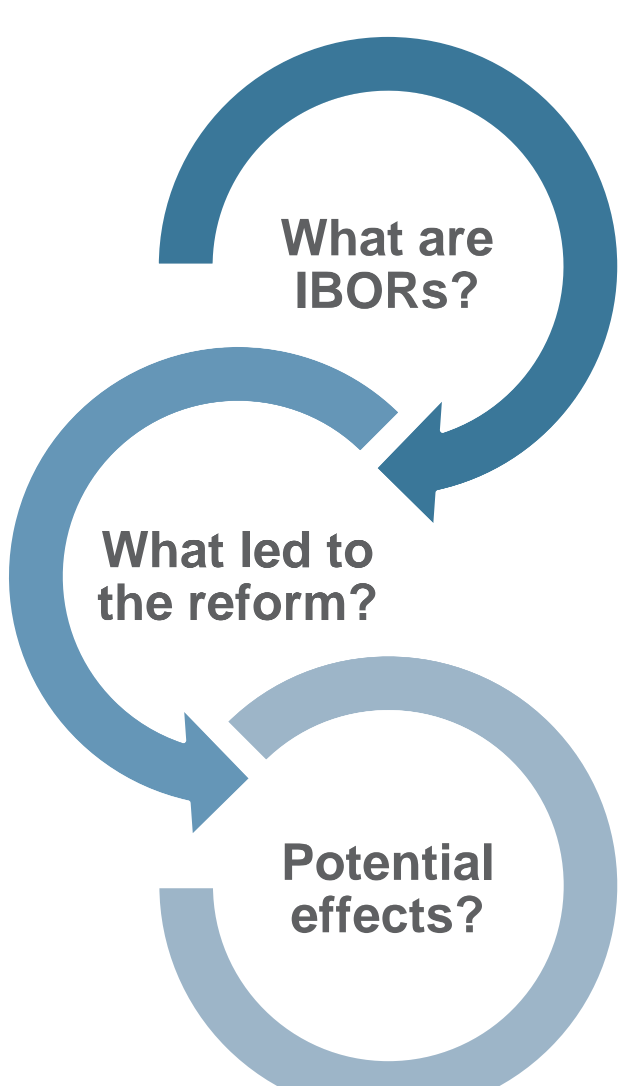
IFRS®

Agenda

- Background
- Phase I – pre-replacement issues
- Phase II – replacement issues

Background

Background



Interest rate benchmarks such as interbank offered rates (IBORs) play an important role in global financial markets. They index a wide variety of financial products worth trillions of dollars, ranging from mortgages to derivatives.

Market developments have undermined the reliability of existing benchmarks. The Financial Stability Board has recommended reforms. Some jurisdictions have made progress towards replacing existing benchmarks with nearly risk-free rates (RFRs).

This has, in turn, led to uncertainty about the future of existing interest rate benchmarks. Such uncertainties have some market implications which may also affect entities' financial reporting.

Two-phase project

The Board identified two groups of accounting issues:

Phase I *Pre-replacement issues*

- Issues affecting financial reporting before the replacement of an existing benchmark with RFR.

Phase II *Replacement issues*

- Issues that might affect financial reporting when an existing benchmark is reformed or replaced with RFR.

The *pre-replacement issues* are more urgent because they may affect financial reporting before the reform is enacted. Therefore, the Board decided to address these issues as a priority.

The amendments to IFRS 9, IAS 39 and IFRS 7 address Phase I issues only

Phase I – pre-replacement issues

IBOR Reform—feedback on the Exposure Draft

Highly probable and prospective assessments		Risk components and application		Disclosure and other information	
Green	Highly probable requirement	Green	Separately identifiable risk components	Amber	Disclosures
Green	Prospective assessment	Green	Mandatory / end of application	Green	Effective Date
Red	IAS 39 retrospective assessment*			Amber	Transition

Key

- Green: broadly agree with no or limited qualifications
- Amber: partially agree with some issues that need addressing or mixed views
- Red: broadly disagree and/or concerns raised

84 comment letters

* Although the Exposure Draft did not include any proposed relief from the retrospective assessment, many commented that it is needed

Phase I amendments

(a) highly probable requirement

(b) prospective assessments

(c) retrospective assessment (IAS 39 only)

(d) separately identifiable risk components

(a) Highly probable requirement

Hedge accounting requirement

When a forecast transaction is designated as a hedged item, that transaction must be highly probable.

Potential effect due to reform

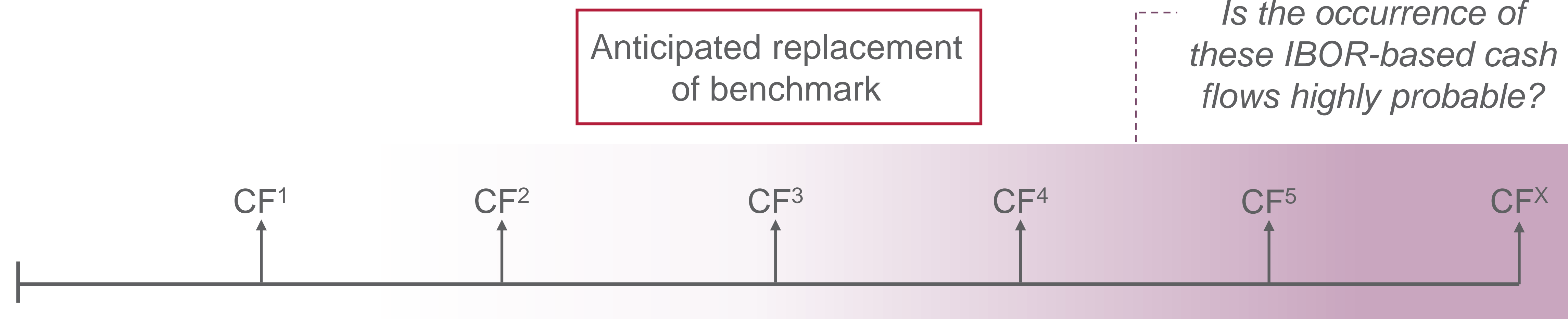
Forecast IBOR-based cash flows may no longer meet the highly probable requirement due to uncertainties arising from the reform. This is because the underlying contracts might need to be amended, so that the future cash flows will be based on RFR rather than IBOR.

Amendment

When determining if a forecast transaction is highly probable, an entity shall assume that the interest rate benchmark on which the hedged cash flows are based is not altered as a result of the reform.

Highly probable requirement

Assume that an entity designates as the hedged item forecast cash flows referenced to IBOR. These cash flows are expected to occur after interest rate benchmark reform takes place.



Until the uncertainty is resolved, the entity should assume the forecast cash flows will not be altered as a result of the reform (ie will continue to be IBOR-based). If, however, the cash flows are no longer expected to occur for other reasons, then hedge accounting must be discontinued.

(b) Prospective assessments

Hedge accounting requirement

A hedging relationship qualifies for hedge accounting only if there is an economic relationship between the hedged item and the hedging instrument (IFRS 9) or the hedge is expected to be highly effective in achieving offsetting (IAS 39).

Potential effect due to reform

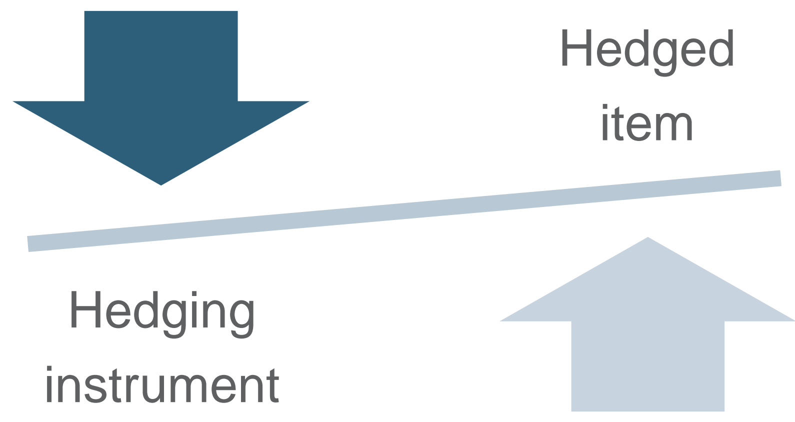
In making these assessments, entities would consider possible changes to future cash flows of hedged items and hedging instruments. Uncertainties arising from the reform can affect these assessments and potentially result in discontinuation of hedge accounting.

Amendment

When performing prospective assessments, an entity shall assume that the interest rate benchmark on which the hedging instrument and hedged item are based is not altered as a result of the reform.

Prospective assessments

For example, in making prospective assessments, currently entities would have to consider possible changes to designated future cash flows.



These assessments might be affected by uncertainties around timing and amount of designated cash flows.

For example, entities might be uncertain about:

(a) what the cash flows from the hedging instrument and hedged item after the reform will be; and

(b) when the replacement will occur.

Until the uncertainty is resolved, entities should assume that the interest rate benchmark on which the cash flows of the hedged item and the hedging instrument are based is not altered as a result of the reform.

(c) Retrospective assessment (IAS 39 only)

Hedge accounting requirement

The actual results of the hedge must be within the range of 80% to 125%.

Potential effect due to reform

Uncertainties from the reform could affect the estimation of future cash flows from the hedging instrument and the hedged item. As a result, this would affect the retrospective assessment under IAS 39.

Amendment

When performing retrospective assessments, an entity should not be required to discontinue hedge accounting when the results of the hedge fall outside the range of 80 to 125%.

Retrospective assessment (IAS 39 only)

In addition to the prospective assessment, IAS 39 requires a *retrospective assessment* where the actual results of the hedge must be within the range of 80–125%.

Uncertainties from the reform could affect timing and amount of designated cash flows and consequently the actual results of a hedge.

Entities must continue to measure the hedging instrument and hedged item as required by current IFRS Standards. This exception does not change the requirement to measure and recognise ineffectiveness in P&L.

Until the uncertainty is resolved, entities should not discontinue hedge accounting when the actual results of a hedge fall outside of the 80–125% range. Entities still need to comply with all other hedge accounting requirements, including the prospective assessment.

(d) Separately identifiable risk components

Hedge accounting requirement

An entity may designate a component of an item as the hedged item in a hedging relationship. The component must be separately identifiable to qualify as a hedged item.

Potential effect due to reform

Determining whether a non-contractually specified risk component is separately identifiable requires an assessment of facts and circumstances around the particular market structure to which that risk relates.

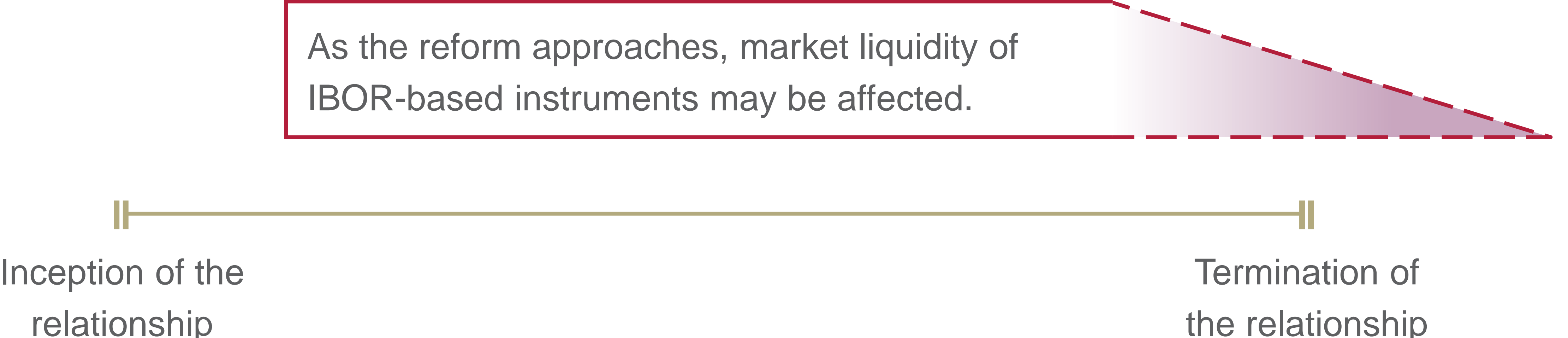
The reform could affect the market structure and, consequently, the assessment of whether risk components are separately identifiable.

Amendment

An entity shall apply the separately identifiable requirement only at the inception of a hedging relationship. Similar exception applies to macro hedges.

Separately identifiable risk components

For example, assume an entity designates the IBOR component of a fixed-rate financial liability as the hedged risk in a fair value hedge. At inception, the entity assesses the relevant facts and circumstances and concludes that IBOR is a separately identifiable risk component.



Entities will assess the separately identifiable requirement at the inception of the relationship only. In other words, the assessment is not reperformed over the life of the hedge. Similar exception applies to macro hedges.

End of application of the relief

Why is the end of application important?

The objective of the amendments is to provide temporary exceptions during the period of uncertainty arising from the reform.

Therefore, the relief should not be necessary when the uncertainty is resolved. Also, focusing on the resolution of uncertainty addresses different timelines in different jurisdictions.

End of application

As a general principle, entities shall cease to apply the exceptions when uncertainties arising from the reform are no longer present or, if earlier, when the hedging relationship is discontinued.

In the next slide we discuss an example with contractual amendments.

End of application does not apply to separately identifiable risk components. That relief applies during the entire life of the hedging relationship.

End of application of the relief – example

Contractual amendments

In some situations, contractual amendments might eliminate uncertainties arising from benchmark interest rate reform.

For example, if a contractual amendment specifies the replacement date and the specific RFR, then the uncertainty regarding the timing and amount of the designated cash flows is eliminated when the contract is amended.

However, some contractual amendments might not eliminate uncertainty (eg may just note replacement has to occur in the future). In such cases, uncertainty continues so the exceptions would still apply.

If a contractual amendment eliminates the uncertainty around timing and amount of the designated cash flows, then the exceptions no longer apply.

Inception of the relationship

Termination of the relationship

Disclosures

For those hedging relationships affected by the amendments, entities would be required to provide the following disclosures:

a) significant interest rate benchmarks to which the entity's hedging relationships are exposed;

b) how the entity is managing the process to transition to alternative benchmarks;

c) the extent of the entity's risk exposure that is directly affected by the reform;

d) significant assumptions or judgements the entity made in applying the exceptions; and

e) the nominal amount of the hedging instruments in those hedging relationships.

Disclosure requirements have been significantly reduced from the proposals in the ED

Phase II – replacement issues

Phase II – replacement issues

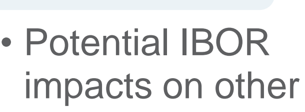
Classification & measurement

- Determining what a modification is
- When does a modification result in derecognition
- In the case of a modification, how to account for change in benchmark rate
- Recognition of new financial instruments

Hedge accounting

- Changes in hedge documentation
- Flexible hedge designations
- Implications for macro hedges
- What happens when Phase 1 relief ends
- Valuation adjustments

Other topics



- Potential IBOR impacts on other IFRSs?
- Any new issues identified

Disclosure

- Additional (or amendments to) disclosure requirements

October 2019 onwards

IBOR Reform – Phase II deliberations

Classification and measurement	The Board tentatively decided to amend IFRS 9 to: a) clarify that a change in the basis for determining contractual cash flows is a modification of a financial instrument. b) provide a practical expedient allowing entities to apply paragraph B5.4.5 of IFRS 9 to modifications related to IBOR reform (ie re-estimate cash flows and update the effective interest rate).

Next steps:

The Board will discuss hedge accounting at a future meeting.

Get involved

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