14 June 2019

International Accounting Standards Board
Columbus Building
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Canary Wharf
London E14 4HD
United Kingdom
Email: commentletters@ifrs.org

Dear Sir/ Madam

**SAICA SUBMISSION ON ED/2019/1 – *INTEREST RATE BENCHMARK REFORM*: PROPOSED AMENDMENTS TO IFRS 9 AND IAS 39**

In response to your request for comments on ED/2019/1 – *Interest Rate Benchmark Reform:* Proposed Amendments to IFRS 9 and IAS 39, attached is the comment letter prepared by the South African Institute of Chartered Accountants (SAICA). This comment letter results from deliberations of SAICA's Accounting Practices Committee (APC), which comprises members from reporting organisations, regulators, auditors, IFRS specialists, investment analysts and academics.

We thank you for the opportunity to provide comments on this exposure draft.

Please do not hesitate to contact us should you wish to discuss any of our comments.

**Ahmed Mohammadali-Haji**
**Chairperson: APC**

**Bongeka Nodada**
**Project Director: Financial Reporting Standards**

## GENERAL COMMENTS

We welcome the proposed amendments to IFRS 9 – *Financial Instruments* and IAS 39 – *Financial Instruments: Recognition and Measurement* as these will provide relief for entities and resolve the pre-replacement issues.

We generally supportive of the proposed amendment. However, the wording in the Exposure Draft seems to imply that the scope of the proposed amendments is limited to the existing interest rate benchmarks which are specified in the Financial Stability Board's July 2014 report 'Reforming Major Interest Rate Benchmarks' (FSB report) such as LIBOR, TIBOR and EURIBOR. We believe that this is not the objective of the Exposure Draft as the proposals would apply equally to interest rate benchmarks that are subject to similar types of reforms as envisaged in the FSB report and recommend that the clarification be provided in the final amendments.

Furthermore, it was noted that the scope is limited to hedges of interest rate risk and this limitation could potentially not resolve all pre-replacement issues. We, therefore, suggest that the International Accounting Standards Board (Board) consider whether the scope should be widened to include all hedges where the valuation of the hedged item or hedging instrument would be impacted by the interest rate benchmark reform.

While, we note that the Exposure Draft does not address the replacement issues, the committee's view is that these issues are also important to consider. Therefore, we would support the Board undertaking some work to determine the financial reporting implications (uncertainties) that could arise when the existing interest rate benchmarks are replaced. These include but are not limited to:

- the replacement of the existing interest rate benchmark. The question is whether the replacement of the existing interest rate benchmark result in substantial modifications of the terms of the financial asset or financial liability.
- the impact on hedge relationships.
- the impact on fair value measurement and disclosures.

The responses to the specific questions are outlined below.

## SPECIFIC COMMENTS

**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.*

We agree with the proposals as the proposed exception will address the pre-replacement issues specifically around the existing requirements within IFRS 9 and IAS 39 to assess on an ongoing basis and determine whether the hedge has been highly effective throughout the financial reporting periods for which the hedge was designated.

Whilst also in agreement with the proposals, we recommend that the board provide relief from requiring a hedge to be highly effective both retrospectively and prospectively under IAS 39 (the so-called 80-125% test). The proposals only set out relief from the prospective hedge effectiveness test. This effectiveness test requirement under IAS 39 could then be replaced, for those hedges within the scope of the reform exemption, with a requirement to demonstrate consistently the existence of an economic relationship between the hedged item and the hedging instrument instead of the hedge ratio requirements.

Furthermore, a minority of the committee's constituents are concerned that the publication of the proposed amendments in its final form could set a precedent in the future that whenever uncertainty of a similar nature arises then this would be addressed in the similar manner.

**Question 2 [paragraph 6.8.7 of IFRS 9 and paragraph 102G of IAS 39]**
***Designating a component of an item as the hedged item***

*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.*

*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 are not opposed to the proposed amendment. However, some constituents do not believe this needs to be stated as the requirement for a designated risk component or designated portion of a risk component to be is separately identifiable at inception of a hedge relationship already exists.

**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.*

We agree with the proposals.

Paragraph 6.8.8 states *"…(a) 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…"*(emphasis added). The use of the wording "is no longer present" appears to establish a high threshold for discontinuing hedge accounting. We believe that this may result in inappropriate outcomes where the impact of the reform can already be determined with a high degree of certainty. For example, if an entity knows with reasonable certainty that it would amend the terms of the hedged item to an alternative reference rate, but would not amend the hedging instrument, there may not be an ongoing economic relationship/the hedge relationship may not be highly effective. In these circumstances, the ED may require the entity to continue applying hedge accounting to this relationship, even though it would ordinarily fail the requirements for hedge effectiveness. We recommend adjusting the wording so that the use of the reform exemption is discontinued once an entity has, for example, reasonable certainty regarding the resolution of the uncertainties which arise from the interest rate reform.

**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?*

IFRS 7 – *Financial Instruments* provides disclosure requirements for financial instruments that are useful to users of financial statements whereas IFRS 9 sets out the recognition and measurement requirements for financial instruments. In light of this, the rationale for positioning the proposed disclosure within IFRS 9 and IAS 39 is unclear and recommend that the Board provide reasons for incorporating these disclosures in IFRS 9 and IAS 39 as opposed to IFRS 7.

In addition, it is not clear from the wording in the Exposure Draft as to the nature and extent of the information that entities will be required to provide. We recommend that the Board consider clarifying these either through an illustrative example or by amending the wording in the proposed disclosures such that the requirements are less ambiguous. From the current wording, it is unclear whether the Exposure Draft is requiring entities to separate the hedge accounting disclosure between those that are impacted by the reform and those that are not impacted and/or no longer impacted.

**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.*

We are unclear as to what is meant by 'applied retrospectively' in this context as the proposals (BC46) indicate that the retrospective application would not permit an entity to reinstate hedge accounting that has already been discontinued. Therefore, we suggest that, if the retrospective application remains, the BC's should provide guidance on how these amendment are to be applied retrospectively. However as an alternative to the retrospective application, we recommend that entities be required to prospectively apply these amendments to all open hedges at the effective date of the amendments to avoid confusion and doubt.

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