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Project	**IBOR Reform and its Effects on Financial Reporting**		
Paper topic	Redeliberation of proposed amendments to IFRS 9 and IAS 39		
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Introduction

1. This paper follows on from the staff analysis of the feedback received on the Exposure Draft *Interest Rate Benchmark Reform* (proposed amendments to IFRS 9 and IAS 39) (the ED) that was discussed at the July 2019 Board meeting. As noted in Agenda Papers 14A and 14B for that meeting, the staff identified some matters raised by respondents for the Board to consider before finalising the proposed amendments.

2. The purpose of this paper is to analyse the key issues for the Board to redeliberate before the proposed amendments to IFRS 9 and IAS 39 are finalised and published. More specifically, in this paper the staff:

    (a) analyse whether the Board should provide an exception from the retrospective assessment required by IAS 39;

    (b) consider how the proposed exceptions should apply to 'macro hedges' and when a group of items is designated as the hedged item;

    (c) consider clarifications to the scope of the proposed amendments; and

    (d) analyse whether the disclosures proposed in the ED should be simplified.

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3. This paper is structured as follows:

   (a) Summary of staff recommendations (paragraph 4);

   (b) Background (paragraphs 5–7);

   (c) IAS 39 retrospective assessment (paragraphs 8–47);

   (d) Clarification of the separately identifiable requirement (paragraphs 48–61);

   (e) End of application for hedges of a group of items (paragraphs 62–68);

   (f) Scope of the proposed amendments (paragraphs 69–74); and

   (g) Disclosure requirements (paragraphs 75–85).

Summary of staff recommendations

4. In this paper the staff recommend that:

   (a) IAS 39 should be amended to provide an exception for the retrospective assessment, so that an entity would continue to apply hedge accounting to a hedging relationship for which effectiveness is outside of the 80–125% range during the period of uncertainty arising from the reform.

   (b) for 'macro hedges' designated under either IFRS 9 or IAS 39, an entity should assess whether a non-contractually specified risk component is separately identifiable only at the time the hedged item is initially designated in the 'macro hedge'. Once a hedged item is designated within a 'macro hedge', the separately identifiable requirement should not be reassessed for that same hedged item at subsequent re-designations.

   (c) the final amendments should clarify that, when an entity designates a group of items as the hedged item in accordance with paragraph 6.6.1 of IFRS 9 or paragraph 83 of IAS 39, the end of application requirement proposed in the ED should apply to each individual item within the designated group of items.

(d) the scope of the proposed exceptions should be clarified so that the exceptions only apply to those hedging relationships that are directly affected by uncertainties about the timing and/or amount of *interest rate benchmark-based cash flows of the hedged item and/or hedging instrument* arising from the reform.

(e) the disclose requirements accompanying the exceptions proposed in the ED should be reduced to some specific disclosures and an exemption should be provided from the disclosure requirements in paragraph 28(f) of IAS 8 upon the initial application of the amendments.

Background

5. As discussed at the July 2019 Board meeting, most respondents welcomed the Board's timely response to address the pre-replacement issues and overall supported the amendments proposed in the ED. There was also a general consensus among respondents that the proposals in the ED should be finalised and published as soon as possible and that any issue that could potentially result in the re-exposure of the proposals in the ED should be dealt with as part of the next phase of the project.

6. Nonetheless, some respondents suggested that the Board should consider the following matters before finalising the proposed amendments:

(a) provide an exception for IAS 39 retrospective assessment when a hedge is temporarily outside the 80-125% range solely due to uncertainties arising from the reform;

(b) provide relief from the separately identifiable requirement for 'macro hedges';

(c) clarify when the relief ceases to apply to a group of items designated as the hedged item;

(d) clarify the scope of the proposed amendments would apply to hedges of both interest rate and foreign currency risks; and

(e) simplify the disclosure requirements.

7. With regards to the next phase of the project, the staff have been analysing the financial reporting implications of the developments in the reform and/or replacement of various major interest rate benchmarks. More specifically, the staff have been engaging with securities regulators, central banks, audit firms, financial institutions and other accounting standard setters to obtain an understanding of the potential replacement issues to be considered in the next phase of the project. Based on the input gathered from these activities as well as the feedback received in comment letters on the ED, the staff have identified key replacement issues to be discussed with the Board at a future Board meeting.

IAS 39 retrospective assessment

8. The retrospective assessment is part of the set of qualifying criteria that must be complied with in order to apply hedge accounting under IAS 39. According to paragraph 88(b) of IAS 39, a hedging relationship qualifies for hedge accounting only if 'the hedge is expected to be highly effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk.' More specifically, paragraph AG105 of IAS 39 states that a hedge is regarded as highly effective only if both of the following conditions are met:

> (a) At the inception of the hedge and in subsequent periods, the hedge is expected to be highly effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk during the period for which the hedge is designated. Such an expectation can be demonstrated in various ways including a comparison of past changes in the fair value or cash flows of the hedged item that are attributable to the hedged risk with past changes in the fair value or cash flows of the hedging instrument, or by demonstrating a high statistical correlation between the fair value or cash flows of the hedged item and those of the hedging instrument.
>
> (b) The actual results of the hedge are within a range of 80–125 per cent. For example, if actual results are such that the loss on the hedging instrument is CU120 and the gain on

the cash instrument is CU100, offset can be measured by 120/100, which is 120 per cent, or by 100/120, which is 83 per cent. In this example, assuming the hedge meets the condition in (a), the entity would conclude that the hedge has been highly effective.

9. These two conditions are commonly referred to in IAS 39 literature as: i) the 'prospective assessment', in the context of paragraph AG105(a) which requires an assessment performed on a forward-looking basis; and ii) the 'retrospective assessment' in the context of paragraph AG105(b) which is based to the actual results of the hedge.

10. The analysis in this paper focuses only on the retrospective assessment required by paragraph AG105(b) of IAS 39 because:

    (a) IFRS 9 does not require a specific retrospective assessment[1]; and

    (b) the ED already proposes an exception for the prospective assessments required by IAS 39 and IFRS 9.[2]

Accounting implications when a hedging relationship fails IAS 39 retrospective assessment

11. When a hedging relationship fails the retrospective assessment, the accounting implications are the same as for when the entity fails the prospective assessment – ie both result in the prospective discontinuation of hedge accounting. In particular, paragraphs 92 and 101(b) of IAS 39 set out the following requirements when hedge accounting is discontinued because a hedging relationship is no longer considered to be highly effective:

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[1] The criteria for a hedge to be considered effective in accordance with IFRS 9 are included in paragraph 6.4.1 of IFRS 9.

[2] In the ED, the requirements in paragraph 6.4.1(c)(i) of IFRS 9 (ie the existence of an economic relationship) and paragraph AG105(a) of IAS 39 (ie whether the hedge is expected to be highly effective) are collectively referred to as 'prospective assessments'.

(a) for fair value hedges, the accumulated fair value hedge adjustment will be amortised to profit or loss based on a recalculated effective interest rate at the date amortisation begins;[3] and

(b) as for cash flow hedges, the accumulated amount in the cash flow hedge reserve will be reclassified to profit or loss when the hedged cash flows occur.[4]

12. Consequently, changes in the fair value of derivatives previously designated in any cash flow hedges would be recognised in profit or loss in full (instead of the effective portion of the gains or losses on the derivatives being recognised in the cash flow hedge reserve in other comprehensive income).[5] Regarding derivatives previously designated in fair value hedges, offsetting between the gains or losses on the hedged item and hedging instrument would not be achieved in profit or loss because the gain or loss on the hedged item attributable to the hedged risk would no longer be recognised in profit or loss.[6]

13. When deliberating the proposals in the ED, the Board decided not to propose an exception from the retrospective assessment required by paragraph AG105(b) of IAS 39. The Board noted in paragraph BC22 of the ED that the proposals were not intended to change the measurement of hedge effectiveness or change how hedges are reflected in the financial statements. The Board further explained in paragraph BC23 of the ED that the retrospective assessment is based on the actual results of the hedging relationship, which are determined based on changes in the fair value of the hedging instrument and changes in fair value of the hedged item that are attributable to the hedged risk, and that existing IFRS Standards already provide an adequate basis for such measurement.

[3] Refer to paragraphs 92 of IAS 39.

[4] Refer to paragraph 101(b) of IAS 39.

[5] Refer to paragraph 95(a) of IAS 39.

[6] Refer to paragraph 89(b) of IAS 39.

Summary of the feedback received

14. As discussed at the July 2019 Board meeting, most of the respondents agreed with the statement in BC22 of the ED that the actual results of a hedge should continue to be measured and recognised in accordance with IFRS Standards.[7] Respondents also noted that all ineffectiveness arising from a hedging relationship should continue to be recognised in the financial statements, irrespective of whether ineffectiveness arises from interest rate benchmark reform or for any other reasons.

15. However, most respondents disagreed with the Board's decision not to provide an exception for the effects of interest rate benchmark reform on the retrospective assessment required by IAS 39. They consider that, for the exceptions proposed in the ED to achieve their objective, the uncertainties arising from the reform should also be excluded for the purposes of the retrospective assessment similar to the way in which it is excluded for the prospective assessment. This is because of the inherent interaction between the assessment of the forward-looking cash flows of the hedged item and its impact on both prospective and retrospective assessments. Respondents noted that it is common practice for entities to use the same method of effectiveness assessment (whether it is regression analysis or "dollar-offset") for both prospective and retrospective assessments. Thus, there would be an inconsistency if, for the purpose of the prospective assessment the uncertainty of the reform is not reflected, but for the purpose of the retrospective assessment the uncertainty should be reflected.

16. Furthermore, respondents also noted that the discontinuation of hedge accounting resulting from breaching the 80-125% range solely due to temporary ineffectiveness caused by the reform would not reflect an entity's risk management strategy and would not provide useful information to the users of the financial statements. Temporary ineffectiveness could for example arise when the hedged item and hedging instrument transition to an alternative benchmark rate at different times.

[7] For further information, refer to the July 2019 Agenda Paper 14B *Additional issues for consideration before finalising the proposed amendments*.

Staff analysis

17. As a result of the reform, contractual cash flows of hedged items and hedging instruments that are based on an existing interest rate benchmark will likely change when such benchmark is reformed or replaced with an alternative interest rate. Until decisions are made with respect to what the alternative interest rate is and when the reform and/or replacement will occur, uncertainties will exist regarding the timing and the amount of future cash flows of the hedged items and the hedging instruments. These uncertainties about the timing and the amount of future cash flows arising from the reform could affect an entity's ability to satisfy the IAS 39 requirements with regards to the retrospective assessment.

18. The staff therefore consider that providing an exception from the retrospective assessment in IAS 39 for the uncertainties arising from the reform would be consistent with the reasons that led the Board to propose an exception for the prospective assessments in both IFRS 9 and IAS 39.

19. As noted in paragraph BC22 of the ED, the existence of offset between the hedged item and the hedging instrument is a fundamental principle of the hedge accounting model in IAS 39. In this context, during its deliberations leading to the ED, the Board considered it critical to maintain such principle unaltered. Therefore, the staff emphasise that any exception from the IAS 39 retrospective *assessment* as proposed in this paper does not amend:

    (a) the measurement of the hedged item and hedging instrument in accordance with existing IFRS Standards; and

    (b) the requirement for ineffectiveness to be *measured and recognised* in the financial statements. Regardless of the nature of any exception that is provided from the retrospective assessment, the extent of ineffectiveness that has occurred should be measured and recognised in accordance with the current requirements in IAS 39.

20. The staff therefore have identified the following possible approaches for providing an exception from the retrospective effectiveness assessment:

    (a) *Approach A*: Assume interest rate benchmark is not altered, similar as for the prospective assessments;

(b) *Approach B*: Continue hedge accounting when ineffectiveness is outside the 80–125% range; and

(c) *Approach C*: Require the existence of an economic relationship similar to IFRS 9.

Approach A: Assume interest rate benchmark is not altered, similar as for the prospective assessments

21. IAS 39 does not prescribe any specific methods for assessing either prospective or retrospective hedge effectiveness. In practice, there are various methods that entities can use, ranging from regression analysis to the dollar offset method. For some hedging relationships, the same method is used for assessing both prospective and retrospective effectiveness, whereas for other hedging relationships one method might be used for the prospective assessment and another for the retrospective assessment. Paragraph AG107 of IAS 39 only states that the methods used to assess hedge effectiveness should be consistent with the entity's risk management strategy and specified in the hedge documentation at the inception of the hedge.[8]

22. If an entity uses the same method for assessing prospective and retrospective hedge effectiveness, applying the exceptions as proposed in the ED would give rise to the following situation:

- for the purpose of the prospective assessment, the entity would assume that the interest rate benchmark on which the hedged risk or hedged cash flows of the hedged item are based, is not altered as a result of the reform and hence the uncertainties arising from the reform would not affect the prospective assessment.
- for the purpose of the retrospective assessment, the entity would apply the exact same method used for assessing prospective effectiveness, but without the exception provided in the ED. In other words, in the absence of an

[8] According to paragraph AG107 of IAS 39, the standard 'does not specify a single method for assessing hedge effectiveness. The method an entity adopts for assessing hedge effectiveness depends on its risk management strategy. […] An entity's documentation of its hedging strategy includes its procedures for assessing effectiveness.'

exception from the IAS 39 retrospective assessment, the results of the hedge might be outside the 80–125% range due to uncertainties arising from the reform. This would result in discontinuation of hedge accounting regardless of whether the hedge has passed the prospective assessment.

23. An outcome where a hedging relationship passes the prospective assessment only to fail the retrospective assessment, which is performed on the same basis, seems to be inconsistent with the objective of the exceptions the Board proposed in the ED. The staff consider that an approach that requires an entity to apply consistent assumptions for the prospective and retrospective assessments to address the apparent inconsistency noted in paragraph 22 above would be better aligned to the objective of the exceptions proposed in the ED.

24. This approach would require the *assessment* of retrospective effectiveness to be separated from the *measurement* of hedge ineffectiveness. More specifically, applying an exception from the retrospective assessment in a similar way as the exception provided in the ED from the prospective assessments would require an entity:

    (a) *for the purpose of the retrospective assessment*, to assume that the interest rate benchmark on which the hedged risk or cash flows are based is not altered as a result of the reform when assessing the degree of offset between the changes in the hedged item attributable to the hedged risk and changes in the hedging instrument.

    (b) to *measure and recognise* the hedging instrument and the hedged item (or a component thereof) in accordance with existing requirements in IFRS Standards. Consequently, entities will continue to measure derivatives at fair value in accordance with IFRS 13 and recognise any ineffectiveness arising from a hedging relationship as currently required.

25. The objective of this approach is to exclude the uncertainties arising from the reform from the assessment of whether a hedge is considered to be highly effective. Therefore, to the extent that the hedge ineffectiveness is assessed to be within the 80-125% range, the hedge is continued even if the *measurement* of the actual ineffectiveness is outside the range.

26. The staff have identified the following advantages with regards to Approach A:

   (a) it is consistent with the other exceptions proposed in the ED and aligns the estimation of future cash flows used for the purpose of the prospective and retrospective assessments with those used when an entity applies the exception from the highly probable requirement as proposed in the ED.[9]

   (b) it simplifies the application of the proposed amendments for hedging relationships under IAS 39 as an entity would apply the same exception to both prospective and retrospective assessments.

   (c) it maintains the essence of the IAS 39 hedge accounting model while excluding the effects of uncertainties arising from the reform from the retrospective assessment. This is because, in contrast to Approach B, the 80-125% range would be still relevant in determining whether hedge accounting should be continued based on the assessment described in paragraph 24(a). This includes situations where ineffectiveness is caused by other factors for example basis risk when the hedged item and hedging instruments are based on different benchmark rates.

Approach B: Continue hedge accounting when ineffectiveness is outside the 80–125% range

27. Another approach considered by the staff proposes an exception from the IAS 39 retrospective assessment such that an entity would continue to apply hedge accounting when the actual results of the hedge are outside of the 80–125% range. During the period of uncertainty arising from the reform, entities would still need to comply with all other IAS 39 hedge accounting requirements, including the prospective assessment (as amended by the ED).[10]

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[9] According to paragraph 102D of the ED, an entity shall determine whether the forecast transaction is highly probable assuming that the interest rate benchmark on which the hedged cash flows (contractual or non-contractually specified) are based is not altered as a result of interest rate benchmark reform.

[10] According to the ED, when an entity demonstrates whether the hedge is expected to be highly effective in achieving offsetting under IAS 39, the entity would assume that the benchmark on which the hedged cash flows are based, and/or the benchmark on which the cash flows of the hedging instrument are based, are not altered as a result of the reform.

28. For the avoidance of doubt, even in a scenario where an entity adopts the same method for assessing prospective and retrospective hedge effectiveness, this approach would not exempt an entity from the prospective assessment. It will only provide an exception to discontinuing hedge accounting when the results of the retrospective assessment are outside the 80-125% range.

29. The retrospective assessment is part of the set of qualifying criteria an entity must comply with in order to apply hedge accounting under IAS 39 and it plays an important role in ensuring the discipline around the application of hedge accounting to those hedging relationships that are proven to be highly effective. In this context, it could be argued that this approach lacks discipline around the application of the IAS 39 hedge accounting model. This concern is especially important in situations where the ineffectiveness in a hedging relationship is already close to breaching the 80-125% range due to reasons other than the uncertainty of the reform, as these hedging relationships would also be temporarily exempted from being discontinued.

30. However, the staff note that the interaction between the prospective and retrospective assessments, coupled with the exception to the prospective assessment as set out in the ED, would mitigate the risk of continuing hedging relationships that are ineffective for reasons other than uncertainties arising from the reform. This is because for the purposes of the prospective assessment, an entity would assume that the interest rate benchmark is unchanged, thereby eliminating the uncertainties arising from the reform from the assessment of whether the hedge is expected to be highly effective in future periods. All other sources of ineffectiveness will continue to be part of the prospective assessment, thereby ensuring that hedging relationships that are not expected to be highly effective for reasons other than the interest rate reform will still be required to be discontinued. This will therefore ensure that the discipline around the application of IAS 39 hedge accounting requirements will be maintained throughout the life of the hedging relationship.

31. In summary, the staff have identified the following advantages arising from Approach B:

(a) it would not impose additional costs to preparers as it does not require additional calculations for the purpose of the retrospective assessment.

(b) it is a very straight-forward approach for providing relief from the impact of uncertainties arising from the reform on the retrospective assessment while it still maintains a level of discipline around the application of IAS 39 hedge accounting model through the prospective assessment.

(c) it does not require the retrospective assessment of effectiveness to be disconnected from the recognition and measurement of ineffectiveness.

(d) all ineffectiveness will continue to be recognised in the financial statements and will provide useful information to the users of financial statements while at the same time lessen the operational burden on entities during the period of uncertainty.

32. The exception from the retrospective assessment is temporary in nature. Therefore, once uncertainties arising from the reform are no longer present, an entity should cease to apply the exception. As it is not possible to determine, at this stage, when this period of transition will end, one could argue that hedge accounting could continue to be applied for a prolonged and undetermined period to hedging relationships for which the actual results are outside the 80-125% range. However, the staff note that such situations are not expected to happen frequently and that entities will want to minimise the extent of ineffectiveness causing volatility in profit or loss, thereby mitigating the risk that ‘bad’ hedges will continue to exist for long periods of time.

33. Finally, one could argue that, in the absence of the retrospective assessment, hedges that have been highly effective in achieving offsetting would receive the same accounting treatment as hedges that have not and thus, this could impair the comparability of financial statements. However, as discussed in paragraph 31(d) of this paper, any ineffectiveness arising in a hedge accounting relationship would continue to be measured and recognised in the financial statements in accordance with IFRS Standards, irrespective of whether ineffectiveness arises from interest rate benchmark reform or for any other reasons. This would provide information about the results of the hedges designated for hedge accounting purposes and

therefore allow users to compare the information about the hedges that different entities have in place.

Approach C: Require the existence of an economic relationship similar to IFRS 9

34. Under this approach, entities would be required, for the purpose of the retrospective assessment, to demonstrate the existence of an economic relationship between the hedged item and the hedging instrument, similar to the requirements in IFRS 9 (as amended by the ED).[11]

35. In applying this approach, an entity would assume that the interest rate benchmark on which the hedged risk or hedged cash flows are based, is unchanged as a result of the reform for the purposes of the prospective assessment, whereas for the retrospective assessment, the entity would consider the hedging relationship to be highly effective as long as there is an economic relationship between the hedged item and the hedging instrument.

36. Proponents of this view argued that one of the main advantages of this approach is that it closer aligns the hedge effectiveness requirements in IAS 39 and IFRS 9, resulting in the same accounting treatment for hedging relationships affected by the reform under both standards. This is because IFRS 9 does not require a specific retrospective assessment and therefore entities that are applying hedge accounting under IFRS 9 would have an advantage over those entities applying IAS 39.

37. However, the staff note that the existence of an economic relationship is not the only hedge effectiveness requirement in IFRS 9. In particular, paragraph 6.4.1(c) states that a hedging relationship qualifies for hedge accounting only if: i) there is an economic relationship between the hedged item and the hedging instrument; ii) the effect of credit risk does not dominate the value changes that result from that economic relationship; and iii) the hedge ratio is the same as that resulting from the quantity of the hedged item that the entity actually hedges and the quantity of

[11] According to the ED, when an entity demonstrates the existence of an economic relationship, the entity would assume that the benchmark on which the hedged cash flows are based, and/or the benchmark on which the cash flows of the hedging instrument are based, are not altered as a result of the reform.

the hedging instrument that the entity actually uses to hedge that quantity of hedged item.[12]

38. In view of this, the staff are concerned that by simply importing one specific element of the effectiveness requirements from IFRS 9 into IAS 39, could have unintended consequences. This is because the requirements in paragraph 6.4.1(c) of IFRS 9 are inherently linked and the application of the existence of an economic relationship in isolation might not capture the intended effects. For example, if the effect of credit risk dominates the value changes that result from an economic relationship, an entity must discontinue hedge accounting irrespective of the results of the other IFRS 9 effectiveness requirements. However, such requirement does not exist under IAS 39.

39. The staff also note that the relief sought by proponents of this approach can similarly be achieved under the other approaches discussed in this paper. Therefore, the staff do not consider the creation of a 'hybrid' hedge accounting model in IAS 39 purely for the purpose of providing an exception to the retrospective assessment, without further considering any consequential impacts on the remainder of the IAS 39 model, to be appropriate.

Mandatory application and end of application

40. Assuming the Board agrees with the staff view in paragraph 18 that IAS 39 should be amended to provide an exception for IAS 39 retrospective assessment, the staff think the application of this exception should be consistent with the other proposals in the ED. In particular, the staff think that:

    (a) For the reasons set out in paragraphs BC28–BC31 of the ED, the exception for IAS 39 retrospective assessment should be mandatory. As a result, entities would be required to apply the proposed exception to all hedging relationships within the scope.

[12] Paragraph 6.4.1(c)(iii) of IFRS 9 also states that the 'designation shall not reflect an imbalance between the weightings of the hedged item and the hedging instrument that would create hedge ineffectiveness (irrespective of whether recognised or not) that could result in an accounting outcome that would be inconsistent with the purpose of hedge accounting'.

(b) For the reasons set out in paragraphs BC32–BC42 of the ED, an entity should prospectively cease applying the exception for IAS 39 retrospective assessment 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.

Staff recommendation

41. The staff are of the view that an exception from the retrospective assessment in IAS 39 should be provided so that an entity would continue to apply hedge accounting to a hedging relationship when effectiveness is outside of the 80–125% range during the period of uncertainty arising from the reform.

42. In this regard, the staff consider both Approach A and Approach B to achieve this objective and to have equal, but different, merits that could result in that approach being the preferred approach.

43. Approach A is closer aligned to the exceptions already provided in the ED and will result in consistent assumptions being applied for both the prospective and retrospective assessments. It will therefore enable entities to exclude the uncertainties arising from the interest rate reform from the assessment of whether a hedging relationship has been highly effective. However, in order to achieve this, the assessment of hedge effectiveness has to be separated from the measurement and recognition of ineffectiveness in the financial statements. In other words, the recognition of hedge ineffectiveness is based on the measurement of the hedged item and hedging instrument in accordance with existing requirements in IFRS Standards, whereas the retrospective assessment of effectiveness is based on the assumption that the interest rate benchmark is not altered as a result of the reform.

44. Approach B on the other hand do not require the assessment of effectiveness to be separated from the recognition and measurement of ineffectiveness and may be simpler for entities to apply. However, under this approach, hedging relationships that are in the scope of the proposed exceptions will be permitted to continue

regardless of whether the source of ineffectiveness is related to the reform or to other reasons. As noted in paragraph 33, the proposed exception to the prospective assessment will only exclude the uncertainties arising from the reform, hence any other factors contributing to ineffectiveness will continue to be included in the assessment and could result in the discontinuation of a hedging relationship.

45. In considering which approach to recommend to the Board, the staff have also considered the following:

    a) entities are required to comply with all other IAS 39 hedge accounting requirements, regardless of which approach is applied;

    b) the hedge items and hedging instruments should continue to be measured in accordance with existing requirements in IFRS Standards; and

    c) all ineffectiveness should be recognised in the financial statements.

46. On balance, the staff therefore recommend that Approach B be used as a basis for an exception to the retrospective assessment in IAS 39.

47. For the reasons expressed in paragraphs 38–39, the staff do not consider Approach C to be an appropriate basis on which to provide an exception to the retrospective assessment in IAS 39.

Question 1 for the Board

Question 1 for the Board
Does the Board agree with the staff recommendation in paragraph 46 that IAS 39 should be amended to provide an exception for the retrospective assessment, so that an entity would continue to apply hedge accounting to a hedging relationship for which effectiveness is outside of the 80–125% range during the period of uncertainty arising from the reform?

Clarification of the separately identifiable requirement

48. In the deliberations leading up to the publication of the ED, the Board noted that the requirement to assess whether a non-contractually specified risk component is separately identifiable, and hence qualifies as a hedged item, requires a continuous assessment.[13] Therefore, an entity's ability to conclude that an interest rate benchmark is a separately identifiable risk component could be affected by the reform. For example, if the outcome of the reform affects the market structure of an interest rate benchmark (eg LIBOR), it could affect an entity's continuous assessment of whether a non-contractually specified LIBOR component is separately identifiable and, therefore, an eligible hedged item in a hedging relationship.

49. Consequently, as noted in paragraph BC26 of the ED, the Board decided to propose an exception to the requirements in IFRS 9 and IAS 39 so that the separately identifiable criteria for hedges of the benchmark component of interest rate risk only needs to be applied at the inception of those hedging relationships. This would avoid discontinuation of hedge accounting solely because the hedged item is no longer separately identifiable as the reform progresses.

50. Almost all respondents agreed with the proposed relief to apply the separately identifiable requirement only at inception of a hedging relationship. However, some noted that the proposed exception does not provide any relief for portfolio hedges of interest rate risk or 'macro cash flow hedges' (as colloquially referred to in BC6.91 of IFRS 9) as the risk position being hedged changes frequently.[14] This is because, as hedging instruments and hedged items are being added or removed from open portfolios, entities have to de-designate and re-designate hedging relationships at regular intervals to operationalise such hedges.

51. Respondents noted that, if each re-designation of the hedging relationship is considered to represent the inception of a new hedging relationship (even though

[13] Refer to the discussion at the February 2019 Board meeting where the Board confirmed that, contrary to the view that the assessment is only required at inception, the assessment of whether a risk component is separately identifiable is one of the qualifying criteria for hedge accounting that requires continuous assessment.

[14] For simplification, such hedges are collectively referred to as 'macro hedges' for the purpose of this paper.

it is still the same hedging strategy), the separately identifiable requirement will need to be assessed at each re-designation. Similar to the situation described in paragraph BC26 of the ED, this could impact an entity's ability to conclude that a non-contractually specified risk component is separately identifiable and, therefore, an eligible hedged item for hedge accounting purposes. Therefore, the exception for the separately identifiable requirement, as proposed in the ED, would have minimal benefit for 'macro hedges'.

Staff analysis

52. As discussed in the ED,[15] the Board decided in the context of IBOR reform and the resulting uncertainties to propose an exception to the existing requirements in IFRS 9 and IAS 39, so that a non-contractually specified risk component only has to satisfy the separate identifiability requirement at inception of a hedging relationship.

53. In practice, risk management often assesses interest rate risk exposures at a portfolio level. Consequently, as time passes new exposures are continuously added to open portfolios and other exposures are removed from them. Hedges that uses a dynamic process to manage interest rate risk exposures arising from open portfolios introduce additional complexity to the accounting for such hedges.[16] In order to operationalise the existing hedge accounting requirements, entities perform periodic discontinuations and re-designations of hedging relationships for the items within the revised portfolios.

54. However, these periodic discontinuations and re-designations do not represent the discontinuation of the hedging relationships because the hedge no longer meets the hedge accounting requirements in IAS 39 or IFRS 9. It is merely a way in which to adjust the hedged items and hedging instruments in a continuing hedging strategy.

55. As stated in paragraph 48, the requirement to assess whether a non-contractually specified risk component is separately identifiable, and hence a qualifying hedged

[15] For further information, refer to paragraphs 6.8.7, 102G and BC26 of the ED.

[16] This includes portfolio hedges of interest rate risk and 'macro cash flow hedges' as colloquially referred to in BC6.91 of IFRS 9. These hedging relationships are collectively referred to as 'macro hedges'.

item, requires a continuous assessment. In view of this, if the outcome of the reform affects the market structure of a benchmark component of interest rate risk that is non-contractually specified, it could affect an entity's continuous assessment of whether that risk component is separately identifiable. The exception proposed in the ED therefore provides that a hedged item that satisfied the separately identifiable criteria when designated in a hedging relationship, does not need to be re-assessed subsequently, subject to continuing to satisfy all other hedge accounting requirements.

56. The staff therefore consider that providing a similar exception for hedged items in a macro hedging relationship to satisfy the separately identifiable criteria only when the hedged items are initially designated (subject to continuing to satisfy all other hedge accounting requirements) would be consistent with the objective of the proposed amendments to IFRS 9 and IAS 39.

57. To illustrate, assume an entity applies hedge accounting for a portfolio hedge of interest rate risk under IAS 39 and designates the LIBOR risk component of fixed-rate loans. At inception of the relationship, the entity assesses whether LIBOR is a separately identifiable risk component for all fixed rate loans designated within the hedging relationship. As the risk position is updated with the origination of new fixed rate loans and the maturity/repayment of existing loans, the hedging relationship is adjusted by de-designating it and re-designating a 'new' hedging relationship for the updated amount of fixed rate loans. Applying the proposed relief as described in paragraph 52 would allow the entity to assess whether LIBOR is a separately identifiable risk component only for the new fixed rate loans added to the hedging relationship. The entity would not reassess the separately identifiable requirement for the fixed rate loans that have been re-designated.

58. Finally, a few respondents suggested that the Board should consider permitting designation of risk components that are not separately identifiable. The staff note that this is different from allowing continued designation of risk components that had met the separately identifiable requirement at the inception of a hedging relationship. The staff also note that this issue was considered by the Board during the deliberations leading to the ED and, as noted in paragraph BC27 of the ED,

the Board decided not to allow entities to designate a benchmark risk component that is not separately identifiable at the inception of the hedging relationship. Therefore, the staff have not considered this approach proposed by respondents.

Mandatory application and end of application

59. Assuming the Board agrees with the staff view in paragraph 56 that the exception for the separately identifiable requirement should be extended to ‘macro hedges’, the staff consider that the application of this exception should be consistent with the proposals in the ED. In particular, the staff consider that:

    (a) the exception for the separately identifiable requirement should be mandatory for the reasons set out in paragraphs BC28–BC31 of the ED; and

    (b) there should not be an end of application requirement for the exception from the separately identifiable requirement applied in the context of ‘macro hedges’ for the reasons set out in paragraph BC43 of the ED.

Staff recommendation

60. The staff recommend that, for ‘macro hedges’ designated under either IFRS 9 or IAS 39, an entity should assess whether a non-contractually specified risk component is separately identifiable only at the time the hedged item is initially designated in the ‘macro hedge’. Once a hedged item is designated within a ‘macro hedge’, the separately identifiable requirement should not be reassessed for that same hedged item at subsequent re-designations.

61. The staff further recommend that the exception is mandatory for all ‘macro hedges’ directly affected by reform and no end of application requirement is specified for the reasons described in paragraph BC43 of the ED.

Question 2 for the Board

Question 2 for the Board
Does the Board agree with the staff recommendation in paragraphs 60–61 that: a) an exception is provided for 'macro hedges' designated under either IFRS 9 or IAS 39 so that an entity would assess whether a non-contractually specified risk component is separately identifiable only at the time the hedged item is initially designated in the 'macro hedge'; and b) the exception is mandatory for all 'macro hedges' directly affected by the reform and no end of application requirement is specified for the reasons described in paragraph BC43 of the ED.

End of application for hedges of a group of items

62. As noted in paragraph BC33 of the ED, an entity should cease applying the proposed exceptions to the highly probable requirement and the prospective assessments at the earlier of: a) when the uncertainty regarding the timing and the amount of interest rate benchmark-based cash flows is no longer present; and b) the discontinuation of the hedging relationship.[17] According to the ED, for uncertainty regarding the timing and the amount of cash flows to be eliminated, the underlying contracts are required to be amended to specify the timing and the amount of cash flows based on the alternative interest rate.

63. Some respondents to the ED suggested that the Board should further clarify how an entity would apply the proposed amendments when the hedged item is made up

[17] The Board decided not to propose an end of application requirement with respect to the exception for the separately identifiable requirement because this would be inconsistent with the objective of the proposed exception. For further information, refer to paragraph BC43 of the ED.

of a group of items, including ‘macro hedges’. More specifically, when assessing whether the uncertainty arising from the reform is no longer present, respondents asked whether this assessment should be performed on an individual basis (ie exceptions are applied to individual items within the group) or on a group basis (ie exceptions are applied until there is no uncertainty surrounding the last item in the group).

Staff analysis

64. Even though IFRS 9 and IAS 39 have different qualifying criteria for the designation of a group of items as a hedged item in a hedging relationship, both standards permit a hedge item to consist of a group of items subject to other qualifying criteria being met.[18]

65. The staff considered an example where an entity designated a group of five LIBOR-based loans in a cash flow hedging relationship. The loan contracts require bilateral negotiation with the counterparties and are amended as and when the negotiations with each counterparty are completed. At the reporting date, three of the five loans are amended so that the contract specifies the new benchmark interest rate and no uncertainty remains regarding the timing and the amount of the hedged cash flows for those three loans. If the proposed exceptions for the highly probable requirement and the prospective assessments are applied on a group basis, the entity will continue to apply the exceptions until all uncertainty regarding the timing and amount of the hedged cash flows in the group are eliminated. In other words, the entity will assume that the hedged cash flows in all five contracts will remain LIBOR-based (even though for some loans the cash flows are already based on the new benchmark interest rate) until the last loan contract has been amended. On the other hand, if the proposed exceptions are applied on an individual basis, the entity will only apply the exceptions to those loan contracts for which there are still uncertainties regarding the timing and amount of the hedged cash flows and cease to apply the exceptions to those loan contracts where the uncertainties have been eliminated.

[18] A detailed discussion of such qualifying criteria is beyond the scope of this paper. For further information, refer to paragraphs 6.6.1–6.6.6 and B6.6.1–B6.6.16 of IFRS 9 and paragraphs 83–84 of IAS 39.

66. The staff are of the view that the proposed exceptions and therefore the assessment of whether uncertainty regarding the timing and amount of hedged cash flows is no longer present, should be performed on an individual basis (ie the proposals apply to each individual item within the designated group of items).

67. More specifically, an entity should cease applying the exceptions to a specific financial instrument 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 of that specific financial instrument.

Staff recommendation

68. The staff recommend that the final amendments should clarify that, when an entity designates a group of items as the hedged item in accordance with paragraph 6.6.1 of IFRS 9 or paragraph 83 of IAS 39, the end of application requirement proposed in the ED should apply to each individual item within the designated group of items.

Question 3 for the Board

Question 3 for the Board
Does the Board agree with the staff recommendation in paragraph 68 that the final amendments should clarify that, when an entity designates a group of items as the hedged item in accordance with paragraph 6.6.1 of IFRS 9 or paragraph 83 of IAS 39, the end of application requirement proposed in the ED should apply to each individual item within the designated group of items.

Scope of the proposed amendments

69. Paragraph BC6 of the ED explains that the hedge accounting issues addressed by the proposed amendments arise in the context of interest rate benchmark reform. On that basis, the ED proposes that an entity should apply the exceptions to all

hedging relationships of interest rate risk that are affected by interest rate benchmark reform and only to such hedge accounting relationships (proposed amendments to paragraphs 6.8.1 of IFRS 9 and 102A of IAS 39).

70. Some respondents however observed that, as set out in the ED (ie referring to hedges of interest rate risk), the scope of the proposed amendments would not contemplate other types of hedging relationships which may also be affected by uncertainties arising from the reform. For example, these may include situations where an entity designates cross currency interest rate swaps to hedge exposures to both foreign currency and interest rate risk. These respondents suggested the Board should clarify the scope of the proposed amendments in order to incorporate such hedging relationships.

71. Some respondents also noted that uncertainties arising from the reform might affect other types of hedging relationships, such as net investment hedges and hedges of inflation risk and requested the Board to also extend the scope of the proposed amendments to include these relationships.

Staff analysis

72. With regards to the feedback received, the staff consider that it was not the intention of the Board to exclude from the scope of the proposals hedging relationships where interest rate risk is not the only hedged risk being designated. Such hedges might also be directly affected by the reform when the reform gives rise to uncertainties about the timing and/or amount of interest rate benchmark-based cash flows of the hedged item and/or hedging instrument and therefore the proposed amendments should also apply in these situations. Furthermore, this is consistent with the implied intention of the scope of the proposed amendments, as noted in paragraph BC6 of the ED, to address hedge accounting issues that arise in the context of interest rate benchmark reform.

73. However, the staff are of the view that the proposed exceptions should only apply to those hedging relationships that are directly affected by uncertainties about the timing and/or amount of *interest rate benchmark-based cash flows of the hedged item and/or hedging instrument* arising from the reform. Therefore, if a hedged item or hedging instrument is designated for risks other than just interest rate risk,

the proposed exceptions only apply to the interest rate benchmark-based cash flows.

Staff recommendation

74. The staff recommend that the scope of the proposed exceptions is clarified so that the exceptions only apply to those hedging relationships that are directly affected by uncertainties about the timing and/or amount of *interest rate benchmark-based cash flows of the hedged item and/or hedging instrument* arising from the reform. This will include hedging relationships in which interest rate risk is not the only hedged risk.

Question 4 for the Board

Question 4 for the Board
Does the Board agree with the staff recommendation in paragraph 74 that the scope of the proposed exceptions should be clarified so that the exceptions only apply to those hedging relationships that are directly affected by uncertainties about the timing and/or amount of *interest rate benchmark-based cash flows of the hedged item and/or hedging instrument* arising from the reform?

Disclosure requirements

75. At the time of its deliberations leading to the ED, the Board noted that IFRS 7 *Financial Instruments: Disclosures* already requires disclosures about hedge accounting. Therefore, the Board identified some specific IFRS 7 disclosures that would result in useful information to users of financial statements when provided separately for hedging relationships to which the proposed exceptions apply. As noted in BC44 of the ED, the objective of the disclosures is to provide users of financial statements with information about the magnitude and extent to which the proposed exceptions apply to an entity's hedging relationships.

76. The disclosure requirements proposed in the ED required an entity to separately disclose the following information for hedging relationships to which the entity applies any of the exceptions proposed in the ED:

   (a) For hedging instruments:

      (i) the carrying amount of the hedging instruments;

      (ii) the change in the fair value of the instrument used as the basis for recognising hedge ineffectiveness for the period; and

      (iii) the nominal amounts of the hedging instruments.

   (b) For hedged items in fair value hedges:

      (i) the carrying amount of the hedged item recognised in the statement of financial position;

      (ii) the accumulated amount of fair value hedge adjustments on the hedged item included in the carrying amount of the hedged item; and

      (iii) the change in value of the hedged item used as the basis for recognising hedge ineffectiveness for the period.

   (c) For hedged items in cash flow hedges:

      (i) the change in value of the hedged item used as the basis for recognising hedge ineffectiveness for the period;

      (ii) the balances in the cash flow hedge reserve for continuing hedges; and

      (iii) the balances remaining in the cash flow hedge reserve from any hedging relationships for which hedge accounting is no longer applied.

77. Most respondents to the ED agreed that the information about the magnitude of the hedging relationships to which the exceptions apply would be useful to users of financial statements and thus entities applying the exceptions proposed in the ED should disclose such information. In addition, a few auditors and regulators noted that absent separate quantitative information on hedging relationships applying the proposed exceptions, there is a risk that useful information about the impact of the reform would be obscured through aggregation with other hedges.

78. However, there were mixed views about the extent of disclosures that would strike the right balance between the costs for preparers and the benefits for the users of financial statements. In particular, many respondents expressed the view that disaggregation of information about the carrying amounts and gains and losses between hedging relationships that are affected by the reform, as proposed in the ED, would impose additional costs for preparers without any discernible benefits for the users of the financial statements.

79. These respondents suggested the following:

(a) disclose only the notional amount of hedging instruments and hedged items to which the proposed exceptions are applied.

(b) disclose only qualitative information about the criteria and key judgments used to determine which hedging relationships the proposed exceptions should be applied to and the impacts of the reform on the entity's risk management strategy.

(c) if the Board decides to proceed with the finalisation of the disclosures as proposed in the ED, to simplify the disclosure requirements for macro hedges. This is because separately disclosing information for these hedges can be complex and impose significant costs given their continuous changing nature.

80. Finally, respondents also expressed concerns about the application of paragraph 28(f) of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, which requires entities to disclose, for the current period and each prior period presented, the amount of the adjustment: i) for each financial statement line item affected; and ii) for basic and diluted earnings per share, if IAS 33 *Earnings per Share* applies to the entity. More specifically, respondents suggested the Board provide an exception from the requirements in paragraph 28(f) of IAS 8 on the basis that:

(a) such disclosure requirements may be onerous for preparers because it would potentially require the maintenance of two sets of records for their hedge accounting activities; one set would record the effects of applying the amendments and the other of not doing so.

(b) the information about the effect had the amendment not been applied (and so likely illustrate the impact of not applying hedge accounting) may not be meaningful, given the primary reason for proposing the amendments is that discontinuing hedge accounting solely due to the uncertainties of the reform would not provide useful information for users of financial statements.

Staff analysis

81. As requested by some Board members during the July 2019 Board meeting, the staff have conducted informal outreach to gain an understanding about the key disclosures that would provide useful information to the users of financial statements about the uncertainties arising from the reform. The key messages heard during the outreach, included:

(a) the potential financial reporting implications arising during the pre-replacement phase is not an area of particular concern to analysts at the moment as they consider this market-wide process to be driven and controlled by the various regulators.

(b) they agree with the overall objective of the exceptions as articulated in the ED, ie to provide exceptions during this period of uncertainty to specific hedge accounting requirements such that entities would assume that the interest rate benchmark is not altered as a result of the reform.

(c) as the proposed exceptions are mandatory, they want to understand the extent to which an entity's hedging relationships are within the scope of the proposed exceptions, for example through disclosure of the nominal amounts of the hedging instruments and hedged items to which the exceptions are applied.

(d) these quantitative disclosures of the nominal amounts should be supplemented by qualitative disclosures that will provide useful information about significant assumptions and/or judgements an entity had to make and how the uncertainties arising from the reform is impacting the entity's risk management policies and strategies.

82. Based on the feedback received, the staff are of the view that useful and more targeted information could be provided to users of financial statements, while at the same time reducing the operational burden on preparers, by requiring the following information to be disclosed about the hedging relationships to which the exceptions are applied:

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

b) the impact of the uncertainties arising from the reform on an entity's risk management strategy, and how the entity is managing the process to transition to an alternative benchmark interest rate;

c) an explanation of significant assumptions or judgements the entity had to make in applying the exceptions to those hedging relationships within the scope of the amendments; and

d) the nominal amount of the hedging instruments and the extent of risk exposure the entity managed that is impacted by the reform.

83. Finally, the staff acknowledge the feedback that the disclosures required by paragraph 28(f) of IAS 8 would not provide useful information to users of financial statements. This is because applying paragraph 28(f) of IAS 8 would require an entity to determine the amount of the adjustment for each financial statement line item affected by discontinuation of hedge accounting should the exceptions proposed in the ED had not been applied. However, as noted in paragraph BC4 of the ED, reporting the effects of discontinuing hedge accounting due to the effects of uncertainties arising from the reform would not provide useful information to users of the financial statements. The staff therefore do not consider the disclosure requirements in paragraph 28(f) of IAS 8 to provide useful information to the users of the financial statements in the context of the uncertainties arising from the reform.

Staff recommendation

84. For the reasons expressed in paragraph 82, the staff recommend that the disclosure requirements accompanying the exceptions proposed in the ED be reduced to only

require the disclosure of the following information in the notes to the financial statements:

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

b) the impact of the uncertainties arising from the reform on an entity's risk management strategy, and how the entity is managing the process to transition to an alternative benchmark interest rate;

c) an explanation of significant assumptions or judgements the entity had to make in applying the exceptions to those hedging relationships within the scope of the amendments; and

d) the nominal amount of the hedging instruments and the extent of risk exposure the entity managed that is impacted by the reform.

85. Furthermore, for the reasons expressed in paragraph 83, the staff recommend that an exemption be provided from the disclosure requirements in paragraph 28(f) of IAS 8 upon the initial application of the amendments.

Question 5 for the Board

Question 5 for the Board
Does the Board agree with the staff recommendations regarding disclosures to be required in the notes to the financial statements as set out in paragraphs 84–85?