identifiable but might, even so, be reliably measurable. However, in our opinion the *Basis for Conclusions* does not make the interplay between these two concepts sufficiently clear, and it may be helpful for the IASB to expand on this issue, and provide one or more examples, in order to clarify the Board's intention. For instance, an example could be developed around a situation in which the impact of a new benchmark rate on the fair value of a financial instrument is reliably measurable even though the new benchmark has not yet become a component of the pricing of such an instrument that is widely accepted in the market.
- **Reinstatement of discontinued hedge accounting relationships.** The ED envisages that where a hedging relationship has been discontinued solely due to interest rate benchmark reform, once the amendments are effective the relationship would be required to be reinstated retrospectively. We appreciate that mandatory retrospective reinstatement promotes consistency and prevents cherry picking. However, such reinstatement could impose a significant operational burden on banks, and we believe the IASB should consider whether entities should be given the option of whether to reinstate retrospectively or not. Cherry picking could be minimised by requiring the chosen approach to be applied to all hedge accounting relationships within the scope of the ED.

Additionally, we are not clear how the proposed approach would interface with the option to revoke a hedge accounting designation in IAS 39: 91(c) and IAS 39: 101(d). Would it be possible for a preparer that wished to avoid reinstatement to do so by revoking the designation?

- **Disclosures.** We agree with the approach taken in the ED of identifying objectives for the proposed disclosures followed by specified disclosures framed to meet those objectives. However, we are concerned that, as drafted, the list of disclosures set out in IFRS 7 [draft] paragraph 24J could be read as an exhaustive list of everything required to meet the disclosure

objectives – whereas in some circumstances additional disclosures may be needed in order to meet those objectives. This concern could be addressed by expressing the list in paragraph 24J – which is a useful and important supplement to the basic disclosure objectives – at a slightly higher level as four sub-objectives.

Regarding disclosures relating to the fair value hierarchy set out in IFRS 13, we agree with the IASB (BC133) that a reclassification due to certain interest rate benchmarks becoming less observable would reflect a real economic difference. However, as interest rate benchmark reform is a discrete and large-scale process, we believe that IFRS 13 should be amended to require disclosure of the amount of Level 3 financial instruments which are assigned to that Level wholly or largely because of benchmark reform. While it is arguable that such a disclosure would be mandated by the existing requirements of IFRS 13 (especially paragraphs 92-95), we believe that an explicit requirement is necessary to avoid excessive diversity of practice. We recognise that producing such a disclosure might require a degree of judgement on the part of preparers, but we believe that is outweighed by the likely deep interest in the extent to which movements in the volume of Level 3 instruments are due to the impact of benchmark reform.

- **End of application.** While acknowledging the IASB's view that the amendments will have a natural end (BC100), we believe that the IASB should periodically review whether they are still required.

We urge the IASB to finalise its work on Phase 2 as soon as possible, as the timetable for the benchmark reform process is short. For example, the relevant regulator has continued to state 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 soon as possible. Additionally, jurisdictions need time to bring the amendments to IAS 39 and IFRSs 4, 7, 9 and 16 into effect for the 2020 year-end.

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 Puneet Pancholy at the Basel Committee Secretariat (+41 61 280 8673).

Yours sincerely



Pablo Hernández de Cos