STAFF PAPER

December 2019

IASB® meeting

Project	IBOR Reform and its Effects on Financial Reporting – Phase 2		
Paper topic	Cover paper and summary of discussions to date		
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Introduction

1. The purpose of this paper is to summarise the Board's discussions to date related to the *IBOR Reform and its Effects on Financial Reporting – Phase 2* project. This paper is structured as follows:

   (a) Background (paragraphs 3–5);

   (b) Objective of this project (paragraphs 6–7);

   (c) Project plan and current stage (paragraphs 8–9);

   (d) Tentative decisions to date (paragraphs 10–12); and

   (e) Next steps (paragraph 13).

2. This paper accompanies **Agenda Paper 14A *Hedge accounting*** which discusses the potential hedge accounting issues that could arise as a result of interest rate benchmark reform (IBOR reform).

Background

3. In September 2019, the Board issued *Interest Rate Benchmark Reform* (Amendments to IFRS 9, IAS 39 and IFRS 7) to provide exceptions from some specific hedge accounting requirements as a result of uncertainty arising from IBOR reform – ie 'pre-replacement' issues. These pre-replacement issues were addressed as a priority in the first phase of the project, because they could affect financial reporting in the period before the replacement or reform of interest rate benchmarks.

4. As discussed at the September 2019 Board meeting, the staff have engaged with securities regulators, central banks, audit firms, industry groups and financial institutions to obtain an understanding of the effects of IBOR reform on financial reporting. The staff also gathered input from the Accounting Standards Advisory Forum and considered the feedback received from comment letters[1] on the May 2019 Exposure Draft *Interest Rate Benchmark Reform* to identify potential issues for the Board to consider as part of Phase 2.

5. With the conclusion of Phase 1 of the project, at the September 2019 Board meeting, the staff presented the preliminary scope of the potential issues to be considered during Phase 2 and the proposed order in which these issues should be discussed with the Board.[2]

Objective of this project

6. As the scope of the issues to be considered by the Board in Phase 2 is broader than the previous phase of the project, thereby increasing the opportunity for 'scope creep', the staff believe that defining the objective of Phase 2 would be important to guide the Board in determining whether and how the various potential issues should be addressed.

[1] For further information, refer to the July 2019 Agenda Paper 14A *Summary of feedback from comment letters* and Agenda Paper 14B *Additional issues for consideration before finalising the proposed amendments*.

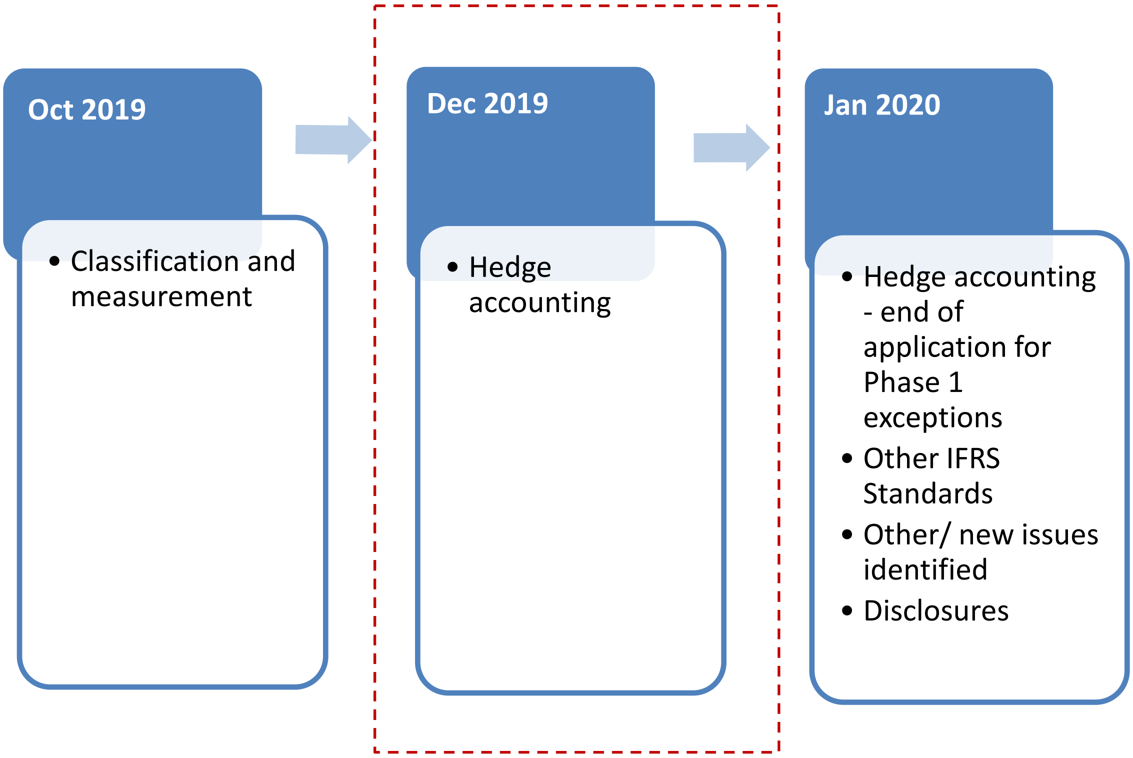
[2] The Board decided to start Phase 2 with classification and measurement given any decisions in this regard will impact the analysis of the other issues in the scope. Refer to the September 2019 Agenda Paper 14 *Project plan and preliminary timing* for further information about the project plan.

7. Consistent with the overall objective of financial reporting as set out in the *Conceptual Framework*, the staff are of the view that the objective of Phase 2 should be to provide useful information about the effects of the transition to alternative benchmark rates on an entity's financial statements and support preparers in applying the requirements of the IFRS Standards during IBOR reform. This will assist the Board in assessing whether it should take any action in the form of amendments to IFRS Standards, which could include narrow-scope exceptions, additional application guidance or illustrative examples.

Project plan and current stage

8. As mentioned in paragraph 4, the staff presented the preliminary scope of the potential issues to be considered during Phase 2 and the proposed order in which these issues should be discussed with the Board. Following the discussion on classification and measurement of financial instruments, held at the October 2019 Board meeting, the next key area for discussion with the Board is the potential hedge accounting issues that could arise as a result of IBOR reform, which are discussed in Agenda Paper 14A of the December 2019 meeting.

9. In view of the September 2019 discussions, the staff prepared the following chart which outlines the indicative timing and key areas for discussion with the Board during Phase 2 of the project.



Note:

- - - Current stage

Tentative decisions to date

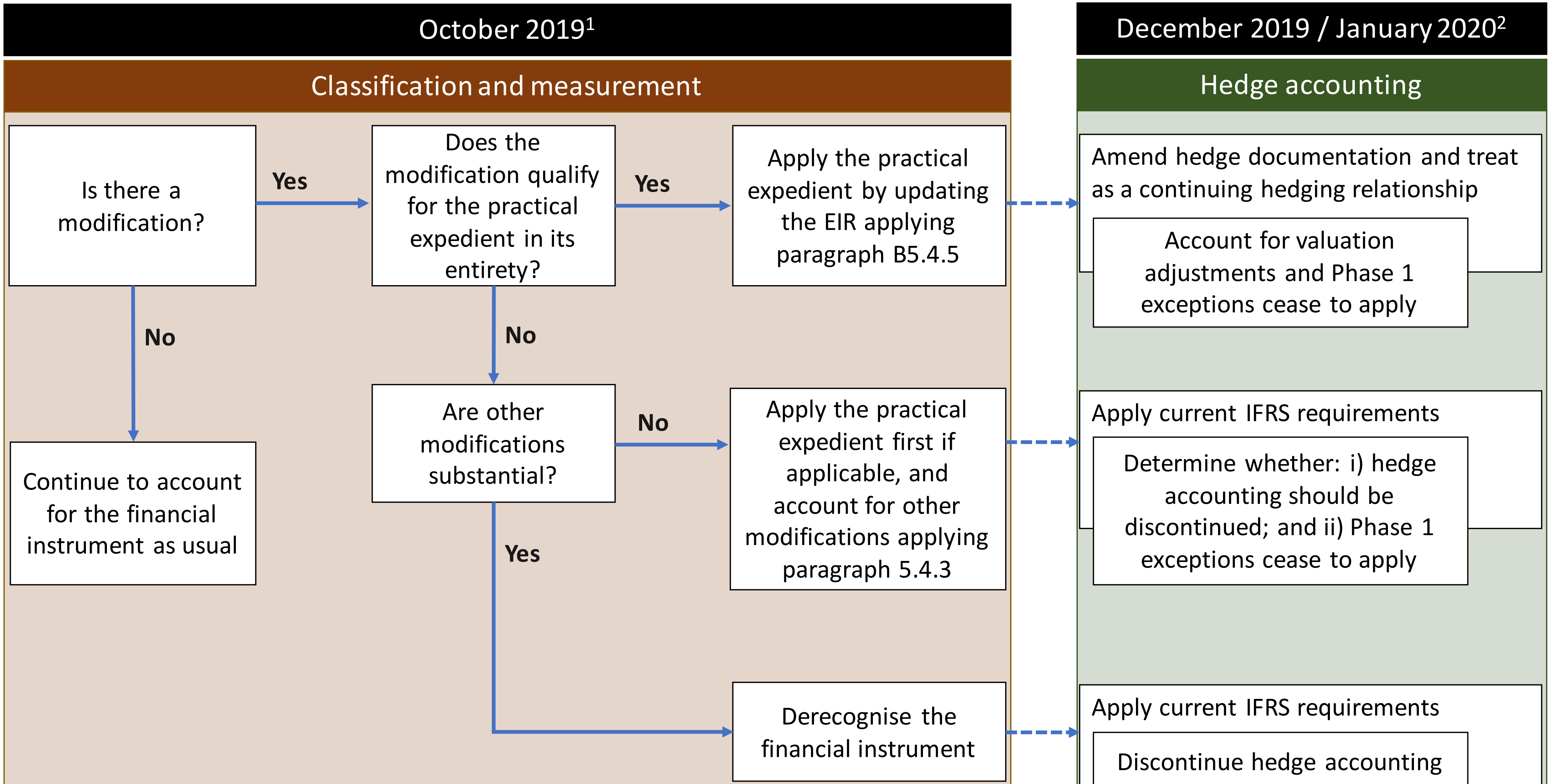
10. The Board met on 23 October 2019 to discuss potential accounting issues related to the classification and measurement of financial instruments that could arise as a result of IBOR reform. The Board tentatively decided to amend IFRS 9 *Financial Instruments* to:

    (a) clarify that, even in the absence of an amendment to the contractual terms of a financial instrument, a change in the basis on which the contractual cash flows are determined that alters what was originally anticipated constitutes a modification of a financial instrument in accordance with IFRS 9.

    (b) provide a practical expedient allowing an entity to apply paragraph B5.4.5 of IFRS 9 to account for modifications to the interest rate benchmark on which a financial instrument's contractual cash flows are based, that are: (a) required as a direct consequence of IBOR reform; and (b) done on an economically equivalent basis. For ease of reference, these are referred to as modifications ‘directly required by the reform’. The Board also tentatively decided to provide examples in IFRS 9 of modifications that are directly required by the reform, and examples of those that are not.

(c) clarify that an entity should first apply paragraph B5.4.5 of IFRS 9 to account for modifications directly required by the reform to which the practical expedient applies. Thereafter, an entity should apply the current IFRS 9 requirements to determine if any other modifications are substantial; if those modifications are not substantial, the entity should apply paragraph 5.4.3 of IFRS 9.

11. The following flowchart summarises the Board’s discussions and tentative decisions reached at the October 2019 Board meeting, and the staff recommendations for hedge accounting that are subject to discussion with the Board at the December 2019 and January 2020 meetings.



Notes:

[1] Discussed and tentatively decided by the Board at its October 2019 meeting.

[2] For discussion with the Board at this and at the January 2020 meeting.

12. At its October 2019 meeting, the Board also tentatively decided that, in the context of IBOR reform, current requirements in IFRS 9 provide sufficient guidance to determine the appropriate accounting treatment in the following situations:

    (a) derecognising a financial asset or a financial liability from the statement of financial position and the recognition of the resulting gain or loss in profit or loss following a substantial modification.

    (b) determining an entity’s business model for managing financial assets.

    (c) determining whether the interest component of the contractual cash flows of a new financial asset referenced to alternative benchmark rates meets the criteria for solely payments of principal and interest on the principal amount outstanding (SPPI), as required by IFRS 9. The Board also tentatively decided to add an example to IFRS 9 to illustrate the application of the SPPI assessment in the context of IBOR reform.

    (d) recognising the expected credit losses for new financial assets and the accounting for embedded derivatives for financial liabilities.

Next steps

13. The next key areas for discussion that will require decisions from the Board are:

    (a) Hedge accounting – end of application for Phase 1 exceptions; and

    (b) Other IFRS Standards and disclosures.

    The staff will bring these areas for discussion with the Board at its January 2020 meeting.