

Accounting Standards Board of Japan (ASBJ)

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Comments on the Exposure Draft *Interest Rate Benchmark Reform* **(Proposed amendments to IFRS 9 and IAS 39)**

1. The Accounting Standards Board of Japan (the “ASBJ” or “we”) welcome the opportunity to provide our comments on the International Accounting Standards Board (“IASB”)’s Exposure Draft *Interest Rate Benchmark Reform* (Proposed amendments to IFRS 9 and IAS 39) (the “ED”), issued in May 2019.
2. We believe that the role of accounting standards is to portray the entity’s transactions and other economic events, and thus should not be developed with the intention to influence that entity’s behaviour. In this regard, developing accounting standards before sufficient information regarding the changes resulting from the interest rate benchmark reform and the responses of the financial institutions to those changes are obtained, generally speaking, would be challenging.
3. At the same time, we think it would be unreasonable for entities to be required to discontinue hedge accounting that would otherwise qualify for hedge accounting, solely due to the uncertainties arising from the interest rate benchmark reform, when there is no change in substance. We also acknowledge that there are certain needs for clarification on how existing standards should be interpreted or for relief. Nevertheless, in principle, transactions that would be subject to relief should be limited to transactions whose substance has not changed. This is because providing

relief to the hedging relationships that would not qualify for hedge accounting due to the changes in their substance could lead to inappropriate accounting.

4. The IASB noted that it would respond to the interest rate benchmark reform in two separate phases, that is, Phase 1 (pre-replacement issues) and Phase 2 (replacement issues). It would be challenging to evaluate the appropriateness of the scope of the transactions that would be provided relief in Phase 1 because sufficient information regarding the changes resulting from the interest rate benchmark reform and the responses of the financial institutions to those changes have not been obtained. Nevertheless, discontinuing hedge accounting under the current situation may not provide useful information and, therefore, we do not disagree with the proposals in the ED.
5. However, when working on Phase 2, we believe that the IASB needs to consider, in a timely manner, whether it would be appropriate to provide clarification on how existing standards should be interpreted or to provide relief, taking into consideration whether it has obtained sufficient information regarding the changes resulting from the interest rate benchmark reform and the responses of the financial institutions to those changes.
6. For our other comments on the specific questions to the ED, please refer to the Appendix of this letter.
7. We hope our comments are helpful for the IASB's consideration in the future. If you have any questions, please feel free to contact us.

Yours sincerely,



Atsushi Kogasaka

Chair

Accounting Standards Board of Japan

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. As described in the main part of this letter, we do not disagree with the proposals because discontinuing hedge accounting under the current situation may not provide useful information.

However, in the future, when the uncertainties regarding the interest rate benchmark on which the hedged cash flows or the cash flows of the hedging instrument are based are sufficiently reduced (for example, when the alternative rates for each contract can

be identified), we believe that the IASB needs to consider, in a timely manner, whether it would be appropriate to provide clarification on how existing standards should be interpreted or to provide relief, from the viewpoint of whether such clarification or relief would represent the new economic substance within the financial statements appropriately.

If the IASB were to provide any relief, we believe that the IASB will need to consider the contents and the scope of such relief carefully. For example, the IASB will need to sufficiently consider how to consider any deviations from the identified items (such as the hedging instrument, the hedged item, or the nature of the risk being hedged) in the formal designation and documentation at inception of the hedging relationship.

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.

2. We agree with the proposals in the ED for the reasons described in paragraphs BC24–BC27.

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.

Mandatory versus voluntary application

3. As described later at the end of paragraph 6 of this Appendix, we agree with the proposal.
4. We understand that the purpose of this ED is intended to provide temporary relief to hedging relationships that may have been discontinued solely due to the uncertainties regarding the interest rate benchmark reform, if the IASB had not addressed this issue. In other words, our understanding is that the proposals in the ED are based on the premise that, hedge accounting may be discontinued following the existing general guidance, in the absence of the proposed exceptions.
5. Generally speaking, exceptions to general guidance are introduced with the acknowledgement that exceptions may lead to financial information that is less relevant or less representationally faithful (or both). In this context, requiring the

use of exceptions and not permitting the use of the general guidance may lead to requiring entities to provide financial information that is less useful.

6. However, if the exception were not made to be mandatory, this may lead to selective discontinuation of hedge accounting on a contract-by-contract or entity-by-entity basis, as described in the Basis for Conclusions of the ED. The objective of hedge accounting is to represent the effect of an entity's risk management activities in the financial statements. We are concerned that certain hedge relationships may be discontinued when there is no change in the risk management activities, because that would be inconsistent with the objective of hedge accounting.

On balance, we agree with the proposal to require entities to apply the exceptions to all hedging relationships affected by the interest rate benchmark reform.

End of application

7. We agree with the proposals in the ED for the reasons described in paragraphs BC32-BC42.
8. However, regarding the end of application for the separately identifiable exception, we propose to describe explicitly in the main part of the standards that "the exception is no longer applicable only when the hedging relationship is discontinued," although it is described in paragraph BC43.

Question 4 [paragraph 6.8.11 of IFRS 9 and paragraph 102K of IAS 39]
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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 proposals in the ED for the reasons described in paragraph BC44.

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. We agree with the proposals in the ED for the reasons described in paragraphs BC45–BC47.