June 17, 2019

To the International Accounting Standards Board

Japanese Bankers Association

Comments on Exposure Draft *Interest Rate Benchmark Reform*
published by the International Accounting Standards Board

The Japanese Bankers Association (JBA) is an organisation whose members consist of banks and bank holding companies operating in Japan, and is an association that represents Japan's banking sector.

JBA has compiled the following comments on the Exposure Draft *Interest Rate Index Reform* ("ED") published by the International Accounting Standards Board ("IASB").

We generally agree with IASB's proposals to provide relief for hedge accounting, but respectfully expect that the following comments will contribute to your further discussion.

1. General Comments

○ Developing standards that address Phase 1 and Phase 2 in a combined manner or providing relief that covers Phase 2

- IASB has divided the project into two phases (i.e., Phase 1 that focuses on pre-replacement issues and Phase 2 that focuses on replacement issue). Based on this, IASB proposes exceptions to the highly probable requirement for forecast transactions and prospective assessments related to transactions that reference IBORs that is a current interest rate benchmark for existing major currencies in Phase 1.
- In order to smoothly facilitate the transition to alternative interest rates on an unprecedented scale for transactions that reference IBORs, it is necessary to take actions in an orderly manner in light of market practice in place at respective jurisdictions and other factors. We therefore basically support proposals related to relief.
- However, temporary conditions that may occur in the transition phase (e.g., uncertainties arising from a case where interest rate benchmarks of a hedged item and

a hedging instrument does not exactly match[1] and the assessment of hedge effectiveness) that would be discussed in Phase 2 as the replacement issues should be included in the scope of relief in this phase.

- If temporary conditions that may occur in the transition phase discussed above would not be included in the scope of this phase, accounting treatments may differ across entities. Furthermore, such an approach may prompt entities' behaviour to withhold from taking voluntary and immediate transition actions due to unpredictability in how accounting standards would be set. This may become a blocking factor for the market as a whole in executing an orderly and smooth transition, and may cause a disruption in financial markets due to practical difficulties arising from the concentration of the transition to certain timing.
- Therefore, essentially, it is preferable to analyse interest rate benchmark reform as a whole and determine standards based on such an analysis, instead of dividing issues into pre-replacement issues and replacement issues. If this suggestion is impracticable, we request IASB to consider temporary relief in this phase until treatments in Phase 2 are finalised rather than taking an approach to discuss all replacement issues in Phase 2 and not to discuss these issues in this phase. Such temporary relief include allowing entities to presume that there is an economic relationship between the hedged item and the hedging instrument, provided that entities intend to execute a transition to alternative interest rates for related hedged items and hedging instruments in the future.
- Determining treatments of these issues related to hedge accounting are extremely important elements in selecting alternative interest rates by market participants. The selection of alternative interest rates, transfer of transactions, system development and other actions can be determined only after treatments for hedge accounting are determined. Therefore, we request IASB to clarify a timeline for Phase 2 discussions at an earlier stage.

2. Specific Comments

Question 1 **Highly probable requirement and prospective assessments**

[1] An example of a case where the hedged item and hedging instrument do not exactly match includes a case where an entity designates IBOR-based financial instruments as hedged items and derivatives reference a new alternative interest rate as hedging instruments. There also may be cases where alternative interest rates of the hedged item and hedging instruments are different, or the alternative interest rate is the same, but the timing of replacing with the alternative interest rate is different.

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) Clarifying treatments of derivatives that have risks in addition to interest rate risk

(Comment)

・ We request IASB to clarify that derivatives (foreign exchange derivatives, etc.) with other multiple risks in addition to interest rate risk are eligible for proposed exceptions.

(Rationale.)

・ As described in Section 6.8.1 of the proposed amendments to IFRS 9, ED focuses solely on interest rate risk. However, risks other than interest rate risk may inherently exist in derivatives that are hedged items. Therefore, there is a concern that, if the temporary exceptions apply only to interest rate risk, FX swaps, currency swaps and other similar derivatives that are existing hedging instruments may be interpreted as not eligible for these exceptions.

- Therefore, in addition to interest rate risk, we request IASB to clarify that derivatives that have other risks such as foreign exchange risk and inflation risk are also eligible for these exceptions.

(2) Clarifying that ED addresses only pre-replacement issues

(Comment)

- As noted in General Comments, we do not support IASB's proposal to divide the project into phases. If however the project would be divided into phases, we request IASB to remove the following sentence in BC22 of ED, "[t]he Board noted that the existence of offset between the hedged item and the hedging instrument is a fundamental principle of the hedge accounting model in both IFRS 9 and IAS 39 and, therefore, considered it critical to maintain this principle."

(Rationale)

- Despite ED's intention to address the pre-replacement issues only, the sentence above may give an impression that the proposed exceptions are determined for the issues including the replacement issues that are to be addressed in Phase 2. Since readers can fully understand the background of the proposals in ED even if this description is not included, we request IASB to remove this to avoid unnecessary misunderstanding.