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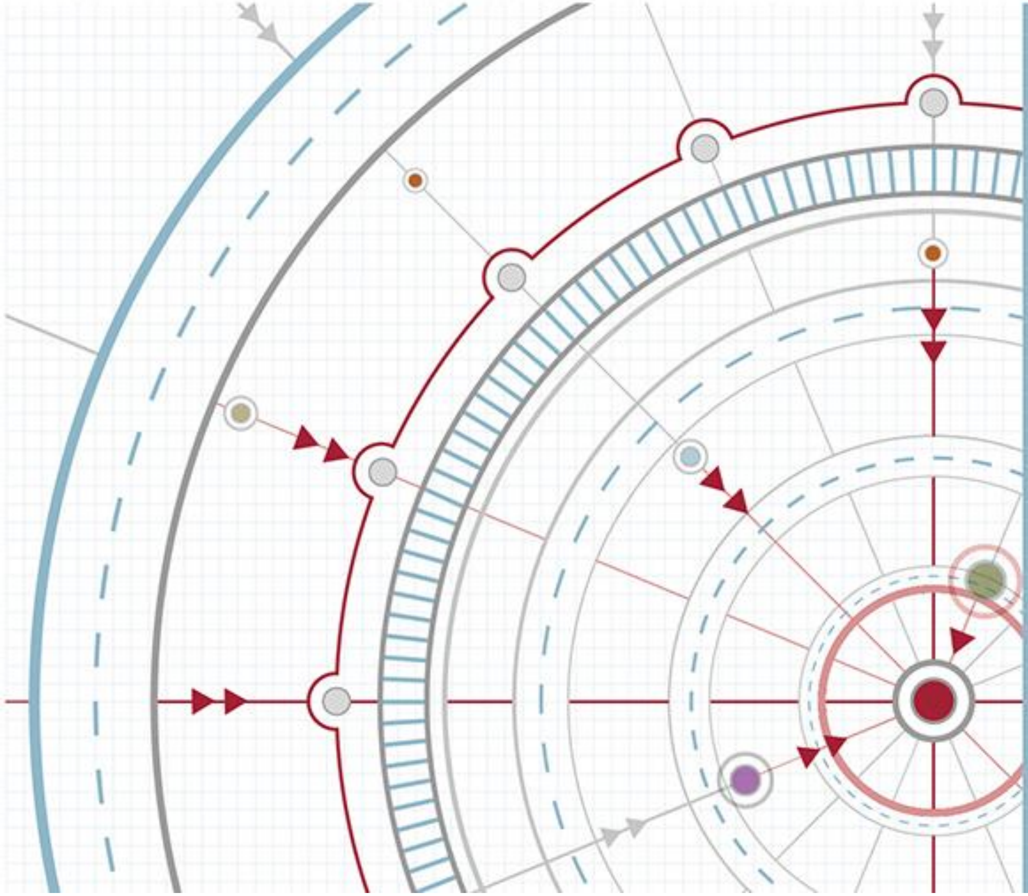

IBOR Reform and its Effects in Financial Reporting—Phase 2

Accounting Standards Advisory Forum meeting

April 2020

ASAF Agenda Paper 2

Objective of this session

- We will provide ASAF members with an overview of proposed amendments in the upcoming Exposure Draft for Phase 2 of the project (Phase 2).

In October 2019 ASAF members provided views on the preliminary scope of issues to be addressed in Phase 2.

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In February 2020 the Board completed its discussions on the issues in scope of Phase 2 and plans to publish an Exposure Draft in April 2020.

- The Board aims to issue final amendments for Phase 2 in Q3 2020.

Background

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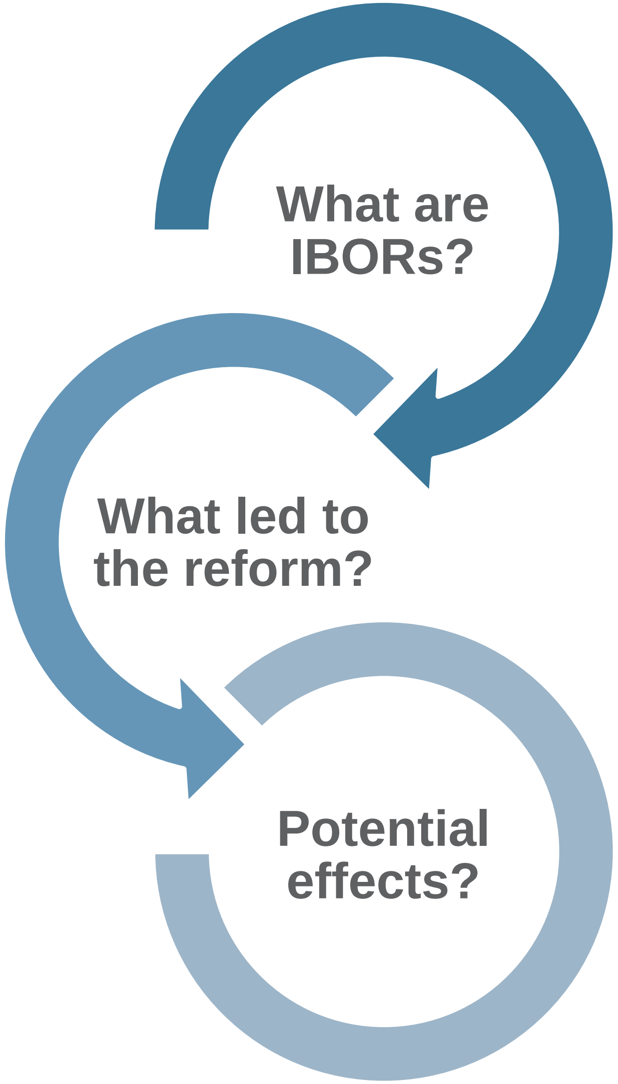

Interest rate benchmarks such as interbank offered rates (IBORs) play an important role in global financial markets. They index a wide variety of financial products worth trillions of dollars, ranging from mortgages to derivatives.

Market developments have undermined the reliability of existing benchmarks. In 2014 the Financial Stability Board recommended reforms of some major interest rate benchmarks. Since then, many jurisdictions have made progress towards replacing existing benchmarks with nearly risk-free rates (RFRs or alternative benchmark rates).

This has, in turn, led to uncertainty about the future of existing interest rate benchmarks. The potential discontinuation of interest rate benchmarks could affect the usefulness of information provided in IFRS financial statements.

Two-phase project and timeline

The Board identified two groups of accounting issues:

Phase I *Pre-replacement issues*

- Issues affecting financial reporting in the period of uncertainty before the replacement of an interest rate benchmark with an alternative interest rate

Phase II *Replacement issues*

- Issues that might affect financial reporting during the reform of an interest rate benchmark, including its replacement with alternative benchmark rates

Q3 2019
Phase I completed

Q3 2019
Board discussed the scope of Phase II issues

Q4 2019
Board started deliberations on Phase II issues

April 2020
Expected publication of Exposure Draft

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Overview of the proposed amendments in Phase 2

Scope of Phase 2

Classification & measurement of financial instruments

- Determining what constitutes a modification
- Proposed practical expedient to account for changes required by the reform
- Distinguishing changes required by the reform from other changes made at the same time

Hedge accounting

- Changes to hedge accounting relationship directly related to the reform
- Measurement differences arising from replacement of benchmark rate
- Interaction with Phase 1 exceptions and end of application
- Qualifying risk components

Other topics

- Proposed practical expedient for lessees
- Amendment to IFRS 4 for insurance entities
- Transition
- Effective date
- Mandatory application

Disclosures

- Disclosure objectives and requirements

Modifications and changes to financial instruments

Summary of proposed amendments

Amendments to IFRS 9, including supplementary amendments to
- **IFRS 4 for insurers applying temporary exemption from IFRS 9**
- **IFRS 16 for lessees**

- Practical expedient for **modifications required by the reform**—those that are required as a direct consequence of IBOR reform and made on an economically equivalent basis.
- Practical expedient also applies to changes in estimates of payments or receipts as a result of the activation of an existing contractual (for example, an existing fallback clause is triggered).
- Such modifications and revisions are accounted for by updating the effective interest rate (EIR)
- All other modifications or revisions are accounted for using the current IFRS requirements (ie recalculate carrying amount and recognise a gain or loss).
- IFRS 4 – require insurers applying temporary exemption from IFRS 9 to apply the proposed amendments to IFRS 9 for IBOR reform
- IFRS 16 – lessees to account for modifications required by the reform using a similar practical expedient.

Stakeholders

What would the reporting outcomes be?

- Distinguish modifications required by reform from other modifications
- Modifications required by the reform not assessed for derecognition
- Update EIR to reflect replacement in benchmark from IBOR to RFR.
- No change to carrying amount for modifications that are required by the reform
- Other modifications accounted for using current requirements
- Lessees will update IBR to reflect replace of benchmark rate

Hedge accounting

Summary of proposed amendments

Amendments to IFRS 9 and IAS 39

- Hedging relationships amended to reflect changes required by the reform
- Any measurement differences arising from the changes are recognised as ineffectiveness when they occur
- No proposed amendments to measurement requirements
- RFR deemed to be separately identifiable risk component if the entity reasonably expects it to meet the requirement within 24 months from the date it is designated as a risk component
- Reset cumulative fair value changes reset to zero for purposes of retrospective assessment (IAS 39) so that impacts of IBOR reform accumulated during Phase 1 don't affect assessment going forward
- Amended hedging relationship required meet all other qualifying criteria to apply hedge accounting

Stakeholders

What would the reporting outcomes be?

- Hedging relationships are not discontinued solely due to IBOR reform.
- Hedging relationships to be amended as the changes occur at different times
- Amounts accumulated in cash flow hedge reserve assumed to be based on alternative benchmark rate
- Hedge items and hedging instruments continue to be measured in accordance with IFRSs
- Hedge ineffectiveness, any measurement differences continue to be recognised in the financial statements as usual.

Disclosure

Summary of proposed amendments

Objective

Entities should disclose information that will enable users of financial statements to understand:

(a) Nature and extent of risks arising from IBOR reform to which the entity is exposed and how the entity manages those risks; and

(b) Progress made on transitioning from IBORs to alternative benchmark rates and how the entity is managing this transition

To met the objective an entity would disclose information about:

(a) how the transition to alternative benchmark rates is managed and progress made at the reporting date;

(b) carrying amount of financial assets and financial liabilities, (including the nominal amount of the derivatives), that are referenced to benchmarks subject to the reform, disaggregated by significant interest rate benchmark;

(c) for each significant alternative benchmark rate to which the entity is exposed, an explanation of how the entity determined which modifications and changes qualify for the practical expedient; and

(d) to the extent that IBOR reform has resulted in changes to an entity's risk management strategy, a description of these changes and how is the entity managing those risks.

Mandatory application and effective date

Mandatory application and effective date

- The proposed amendments apply mandatorily for annual periods beginning on or after **1 January 2021**. Earlier application is permitted.

Retrospective application

- Proposed retrospective application to items that exist at the beginning of the reporting period in which an entity first applies the amendments, including the amount accumulated in the cash flow hedge reserve
- However, an entity is required to reinstate a hedging relationship that has been discontinued before that date, only if:
  a) it has been discontinued solely due to changes directly required by the reform; and
  b) the entity can demonstrate, without the use of hindsight, that the hedging relationship would not have been discontinued if the amendments had been applied at that time

Next steps

- Exposure Draft to be issued in April 2020 with 45 days comment period.

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