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Jenny Carter
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By email: ukfrs@frc.org.uk

Dear Ms Carter

FRED 74: Draft amendments to FRS 102 – Interest rate benchmark reform (Phase 2)

Deloitte LLP welcomes the opportunity to comment on FRED 74 Draft amendments to FRS 102 – Interest rate benchmark reform (Phase 2) (FRED 74).

We are supportive of the overall approach to reflect the International Accounting Standards Board's (IASB) proposals in ED/2020/1 Interest Rate Benchmark Reform – Phase 2: Proposed amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16 (ED) in FRS 102 to the extent relevant in order to ensure the amendments are available to all entities on a timely basis and that no significant deviations occur between the International Financial Reporting Standards (IFRS) and UK Generally Accepted Accounting Practice (UK GAAP). As part of finalising the Phase 2 amendments (the final amendments) the IASB made some important changes to the original proposals in the ED that FRED 74 is based on. We believe some of these changes should be reflected in FRS 102 and have included our recommendations in the answer to Question 1 in the Appendix to this letter.

We support the key amendments proposed in FRED 74 that ensure that entities that apply hedge accounting will continue to do so as they transition to alternative benchmark rates and entities can apply the practical expedient to account for changes in the basis for determining contractual cash flows of a financial asset or financial liability that are required by the interest rate benchmark reform (IBOR reform) by updating the effective interest rate. We consider these as being the two most important elements of the proposals.

Our responses to the specific questions raised in FRED 74 are in the Appendix to this letter.

Given the speed at which market participants are choosing, or being required, to switch to new interest rate benchmarks, we encourage the FRC to act swiftly in finalising the amendments arising from this FRED.

If you have any questions, please contact Veronica Poole on 020 7007 0884 or Kush Patel on 020 7303 7155.

Yours sincerely

Veronica Poole
UK National Head of Accounting and Corporate Reporting
Deloitte LLP

<u>Appendix – Responses to specific questions</u>

Question 1 – Do you agree with the proposed amendments to FRS 102? If not, why not?

Overall, we support the proposals in FRED 74 to ensure that relief is available to all entities affected by IBOR reform on a timely basis. The IASB has now released the final amendments, Interest Rate Benchmark Reform—Phase 2: Amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16, which includes changes to the original proposals in the ED. We are supportive of the FRC reflecting the changes made by the IASB in the final amendments, with the exception of the disclosure requirements where we believe the FRED 74 disclosure requirements are sufficiently detailed for an FRS 102 reporter. We note that the FRC has not included the text from the IASB's Basis of Conclusion that accompanied the IASB's ED and we agree with this approach.

We note that the IASB made some important changes to its proposals in the original ED that FRED 74 is based on. We believe that FRS 102 would benefit from the following changes that the IASB included in the final amendment:

- The IASB no longer refers to the term 'modification' when referring to changes in the basis for determining the contractual cash flows of a financial asset or financial liability. We agree with this change as the scope of the proposed FRS 102 amendments goes beyond situations where contracts have been contractually modified and includes, for example, the activation of existing fallback provisions.

- The IASB has made it clear that an entity can de-designate a portion of fixed rate debt to reflect the interest rate differential between the old and new benchmark interest rate and in so doing minimise the change in fair value hedge accounting adjustments when transitioning from one benchmark interest rate to the other. We have outlined this in more detail below in the section 'Amendments to hedging relationship'.

- The IASB has made it clear that entities have until the end of the reporting period in which the change required by IBOR reform occurs to amend the hedging relationship.

- The IASB has made it clear that the 24 month period applies to each alternative benchmark interest rate separately (i.e. on a rate by rate basis) and the provision also applies to new hedging relationships in which an alternative benchmark interest rate is designated as a non-contractually specified risk component.

Amendments to hedging relationships

We are supportive of the proposals to permit hedge accounting relationships and associated documentation to be amended without cessation of hedge accounting. However, in line with changes made by the IASB, the drafting could be clearer as to the changes that are permitted to the documentation of fair value hedges when an entity re-designates the portion of cash flows reflecting the new designated risk. For fair value hedges of interest rate risk, the quantum of the hedged cash flows will often be re-designated, reflecting the fact that the portion of the cash flows designated under the old benchmark rate will differ from the portion under the new interest rate benchmark (given new benchmark interest rates are generally lower than old benchmark interest rates). Proposed paragraph 12.25I could be clearer that such a designation is acceptable as paragraph 12.25I(b) refers to "amending the description of the hedged item". This could be read as simply amending for the change in the benchmark rate, as opposed to the designated amount that the interest rate benchmark represents. Fair value hedging of interest rate risk for a designated portion equal to the interest rate benchmark is a common hedge accounting strategy and therefore we would favour an explicit reference to amending the amount of the hedged item to reflect the differential between the old and the new rate.

We agree with the proposal to maintain consistency between the hedge accounting requirements of IAS 39 Financial Instruments: Recognition and Measurement for entities continuing to apply those requirements under IFRS and entities applying the recognition and measurement provisions of IAS 39 under FRS 102.

Additional points specific to the FRED 74

FRED 74 is explicit that it only applies to interest rate risk hedges. We believe it should not be restricted to hedges of interest rate risk only given benchmark interest rates are relevant to hedges of foreign currency risk too. We note the IASB's final amendments are not limited to hedges of interest rate risk only and therefore consistent with our previous comment we believe FRS 102 should follow the same approach as concluded by the IASB.

Question 2 – In relation to the Consultation stage impact assessment, do you have any comments on the costs and benefits identified? Please provide evidence to support your views.

We agree that the amendments to FRS 102 proposed in FRED 74 will have a positive impact on financial reporting. We believe that the benefit of avoiding discontinuation of hedge accounting relationships, resulting from the transition to alternative benchmark rates as a direct consequence of interest rate benchmark reform exceeds the cost of compliance with the proposed amendments.