September 2019

IFRS® Standards
Project Summary

Interest Rate Benchmark Reform

Amendments to IFRS 9, IAS 39 and IFRS 7

Background

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

Market developments have undermined the reliability of some existing benchmarks. In this context, the Financial Stability Board has published a report setting out recommendations to reform some major benchmarks.[1] Some jurisdictions have already made clear progress towards replacing existing benchmarks with alternative, nearly risk-free rates.

This work has, in turn, led to uncertainty about the future of some existing interest rate benchmarks, which may affect companies' financial reporting.

The amendments made provide relief from the potential effects of the uncertainty caused by the reform.

Some hedge accounting requirements in IFRS 9 and IAS 39 may be affected by uncertainties arising from the impact of the reform on the timing and amount of designated future cash flows.

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Due to such uncertainties, companies could be required to discontinue hedge accounting. Companies may also not be able to designate new hedging relationships.

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In the Board's view, discontinuation of hedge accounting solely due to such uncertainties would not provide useful information to users of financial statements.

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Therefore, the Board decided to amend specific hedge accounting requirements in IFRS 9 and IAS 39 to provide exceptions during this period of uncertainty.

1 The Reforming Major Interest Rate Benchmarks report is available at http://www.fsb.org/wp-content/uploads/r_140722.pdf.

Scope of the amendments

A two-phase project

In its outreach with stakeholders, the Board identified two groups of accounting issues that could affect financial reporting. These are:

- *pre-replacement issues*—issues affecting financial reporting in the period before the reform; and
- *replacement issues*—issues that might affect financial reporting when an existing interest rate benchmark is either reformed or replaced.[2]

The Board considered the pre-replacement issues to be more urgent and decided to address the following hedge accounting requirements as a priority in the first phase of the project:

(a) the highly probable requirement;

(b) prospective assessments;

(c) IAS 39 retrospective assessment; and

(d) separately identifiable risk components.

All other hedge accounting requirements remain unchanged.

Scope

A company shall apply the exceptions to all hedging relationships directly affected by interest rate benchmark reform.

A hedging relationship is 'directly affected' if the reform gives rise to uncertainties about:

- the interest rate benchmark designated as a hedged risk (contractually or non-contractually specified); and/or
- the timing or the amount of interest rate benchmark-based cash flows of the hedged item or of the hedging instrument.

IFRS 9 allows companies, when they first apply IFRS 9, to choose, as an accounting policy, to continue to apply the hedge accounting requirements of IAS 39.

A significant number of IFRS preparers —financial institutions in particular— have elected to continue to apply hedge accounting according to IAS 39 rather than IFRS 9. For this reason, the Board decided to amend both IFRS 9 and IAS 39.

2 The replacement issues will be addressed in the next phase of the project. For more information, refer to page 10 of this document.

Highly probable requirement

Hedge accounting requirement

According to IFRS 9 and IAS 39, when a forecast transaction is designated as a hedged item, that transaction must be highly probable to occur.

Potential effects due to reform

At some point in time, forecast IBOR-based cash flows may no longer meet the highly probable requirement due to uncertainties arising from interest rate benchmark reform.

This is because the underlying contracts might need to be amended with the result that the future cash flows would be based on an alternative nearly risk-free rate, rather than on IBOR.

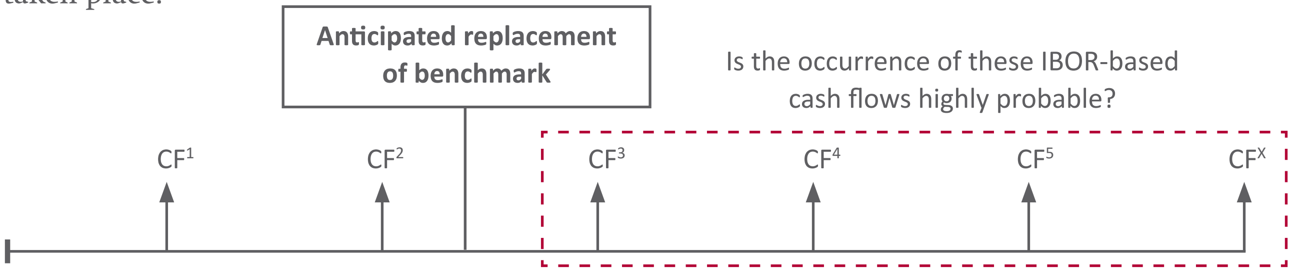
Amendment

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

The amendment also applies to cash flow hedges that have been discontinued with an amount remaining in the cash flow hedge reserve.

Applying the amendment

For example, assume a company designates as the hedged item forecast IBOR-based cash flows (shown as 'CF' below) that are expected to occur after interest rate benchmark reform has taken place.



Applying the amendment, the company will assume that the designated forecast cash flows will not be altered as a result of the reform (ie they will continue to be IBOR-based). If, however, the forecast cash flows are no longer expected to occur for other reasons, then the company must discontinue hedge accounting as usual.

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 (described in IFRS 9) or the hedge is expected to be highly effective in achieving offsetting (described in IAS 39). Companies must demonstrate such prospective assessments on a regular basis.

Potential effects due to reform

Today, in making these assessments, companies would consider possible changes to future cash flows of hedged items and hedging instruments.

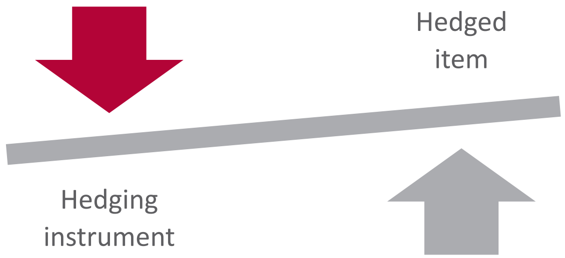
Prospective assessments could be affected due to the uncertainties arising from the reform and potentially this could result in discontinuation of hedge accounting.

Amendment

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

Applying the amendment

For example, in making these prospective assessments, companies would have to consider possible changes to future cash flows of hedged items and hedging instruments.



At some point in time, it is possible that companies would not be able to demonstrate the required prospective assessments to continue hedge accounting due to uncertainties arising from the reform.

These assessments might be affected by uncertainties around timing and amount of designated cash flows. For example, companies 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 cash flows will be changed.

Applying the amendment, companies will assume that the interest rate benchmark associated with the hedged item, hedged risk and/or hedging instrument is not altered as a result of interest rate benchmark reform.

IAS 39 retrospective assessment

Hedge accounting requirement

To apply hedge accounting under IAS 39, companies must demonstrate that the actual results of the hedge are within a range of 80–125%. This requirement is commonly known as the 'IAS 39 retrospective assessment'.

Potential effects due to reform

The feedback from comment letters on the Exposure Draft emphasised that uncertainties arising from the reform could affect the assessment of whether the actual results of the hedge are within the 80–125% range.

According to IAS 39, failure to meet this requirement would require discontinuation of hedge accounting.

Companies must continue to measure the hedging instrument and hedged item as required by current IFRS Standards. The exception from IAS 39 retrospective assessment does not change the requirement to measure and recognise all ineffectiveness in profit or loss.

Amendment

In response to feedback on the Exposure Draft *Interest Rate Benchmark Reform* (Exposure Draft), the Board decided to amend IAS 39 so that a company is not required to undertake the IAS 39 retrospective assessment for hedging relationships directly affected by the reform. However, the company must comply with all other IAS 39 hedge accounting requirements, including the prospective assessment.

Applying the amendment

For example, assume an IBOR-based hedging instrument and hedged item are designated in a hedging relationship under IAS 39 that has been highly effective—it has passed the periodic prospective assessments and its actual results have been within the 80–125% range.

At some point in time, the reform might give rise to uncertainties about the timing and the amount of the designated IBOR-based cash flows.

In this scenario, it is possible that effectiveness calculated for the purpose of IAS 39 retrospective assessment would fall outside of the 80–125% range due to uncertainties from the reform.

Applying the amendment, companies are not required to apply the IAS 39 retrospective assessment. This means companies would not discontinue hedge accounting if the hedge falls outside the 80–125% range during the period of uncertainty arising from the reform.

Separately identifiable risk components

Hedge accounting requirement

While there are some differences between IFRS 9 and IAS 39 regarding designation of risk components, both Standards require a risk component (or a portion) to be separately identifiable to be eligible for hedge accounting.

A company may designate an item in its entirety or a component of an item as a hedged item in a hedging relationship. IFRS 9 and IAS 39 require the component to be separately identifiable to qualify as a hedged item.

Potential effects due to reform

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

Interest rate benchmark reform could affect the market structure and, consequently, affect the assessment of whether non-contractually specified risk components are separately identifiable.

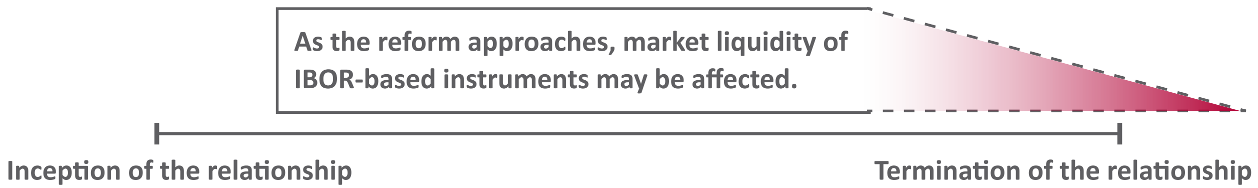
Amendment

For hedges of a non-contractually specified benchmark component of interest rate risk, a company shall apply the separately identifiable requirement only at the inception of such hedging relationships.

In response to feedback from comment letters on the Exposure Draft, the Board decided to amend IFRS 9 and IAS 39 so that a company shall apply the separately identifiable requirement only when an instrument is initially designated as a hedged item in a 'macro hedge' relationship. The hedged item is not reassessed at any subsequent re-designation in the same hedging relationship.

Applying the amendment

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



The amendment will require companies to assess the separately identifiable requirement at the inception of the hedging relationship only. The company does not continue this assessment over the life of the hedge.

End of application of the exceptions

The objective of the amendments is to provide temporary exceptions from applying specific hedge accounting requirements during the period of uncertainty arising from the reform.

The exceptions will end once the uncertainty is resolved. This also means that the period for which the exceptions are necessary and available may vary by jurisdiction.

End of application

A company shall cease applying the exceptions when:

(a) 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; or

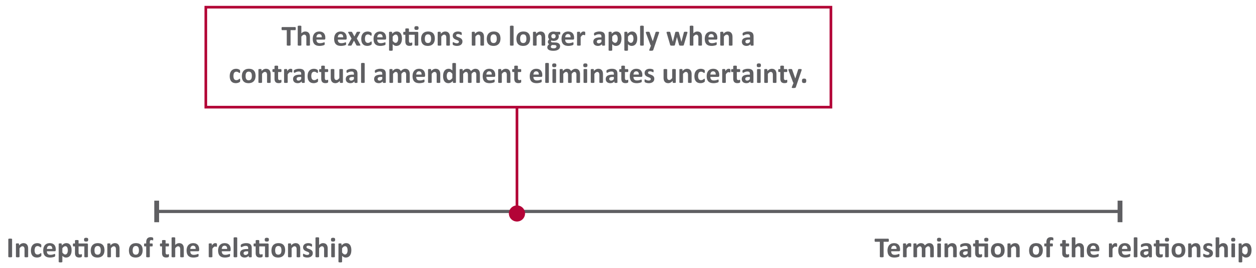
(b) the hedging relationship is discontinued.

End of application does not apply to the test for separately identifiable risk components.

In response to feedback from comment letters on the Exposure Draft, the Board decided to clarify that, when a company designates a group of items as the hedged item, or a combination of financial instruments as the hedging instrument, the end of application requirement should be applied to each individual item in the hedge.

The way in which the uncertainty is resolved will vary. 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 alternative, nearly risk-free rate on which the designated cash flows will be based, the uncertainty regarding the timing and amount of those cash flows is eliminated when the contract is amended. In this scenario, the company would cease to apply the exceptions once the contract is amended.



However, some contractual amendments might not eliminate the uncertainties (eg timing and amount of the amended cash flows are not specified or only one of them is specified). In such cases, the exceptions would still apply.

Effective date and disclosures

Effective date

The amendments apply for annual reporting periods beginning on or after 1 January 2020. Earlier application is permitted. The effective date reflects the urgency of this issue.

The amendments are mandatory for all hedges within the scope. The Board considered but decided against voluntary application, as it could give rise to selective discontinuation of hedge accounting.

Disclosures

The Board considered the feedback from comment letters and decided to reduce the disclosure requirements initially proposed in the Exposure Draft.

Disclosure requirements

For hedging relationships affected by the amendments, companies are required to provide the following disclosures:

- the significant interest rate benchmarks to which the company's hedging relationships are exposed;
- the extent of the risk exposure the company manages that is directly affected by the interest rate benchmark reform;
- how the company is managing the process to transition to alternative benchmark rates;
- description of significant assumptions or judgements the company made in applying the exceptions (for example, assumptions or judgements about when the uncertainty arising from interest rate benchmark reform is no longer present); and
- the nominal amount of the hedging instruments in those hedging relationships.

Next steps – replacement issues

Background

While the Board developed solutions to the time-critical pre-replacement issues (Phase 1), more information became available about the replacement issues (Phase 2).

As such, the Board will commence its deliberations on the potential financial reporting implications of replacement issues to determine whether it should take any action in the form of further amendments to IFRS Standards.

Staff research activities to date

The staff have engaged with securities regulators, central banks, audit firms, industry groups and financial institutions to obtain an understanding of the effects of the reform on financial reporting. The staff have also gathered inputs from the Accounting Standards Advisory Forum on potential accounting implications of the reform that should be considered by the Board in Phase 2.

The staff also considered the feedback from comment letters on the Exposure Draft, as most respondents commented on potential issues for the Board to consider as part of Phase 2.

Phase 2 next steps

The staff have presented a preliminary list of potential accounting issues to be considered by the Board in Phase 2.

The Board expects to commence the discussions about specific replacement issues in Q4 of 2019.

The Board is aware that any necessary amendments to address these issues need to be considered on a timely basis.

Important information

This Project Summary has been compiled by the staff of the IFRS Foundation for the convenience of interested parties. The views within this document are those of the staff who prepared this document and are not the views or the opinions of the Board and should not be considered authoritative in any way. The content of this Project Summary does not constitute any advice. Official pronouncements of the Board are available in electronic format to eIFRS subscribers. Publications are available for ordering from our website at www.ifrs.org.

Further information

The Basis for Conclusions on the *Interest Rate Benchmark Reform*, which amends Amendments to IFRS 9, IAS 39 and IFRS 7, analyses the considerations of the Board when developing these amendments including comprehensive analysis of the feedback on the proposals that preceded the amendments and how the Board responded to that feedback.

Stay informed

To stay up to date with the latest developments and to sign up for email alerts about the project, please visit the project homepage on https://www.ifrs.org/projects/work-plan/ibor-reform-and-its-effects-on-financial-reporting-phase-1/.

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