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International Accounting Standards Board
Columbus Building
7 Westferry Circus, Canary Wharf
London E14 4HD
United Kingdom

Dear Sirs:

Re: Interest Rate Benchmark Reform (ED/2019/1)

This letter is the response of the [Canadian Accounting Standards Board](http://www.frascanada.ca) (AcSB) to the International Accounting Standards Board's (IASB) Exposure Draft, "Interest Rate Benchmark Reform" (Proposed amendments to IFRS 9 and IAS 39)", issued in May 2019.

Our process

As part of our due process for these proposals, we consulted with members of our [IFRS® Discussion Group](#), [Insurance Transition Resource Group](#) and the Canadian Bankers Association. We considered the results of these discussions when developing this letter.

Our views

We commend the IASB's work to proactively respond to the global interest rate benchmark reform (the IBOR Reform). We support the IASB's decision to provide relief to the forward-looking aspect of the hedged accounting requirements in the first phase of this project. This relief will ensure the continuation of hedge accounting during the period when the specific timing and amount of future cash flows is still uncertain. We understand this uncertainty will be resolved when the transition between the IBOR to the alternative interest benchmark rate is complete. The IASB will then be in a better position to address other effects on financial reporting from the IBOR Reform.

Nevertheless, we think some of the project issues in Phase 2, such as the retrospective assessment and the recycling of the accumulated other comprehensive income balance, are closely related to the issues in the first phase and should be addressed as soon as possible. We have separately identified some of these closely related issues in our response documented in [Appendix 1](#). Furthermore, given the effect on the financial markets, we strongly recommend the IASB continue to work on addressing issues, to the extent possible, in the second phase of the project concurrently without causing delays to the finalization of Phase 1. To bring awareness of potential issues to the IASB, we have separately elaborated on Phase 2 issues in [Appendix 2](#).

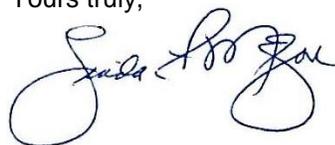
Given the urgency and the impact of the project, we support an effective date as proposed, for periods beginning on or after 1 January 2020. In finalizing the proposals, the IASB should consider the endorsement processes in Canada and other jurisdictions around the world. Before entities can apply a new IFRS in Canada, it must be incorporated into our Handbook, which also requires translation. The timely issuance will help jurisdictions in finalizing the incorporation of the amendments into their local accounting regimes.

Our response to your questions

[Appendix 1](#) to this letter responds to the questions posted in the Exposure Draft and expands on the points raised above. [Appendix 2](#) to this letter provides some issues our stakeholders would like the IASB to address in Phase 2 of the Project.

We would be pleased to elaborate on our comments in more detail if you require. If so, please contact me or, alternatively Katharine Christopoulos, Senior Principal, Accounting Standards (+1 416 204-3270 or email kchristopoulos@acsbcanada.ca), or Sean Wang, Principal, Accounting Standards (+1 416 204-2969 or email swang@acsbcanada.ca).

Yours truly,



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About the Canadian Accounting Standards Board

We are an independent body with the legal authority to establish accounting standards for use by all Canadian publicly accountable enterprises, private enterprises, not-for-profit organizations and pension plans in the private sector. We are comprised of a full-time Chair and volunteer members from a variety of backgrounds, including financial statement users, preparers, auditors and academics; a full-time staff complement supports our work.

Our standards

We have adopted IFRS[®] Standards as issued by the IASB for publicly accountable enterprises. Canadian securities legislation permits the use of U.S. GAAP in place of IFRS Standards in certain circumstances. We support a shared goal among global standard setters of high-quality accounting standards that result in comparable financial reporting outcomes regardless of the GAAP framework applied.

We developed separate sets of accounting standards for private enterprises, not-for-profit organizations and pension plans. Pension plans are required to use the applicable set of standards. Private enterprises and not-for-profit organizations can elect to apply either the set of standards developed for them, or IFRS Standards as applied by publicly accountable enterprises.

Our role vis-à-vis IFRS Standards

Our responsibility to establish Canadian GAAP necessitates an endorsement process for IFRS Standards. We evaluate and rely on the integrity of the IASB's due process as a whole, and monitor its application in practice. In addition, we perform our own due process activities for each new or amended IFRS Standard to ensure that the standard is appropriate for application in Canada. We reach out to Canadians on the IASB's proposals to understand and consider their views before deciding whether to endorse a final IFRS Standard. A final standard is available for use in Canada only after we have endorsed it as Canadian GAAP.

APPENDIX 1

Question 1 [paragraphs 6.8.4–6.8.6 of IFRS 9 and paragraphs 102D–102F of IAS 39]

Highly probable requirement and prospective assessments

For hedges of interest rate risk that are affected by interest rate benchmark reform, the Board proposes amendments to IFRS 9 and IAS 39 as described below.

- a. For the reasons set out in paragraphs BC8–BC15, the Board proposes exceptions for determining whether a forecast transaction is highly probable or whether it is no longer expected to occur. Specifically, the Exposure Draft proposes that an entity would apply those requirements assuming that the interest rate benchmark on which the hedged cash flows are based is not altered as a result of interest rate benchmark reform.
- b. For the reasons set out in paragraphs BC16–BC23, the Board proposes exceptions to the hedge accounting requirements in IFRS 9 and IAS 39 so that an entity would assume that the interest rate benchmark on which the hedged cash flows are based, and/or the interest rate benchmark on which the cash flows of the hedging instrument are based, are not altered as a result of interest rate benchmark reform when the entity determines whether:
 - (i) there is an economic relationship between the hedged item and the hedging instrument applying IFRS 9; or
 - (ii) the hedge is expected to be highly effective in achieving offsetting applying IAS 39.

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.

1. We agree with providing relief to the highly probable requirement and prospective assessments from the effects of the IBOR Reform. This relief will ensure the entity can continue to meet the forward-looking hedge accounting requirements in the periods amid the uncertainties from the IBOR Reform.
2. However, we are concerned with the IASB's decision to limit the relief to hedging relationships of interest rate risk only. We believe hedges of foreign currency risk can also be impacted by the IBOR Reform. For example, an entity can use a floating-for-floating cross currency interest rate swap (hedging instrument) to convert a floating-rate, foreign-currency-denominated loan (hedged item) into a floating-rate, functional currency loan. This relationship can qualify as a fair value hedge of foreign currency risk. The floating rates, commonly based on IBOR, are components in both the hedged item and the hedging instrument. Absent any relief, the uncertainty of the future cash flows based on IBOR will cause a failure in the prospective assessment, leading to the discontinuation of hedge accounting. Therefore, we recommend the IASB consider extending the scope of the relief to hedges of other risks in which the hedging instruments and hedged items have IBOR components.

Replacement Issues to be address in Phase 2

3. We believe further relief should be considered regarding the IAS 39 retrospective assessment. In addition to the prospective assessment, IAS 39 requires an ongoing retrospective effectiveness test having the actual results of the hedge be within a range of 80-125 percent to continue qualifying for hedge accounting. The valuation uncertainties due to the IBOR Reform and the potential timing mismatch in the IBOR replacement can cause the actual results to be outside the range, causing the discontinuation of hedge accounting. Considering the largest financial institutions in Canada all have elected to apply hedge accounting under IAS 39, the impact of discontinuation of hedge accounting is significant. Therefore, we recommend the IASB to prioritize this issue in the second phase of the project. We further elaborate on these retrospective assessment issues in [Appendix 2](#).

Question 2 [paragraph 6.8.7 of IFRS 9 and paragraph 102G of IAS 39]
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Designating a component of an item as the hedged item
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<p>For the reasons set out in paragraphs BC24–BC27, the Board proposes amendments to the hedge accounting requirements in IFRS 9 and IAS 39 for hedges of the benchmark component of interest rate risk that is not contractually specified and that is affected by interest rate benchmark reform. Specifically, for such hedges, the Exposure Draft proposes that an entity applies the requirement—that the designated risk component or designated portion is separately identifiable—only at the inception of the hedging relationship.</p>
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<p>Do you agree with this proposal? Why or why not? If you disagree with the proposal, please explain what you propose instead and why.</p>

4. We agree with this proposal. The proposal will ensure the eligibility of previously designated non-contractually specified risk components as a hedged item remain unchanged as the Reform progresses.
5. During the initial period of the transition from IBOR to the new benchmark rate, the new benchmark rate can still be developing in the financial market. Therefore, a lack of historical data or market activity may prevent the new benchmark rate from being separately identifiable to be an eligible hedged item. If the new benchmark rate will ultimately replace the existing IBOR, we think relief on the separately identifiable criterion is necessary. This relief will allow the new benchmark rate as a non-contractually specified risk component to be an eligible hedged item in the period when the benchmark is developing the liquidity.

Question 3 [paragraphs 6.8.8–6.8.10 of IFRS 9 and paragraphs 102H–102J of IAS 39]

Mandatory application and end of application

- a. For the reasons set out in paragraphs BC28–BC31, the Board proposes that the exceptions are mandatory. As a result, entities would be required to apply the proposed exceptions to all hedging relationships that are affected by interest rate benchmark reform.
- b. For the reasons set out in paragraphs BC32–BC42, the Board proposes that the exceptions would apply for a limited period. Specifically, an entity would prospectively cease applying the proposed amendments at the earlier of:
 - (i) when the uncertainty arising from interest rate benchmark reform is no longer present with respect to the timing and the amount of the interest rate benchmark-based cash flows; and
 - (ii) when the hedging relationship is discontinued, or if paragraph 6.8.9 of IFRS 9 or paragraph 102I of IAS 39 applies, when the entire amount accumulated in the cash flow hedge reserve with respect to that hedging relationship is reclassified to profit or loss.
- c. For the reasons set out in paragraph BC43, the Board is not proposing an end of application in relation to the separate identification requirement.

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.

6. We agree with the mandatory application of the amendments to all hedging relationships that are affected by IBOR for the reasons provided in paragraphs BC28-BC31 of the Basis for Conclusions.
7. We agree with the proposal that the relief included in the Exposure Draft would apply for a limited period until the uncertainty of the reform is resolved. We agree that there would be no end of application in relation to the separate identification requirement for the reasons provided in paragraphs BC32-BC43 of the Basis for Conclusions.

Replacement Issues to be addressed in Phase 2

8. We believe further relief and clarification are needed in the next phase of the project regarding the retrospective test requirement when the relief for hedged items and the hedging instruments end at different times. This issue is listed in [Appendix 2](#).

Question 4 [paragraph 6.8.11 of IFRS 9 and paragraph 102K of IAS 39]

Disclosures

For the reasons set out in paragraph BC44, the Board proposes that entities provide specific disclosures about the extent to which their hedging relationships are affected by the proposed amendments.

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

9. We agree with the proposed disclosures for the reasons set out in paragraph BC44 of the Basis for Conclusions.

Question 5 [paragraphs 7.1.9 and 7.2.26(d) of IFRS 9 and paragraph 108G of IAS 39]

Effective date and transition

For the reasons set out in paragraphs BC45–BC47, the Board proposes that the amendments would have an effective date of annual periods beginning on or after 1 January 2020. Earlier application would be permitted. The Board proposes that the amendments would be applied retrospectively. No specific transition provisions are proposed.

Do you agree with these proposals? Why or why not? If you disagree with the proposals, please explain what you propose instead and why.

10. Given the urgency and the impact of the project, we support an effective date as proposed, for periods beginning on or after 1 January 2020. In finalizing the proposals, the IASB should consider the endorsement process in Canada and other jurisdictions around the world. The timely issuance will help jurisdictions in finalizing the incorporation of the amendments into their local accounting regimes.
11. Considering the endorsement process in Canada, the proposals need to be translated and endorsed by the AcSB before the amendments are included into the Canadian Handbook and can be applied by our stakeholders. Getting this done by January 1, 2020 will be challenging, but it won't be possible if there is any delay at all in issuing the final amendments.

Appendix 2- Potential issues to consider in the second phase of the Project

As noted in our cover letter, we recommend the IASB continue to work on addressing the issues in Phase 2 of the IBOR Reform project now to the extent possible, without causing delays to the finalization of Phase 1. During our outreach, we are informed of many issues that our stakeholders believe should be addressed in Phase 2. We have summarized them into two categories: Hedge Accounting and Other Issues.

Hedge Accounting

Retrospective Assessment

12. In addition to the prospective test, Paragraph AG105 in the Application Guidance to IAS 39 requires an ongoing retrospective effectiveness test in order to continue hedge accounting. To continue hedge accounting, the effective hedge result must be between 80 to 125 percent. During the transition from IBOR to the new benchmark rate, the valuation uncertainties and the timing mismatch can result in the hedged results falling outside of the range. We outlined three scenarios below to highlight the need for transitional relief in this aspect:
 - a. During the transitional period in which the IBOR-based hedges have not been replaced by the new benchmark rate: although the IBOR rate is still quoted in the market, the liquidity of the IBOR has significantly deteriorated. This could lead to the hedge result being outside of the acceptable range.
 - b. In the initial period when the market is still developing liquidity for the new benchmark rate: an entity may encounter difficulties collecting enough historical data to perform the retrospective assessment.
 - c. The benchmark rates for hedged item and the hedging instrument may transition at different times: the mismatch in timing will result in a difference in cash flows used to measure hedge effectiveness material enough to be outside of the acceptable range.
13. We recommend the IASB provide relief to the 80 to 125 percent range to accommodate the differences in the transition timing and decrease in liquidity due to the IBOR Reform. To be clear, we believe the relief is only necessary to continue hedge accounting, not to change the measurement of hedge ineffectiveness. The hedge ineffectiveness should continue to be reported in profit or loss.
14. To address the lack of historical data issue, we think the IASB should permit entities to change the effectiveness test methodology or data inputs without causing a de-designation of the hedging relationship due to insufficient historical data.
15. Considering the largest financial institutions in Canada have elected to continue to apply hedge accounting under IAS 39 and the impact of the retrospective test on the continuation of hedge accounting, we recommend the IASB prioritize addressing this issue in the second phase of the project.

Recycle of accumulated other comprehensive income (AOCI) balances when the relief ends

16. When the uncertainty regarding the timing and amount of the IBOR based cash flow is no longer present, the relief ends. If hedge accounting is discontinued at the end of the relief because the forecasted IBOR based cash flow will not be probable to occur, the effective portion of the hedging relationship recorded in AOCI would be recycled immediately to profit or loss. This accounting result appears to undo what the relief has achieved in the first phase of the project. We think the IASB should provide further guidance on the timing of releasing the effective portion of the hedge from AOCI to profit or loss.

Hedge Documentation

17. The discontinuation of IBORs may require redefining the hedge risk in the hedge documentation to reference to new benchmark interest rates. This will result in a discontinuation of hedge accounting in accordance with paragraph B6.5.26(a) of the Application Guidance of IFRS 9 and paragraph 88(b) of IAS 39. When the hedging relationship based on the new benchmark interest rate is re-designated, the hedging instrument based on the new interest rate will have a non-zero fair value at the re-designation date, causing significant hedge ineffectiveness. We think relief may be necessary to avoid de-designating the hedging relationship if the entity can clearly demonstrate the intention to hedge the benchmark interest risk.

Other Issues

Modification vs. Derecognition

18. In the process of the transition from IBOR to the alternative interest rate, the contractual terms for financial instruments (both financial assets and financial liabilities) may be modified by the insertion of permanent fallback provisions. We question whether this insertion of the fallback provisions constitutes a contractual amendment. If so, further analysis is required to assess whether this modification meets the derecognition condition under IFRS 9 and IAS 39.

Classification and measurement of debt instruments

19. When the modification of the benchmark interest rate leads to derecognition, the existing financial asset classified as amortized cost or fair value through OCI is derecognized and a new financial asset is recognized. The IASB should further clarify whether the new financial asset can continue to meet the business model test of “held for collection of cash flows” or “held for collection of cash flows and sale”.

Fair value measurement

20. IBOR is often used as the benchmark to the discount rate used to measure fair value beyond financial instruments. IFRS 13 *Fair Value Measurement* requires the maximum use of observable market

inputs. Due to the decreased liquidity of the IBORs, the IBORs may no longer be used by market participants even before the actual replacement in the contract. We encourage the IASB to provide additional guidance related to addressing the disclosure impacts of the IBOR Reform more broadly in the next phase of the project.