

## STAFF PAPER

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Project	IBOR Reform and its Effects on Financial Reporting—Phase 2		
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CONTACT(S)	Iliriana Feka	<a href="mailto:ifeka@ifrs.org">ifeka@ifrs.org</a>	+44 (0) 20 7246 6482
	Elizabeth Figgie	<a href="mailto:efiggie@ifrs.org">efiggie@ifrs.org</a>	+44 (0) 20 7246 6410
	Riana Wiesner	<a href="mailto:rwiesner@ifrs.org">rwiesner@ifrs.org</a>	+44 (0) 20 7246 6412
	Christos Sortsis	<a href="mailto:csortsis@ifrs.org">csortsis@ifrs.org</a>	+44 (0) 20 7246 6964

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## 1. Introduction

1. The International Accounting Standards Board (Board) published the Exposure Draft *Interest Rate Benchmark Reform—Phase 2 (Proposed Amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16)* (Exposure Draft) on 9 April 2020. The 45-day comment period closed on 25 May 2020.
2. This paper provides feedback analysis for question 6 of the Exposure Draft, which relates to the proposed amendments to IFRS 7 *Financial Instruments: Disclosures* for additional disclosures related to interest rate benchmark reform (the reform). The feedback received comprises feedback from both comment letters and additional outreach with users of financial statements (investors).
3. This paper is structured as follows:
  - (a) Summary of staff recommendations (Section 2);
  - (b) Feedback received and staff analysis (Section 3); and
  - (c) Question for the Board (Section 4).
4. This paper has one appendix: Appendix A—Analysis of other comments.

## 2. Summary of staff recommendations

5. We recommend that the Board finalise the proposed disclosures in paragraphs 24I-24J of the Exposure Draft subject to the following two changes:
- (a) Amend paragraph 24J(b) to require disclosure of quantitative information<sup>1</sup> about non-derivative financial assets, non-derivative financial liabilities and derivatives (each shown separately) that, at the end of the reporting period, remain referenced to interest rate benchmarks subject to the reform. This information would be disaggregated by significant interest rate benchmark. For the purposes of this disclosure, an entity would choose the representative basis for disclosing the quantitative information and explain the basis applied in the financial statements. Examples of possible basis for providing this quantitative information are described in paragraph 29 of this paper.
  - (b) Delete the proposed disclosure in paragraph 24J(c) of the Exposure Draft.

## 3. Feedback received and staff analysis

6. This section provides:
- (a) the disclosure proposals in the Exposure Draft (paragraph 7);
  - (b) a summary of feedback from investors (paragraphs 8-11);
  - (c) a summary of feedback from comment letters (paragraphs 12-21); and
  - (d) staff analysis and recommendations (paragraphs 22-34).

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<sup>1</sup> This information would replace the proposal in the Exposure Draft requiring disclosure of the carrying amount of non-derivative financial assets, the carrying amount of non-derivative financial liabilities and the nominal amount of derivatives.

### **3.1 Proposals in the Exposure Draft**

7. Paragraphs 24I and 24J of the Exposure Draft proposed the following:
- 24I To enable users of financial statements to understand the effect of interest rate benchmark reform on an entity's financial instruments and risk management, an entity shall disclose information about:
- (a) the nature and extent of risks arising from interest rate benchmark reform to which the entity is exposed, and how the entity manages those risks; and
  - (b) the entity's progress in completing the transition from interest rate benchmarks to alternative benchmark rates, and how the entity is managing that transition.
- 24J To meet the objectives in paragraph 24I, an entity shall disclose:
- (a) how the entity is managing the transition to alternative benchmark rates, its progress at the reporting date and the risks arising from the transition;
  - (b) disaggregated by significant interest rate benchmark, the carrying amount of non-derivative financial assets, the carrying amount of non-derivative financial liabilities and the nominal amount of derivatives, each shown separately, that continue to reference interest rate benchmarks subject to interest rate benchmark reform;
  - (c) for each significant alternative benchmark rate to which the entity is exposed, a description of how the entity determined the base rate and relevant adjustments to that rate, including any significant judgements the entity made to assess whether the conditions in paragraphs 6.9.3 and 6.9.5(b)–6.9.5(c) of the draft amendments to IFRS 9 proposed in the Exposure Draft were met; and
  - (d) to the extent that interest rate benchmark reform has resulted in changes to an entity's risk management strategy, a description of those changes and of how the entity is managing these risks.

### **3.2 Feedback from investors**

8. The Board did not receive any comment letter from investors. However, the staff conducted outreach meetings with a few investors and participants of the Banking sub-group of the Corporate Reporting Users Forum (Banking CRUF) to discuss the proposed disclosures. In addition, the staff obtained feedback on the proposed

disclosures from Capital Markets Advisory Committee (CMAC) members. In the following paragraphs of this paper we collectively refer to the participants in these meetings as ‘investors’.

9. Investors supported the Board’s objective to assist preparers in applying IFRS Standards, and understood the need for the relief proposed in the Exposure Draft, when changes are made to contractual cash flows or hedging relationships, as a result of the transition to alternative benchmark rates while also ensuring that entities continue to provide useful information to investors.
10. Investors were primarily concerned that entities would make substantial changes to the contractual terms of affected financial instruments—ie changes in addition to changes required by the reform—and apply the Board’s proposed amendments to account for such additional changes. In this context, they highlighted the importance of faithfully representing in the financial statements the economic effects of a change in the basis for determining the contractual cash flows of a financial asset or financial liability. A few investors explicitly supported:
  - (a) the proposed conditions in paragraphs 6.9.3 and 6.9.5(b)-6.9.5(c) of the Exposure Draft, which limit the population of changes to which entities would apply the proposed practical expedient;
  - (b) mandatory application of all proposed amendments; and
  - (c) application of existing requirements in IFRS Standards to changes made to financial instruments and hedging relationships other than those required by the reform.
11. Almost all investors supported the disclosure objectives proposed in paragraph 24I. They also broadly agreed with the proposed disclosures in paragraph 24J except for the following comments:
  - (a) the proposed disclosures are primarily qualitative in nature and therefore, there is a risk that entities will provide only ‘boilerplate’ disclosures. Nonetheless, investors understood the Board’s reasons for deciding to propose such disclosures (as described in paragraphs BC105-BC109 of the Basis for Conclusions on the Exposure Draft) and agreed those proposals are appropriate given the regulatory framework of the reform

and the temporary nature of the proposed amendments. A few investors explicitly said that since IFRS Standards do not generally require entities to disclose information about financial instruments disaggregated by interest rate benchmarks, requiring more quantitative information about alternative benchmark rates may not be justified—therefore, they agreed with the extent of quantitative information proposed on the Exposure Draft.

- (b) the quantitative information required by paragraph 24J(b) would be a useful measure of an entity’s progress in the reform. Such quantitative data would be a subset of the amounts already presented in an entity’s relevant financial statement line items, therefore they do not expect the information to be reconciled; consequently, investors said they would agree with an approach whereby entities choose the most representative basis on which to disclose the quantitative data.
- (c) expressed mixed views on the disclosure proposed in paragraph 24J(c). While some investors said this disclosure could be useful for the reason noted in paragraph 10 of this paper (as long as the information disclosed is sufficient for that assessment), many investors:
  - (i) questioned whether entities would disclose information with sufficient granularity for it to be meaningful—they said there is a risk that the disclosures would be summarised at such a level that it would not be useful;
  - (ii) said they would regard a requirement for an entity to explain how it has determined that it met the conditions to apply the practical expedient proposed in paragraph 6.9.3 to be an audit or regulatory enforcement matter, rather than a matter for disclosure in the financial statements; and
  - (iii) said they would use this information indirectly, for example, to assess if different entities used different approaches to effect the reform of an interest rate benchmark (eg if the disclosed fixed spread adjustments for the same alternative benchmark rate significantly differ between different entities).

### **3.3 Feedback from comment letters**

12. Almost all respondents supported the disclosure objectives proposed in paragraph 24I of the Exposure Draft. Respondents said these objectives would help entities provide useful information to investors.
13. These respondents also broadly agreed with the disclosure requirements set out in paragraph 24J of the Exposure Draft for the reasons that the Board described in paragraphs BC105-BC109 of the Basis for Conclusions on the Exposure Draft. However, many respondents suggested the Board clarify or reconsider the proposed disclosures in paragraph 24J(b) or 24J(c), or aspects of those disclosures. In the following paragraphs we provide further details about those comments.

#### *Disclosure of comparative information*

14. Many respondents asked the Board to specify that the proposed disclosures—particularly the quantitative information proposed in paragraph 24J(b)—would not be required for the comparative period unless the entity restates comparative periods. These respondents said the costs of providing such information would outweigh the benefits. In particular, they said the information for the comparative period would not be useful to investors because in the comparative period they would have either not started, or be in early stages, of effecting the reform; and preparing this information could be challenging—particularly if an entity applies the amendments earlier than the effective date, ie in 2020.

#### *Possible improvements to paragraph 24J(b)*

15. Respondents generally agreed that providing quantitative information to help investors understand the extent of financial instruments that are yet to transition to alternative benchmark rates is useful and would helpfully supplement the narrative disclosure proposed in paragraph 24J(a) of the Exposure Draft that would require an entity to describe its progress towards effecting the reform. However, some respondents said that IFRS Standards do not currently require entities to disclose information about financial instruments that reference variable rates disaggregated by interest rate benchmarks. Also, while in some cases such information might be available and consistent with information already required by regulators, in other cases, it could require entities to make costly enhancements to reporting systems

and implement additional controls and reconciliations; which in the light of a limited timeframe, could be challenging for preparers to do, in particular early adopters.

16. These respondents suggested the Board permit entities to disclose quantitative information in alternative ways—for example, if the information that would be required by proposed disclosure in paragraph 24J(b) would not be available without undue cost or effort, entities would be permitted to disclose quantitative information used internally in managing the reform.
17. A few respondents also suggested the Board clarify that the scope of the proposed disclosure in paragraph 24J(b) would not apply to financial instruments which, at reporting date, reference interest rate benchmarks subject to the reform but will mature prior to transitioning to alternative benchmark rates.

*Reconsider paragraph 24J(c)*

18. Many respondents said that they understood the Board's reasons for proposing the disclosure in paragraph 24J(c) of the Exposure Draft and investors' desire to understand how an entity effected the reform. However, these respondents said that in light of the regulatory nature of the reform, entities might be unable to provide this information in a way that would be sufficiently granular and entity-specific for it to be useful to investors.
19. These respondents said the fact that an entity has applied the practical expedient would automatically inform investors that the entity has assessed that the conditions in paragraphs 6.9.3 and 6.9.5(b)–6.9.5(c) of the Exposure Draft were met. Also, these respondents said if applying those conditions required significant judgement, paragraph 122 of IAS 1 *Presentation of Financial Statements* would require an entity to disclose those judgements.<sup>2</sup>
20. Respondents often described the potential challenges in disclosing this information in a meaningful way by reference to multinational entities that are exposed to different alternative benchmark rates. For example, they said, disclosing

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<sup>2</sup> Paragraph 122 of IAS 1 states that an entity shall disclose, along with its significant accounting policies or other notes, the judgements, apart from those involving estimations, that management has made in the process of applying the entity's accounting policies and that have the most significant effect on the amounts recognised in the financial statements.

information about the fixed spread adjustments for the different rates and different jurisdictions may not be meaningful without disaggregating that information between operating segments (eg corporate or retail) or geographic regions. However, the costs of providing information in this level of granularity could outweigh its benefits for investors.

21. A few other respondents said, in their view, the objective for this disclosure could be met by disclosing information that an entity considered when assessing whether changes to the financial instruments met the conditions in paragraphs 6.9.3 and 6.9.5(b)–6.9.5(c) of the Exposure Draft. For example, in assessing the economic equivalence condition for fixed spread adjustments applied to cash products, whether the entity referred to the spread adjustment applied in derivative markets or used other sources of information.

### **3.4 Staff analysis and recommendations**

#### *Disclosure of comparative information*

22. The proposals in the Exposure Draft would not require an entity to disclose comparative information with respect to the disclosures proposed in paragraph 24J. In particular, the proposed transition requirements in paragraphs 7.2.38 of IFRS 9, 108J of IAS 39, 51 of IFRS 4 and C1B of IFRS 16 specify that an entity would not be required to restate prior periods to reflect the application of these amendments. Paragraph 44HH of the Exposure Draft states that an entity shall apply the proposed amendments to IFRS 7 (ie paragraphs 24I and 24J) when it applies the amendments to IFRS 9, IAS 39, IFRS 4 or IFRS 16.
23. Accordingly, we recommend no change to the proposed amendments with respect to this matter. In drafting the final amendments, we will consider whether there is a need to emphasise this matter.

#### *Possible improvements on disclosure in paragraph 24J(b)*

24. Consistent with feedback from investors (see paragraph 11(b) of this paper), we think the information required by paragraph 24J(b) of the Exposure Draft provides a useful measure of progress. Specifically, information about the entity's financial assets and financial liabilities that remain referenced to interest rate benchmarks subject to the reform would supplement the qualitative disclosures in paragraph



24J(a) of the Exposure Draft about the progress made in completing the transition to alternative benchmark rates and would help investors assess an entity's stage of completion towards effecting the reform.

25. Nonetheless, we acknowledge the challenges that some preparers may encounter in providing this information, in particular early adopters and entities that are not currently required to provide this information for other purposes, such as regulatory purposes.
26. We agree with respondents who say that entities could still meet the underlying objective of the disclosure by providing the relevant quantitative information on an alternative basis (for example, disclose the contractual par amounts instead of the carrying amounts of affected non-derivative financial instruments). Consistent with the feedback from investors, we think disclosing this information using a basis other than carrying amounts would not reduce the usefulness of such information.
27. Furthermore, permitting entities to select the most representative basis on which they provide the relevant quantitative information to achieve that objective could allow entities to leverage information already available which would reduce costs while still providing useful information.
28. We therefore, recommend the Board amend the proposed disclosure in paragraph 24J(b) such that it would require an entity to disclose quantitative information that enables investors to understand the magnitude of financial instruments that are left to transition to alternative benchmark rates, instead of requiring disclosure of carrying amounts of non-derivative financial assets and financial liabilities, and nominal amounts of derivatives. Specifically, entities would be required to disclose quantitative information about non-derivative financial assets, non-derivative financial liabilities and derivatives (each shown separately) that, at the end of the reporting period, remain referenced to interest rate benchmarks subject to the reform. This information would be disaggregated by significant interest rate benchmark.
29. For the purposes of this disclosure, an entity would choose the representative basis for disclosing the quantitative information and explain what basis it applied in the financial statements. For example, the quantitative information may be based on:

- (a) the carrying amounts of non-derivative financial assets, the carrying amount of non-derivative financial liabilities and the nominal amount of derivatives (ie as proposed in the Exposure Draft);
  - (b) the amounts related to recognised financial instruments (eg the contractual par amount of non-derivative financial assets and non-derivative financial liabilities, and nominal amounts of derivatives); or
  - (c) the amounts provided internally to key management personnel of the entity about these financial instruments (as defined in IAS 24 *Related Party Disclosures*), for example, the entity's board of directors or chief executive officer.
30. With respect to the comments described in paragraph 17 of this paper, we think, consistent with the underlying objective of this disclosure, the financial instruments in scope of paragraph 24J(b) would be financial assets and financial liabilities that—as at reporting date—continue to reference interest rate benchmarks that are subject to the reform. Therefore, the scope of this disclosure would capture only those instruments required to transition to alternative benchmark rates before their maturity.

*Reconsider disclosure in paragraph 24J(c)*

31. The requirement proposed in paragraph 24J(c) was intended to provide information to enable investors to understand how the entity effected the reform. For that reason, the proposed disclosure requirement included information such as the significant alternative benchmark rates to which the entity is exposed and relevant adjustments to those rates (ie spread adjustments).
32. We think the feedback described in paragraphs 18-21 of this paper suggests that this proposed disclosure may not achieve its objective. Also, the feedback highlights the potential lack of comparability between different entities because their respective granularity of information disclosed may be different for the same alternative benchmark rate. Consequently, as noted from investors' feedback (see paragraphs 11(c) of this paper) the information resulting from this proposed disclosure may not be particularly useful to them.
33. Therefore, we recommend the Board delete the proposed disclosure in paragraph 24J(c) of the Exposure Draft.

**Other comments**

34. A few respondents and one investor suggested additional disclosures or potential edits with respect to the location of proposed disclosures. We have summarised these comments in Appendix 1 to this paper together with our analysis and conclusions. Based on our analysis, we recommend no changes to the proposed disclosures for these matters.

**4. Question for the Board****Question for the Board**

1. Does the Board agree with the staff recommendation to finalise the proposed amendments in paragraphs 24I-24J of the Exposure Draft with the two changes described in paragraph 5 of this paper?

## Appendix A—Analysis of other comments

A1. This table summarises other comments on disclosures related to interest rate benchmark reform, together with our analysis and recommendations.

Feedback	Staff analysis	Recommendations
<b>Introduce additional disclosures related to interest rate benchmark reform to IFRS Standards</b>		
<p>A few respondents suggested requiring the following additional disclosures related to the reform:</p> <ul style="list-style-type: none"> <li>(a) amending IFRS 13 <i>Fair Value Measurement</i> to require disclosure of financial instruments transferred to Level 3 of the fair value hierarchy as a consequence of interest benchmark reform;</li> <li>(b) requiring disclosure of the fair value of the hedging instruments and the hedged items for those hedging relationships that are directly affected by the reform; and</li> <li>(c) requiring more granular disclosure of how entities effected the reform, including details of how they determined the fixed spread adjustments applied in the modified financial instruments.</li> </ul>	<p>Notwithstanding the reasons for respondents' suggestions, we do not recommend the Board requires additional disclosures related to the reform for the following reasons:</p> <ul style="list-style-type: none"> <li>(a) Paragraph 93(e)(iv) of IFRS 13 already requires entities to provide a reconciliation from the opening balances to the closing balances, disclosing separately changes during the period attributable to the <u>amounts of any transfers into or out of Level 3 of the fair value hierarchy, the reasons for those transfers</u> and the entity's policy for determining when transfers between levels are deemed to have occurred. Accordingly, adding the suggested disclosure may be unnecessary.</li> <li>(b) We think the benefits of providing the other disclosures suggested in bullets (b)-(c) would not outweigh the costs. These disclosures are similar to either what was proposed by the Board for Phase 1 in the May 2019 Exposure Draft (see paragraph BC35UU of the Basis for Conclusions on IFRS 7); or the information proposed in paragraph 24J(c) of this Exposure Draft (see paragraph 7 of this paper). In both cases the feedback suggested the cost of providing this information would outweigh the benefits to investors.</li> </ul>	<p>We recommend no changes to the final amendments for these matters.</p>
<p>One investor suggested that the Board consider requiring entities to disclose information akin to a sensitivity analysis. Specifically, disclosing how profit or loss and equity would have been affected if the entity had agreed to a range of, reasonably possible, different fixed spread adjustments when transitioning to alternative benchmark rates.</p>	<p>We think a potential requirement to provide this suggested disclosure would be associated with similar challenges to those described by investors in paragraph 11(c)(i) of this paper and respondents to the Exposure Draft described in paragraph 20 of this paper. Therefore, we do not recommend the Board adding this disclosure.</p>	<p>We recommend no changes to the final amendments for this matter.</p>
<b>The location of the draft amendments in IFRS 7</b>		
<p>A few respondents suggested the Board move these proposed amendments from paragraphs 24I-24J to another location in IFRS 7. Specifically, these respondents said putting these amendments as paragraphs 24I-24J of IFRS 7 could result in them being applied as part of disclosures for hedge accounting, which would be inappropriate.</p>	<p>We do not agree that the location of paragraphs 24I and 24J of the Exposure Draft could imply they apply only to hedge accounting. These paragraphs were inserted as a new sub-section under the <u>Other Disclosures</u> section in IFRS 7 and therefore do not fall under the hedge accounting sub-section in IFRS 7.</p>	<p>We recommend no changes to the final amendments for this matter.</p>