IFRS

STAFF PAPER

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IASB® meeting

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

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Purpose of this paper

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

   (a) Objective of this project (paragraphs 3–4);

   (b) Project plan and current stage (paragraphs 5–7);

   (c) The Board's tentative decisions to date (paragraphs 8–15); and

   (d) Next steps (paragraph 16).

2. This paper accompanies the following agenda papers:

   (a) Agenda Paper 14A *Phase 1 End of relief*, which discusses the end of application of the Phase 1 exceptions from specific hedge accounting requirements in IFRS 9 *Financial Instruments* and IAS 39 *Financial Instruments: Recognition and Measurement* in the context of interest rate benchmark reform (IBOR reform).

   (b) Agenda Paper 14B *Other IFRS Standards*, which discusses the potential effects of IBOR reform on IFRS Standards other than those related to financial instruments accounting.

(c) Agenda Paper 14C *Disclosures*, which discusses potential disclosure requirements to accompany the tentative decisions the Board has made during Phase 2 of the IBOR project.

Objective of this project

3. Consistent with the overall objective of financial reporting as set out in the *Conceptual Framework*, the objective of Phase 2 project is 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. The Board observed that for information about the effects of transitioning to alternative benchmark rates to be useful it must be relevant and faithfully represent the economic effects of transition to alternative benchmark rates on an entity's financial statements.

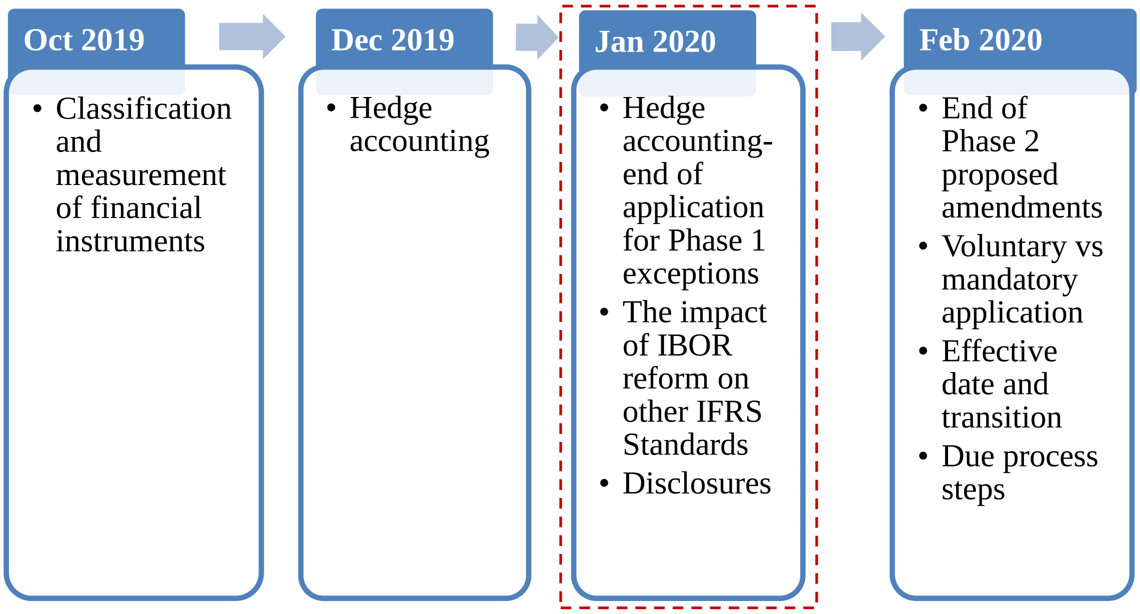
4. This objective assists the Board in assessing whether it should take any action in the form of amendments to IFRS Standards, which could include narrow-scope exceptions, additional application guidance or illustrative examples.

Project plan and current stage

5. At the September 2019 Board meeting, the Board tentatively decided on the scope of the issues to be considered during Phase 2 and the proposed order in which these issues should be discussed (project plan).

6. Following this project plan, at the October and December 2019 meetings the Board discussed and tentatively decided to make amendments to IFRS 9 for specific aspects of classification and measurement of financial instruments and to IFRS 9 and IAS 39 for specific aspects of hedge accounting.

7. The following chart outlines the areas that are part of the project plan and the current stage of discussions with the Board.



Note:

- - - Current stage.

The Board's tentative decisions to date

8. At the October 2019 meeting the Board tentatively decided to amend IFRS 9 to:

   (a) require that a change in the basis on which the contractual cash flows are determined that alters the calculation applicable at the time the contract was entered into, even in the absence of an amendment to the contractual terms of a financial instrument, 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 first applies 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 applies the current IFRS 9 requirements to determine if any other modifications are substantial; if those modifications are not substantial, the entity applies paragraph 5.4.3 of IFRS 9.

9. At the October 2019 meeting, the Board also noted that, although not a modification as described above, the practical expedient described in paragraph 8(b) equally applies to situations in which the contractual cash flows of a financial instrument are altered following the activation of existing contractual fallback clauses that contemplated IBOR reform, as long as these changes qualify for the practical expedient (ie they are as a direct consequence of the reform and done on an economically equivalent basis).

10. 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, however, 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.

11. At its December 2019 meeting, the Board tentatively decided to:

    (a) retain the requirements in IFRS 9 and IAS 39 that determine whether a hedging relationship should be discontinued after:

        (i) a substantial modification that results in derecognition of the hedged item or the hedging instrument; or

(ii) a modification that does not result in derecognition and is not required as a direct consequence of IBOR reform or is not done on an economically equivalent basis.

(b) amend IFRS 9 and IAS 39 to provide an exception from the current requirements so that the following changes in hedge documentation necessary to reflect modifications that are required as a direct consequence of IBOR reform and are done on an economically equivalent basis do not result in the discontinuation of hedge accounting:

(i) redefining the hedged risk to refer to an alternative benchmark rate; and

(ii) redefining the description of the hedging instruments or the hedged items to refer to the alternative benchmark rate.

(c) amend IAS 39 to provide an exception from the current requirements so that a change to the method used for assessing hedge effectiveness does not result in the discontinuation of hedge accounting when, due to IBOR reform, it is impractical to continue using the same method defined in the hedge documentation at the inception of the hedging relationship.

12. The Board also tentatively decided to amend IAS 39 to require an entity changing the hedged risk in the hedge documentation for a portfolio hedge of interest rate risk, as noted in paragraph 11(b)(i), to assume that all items included in the portfolio of financial assets or financial liabilities share the risk being hedged.

13. For changes in hedge documentation noted in paragraph 11(b) and 11(c), an entity is required to continue to apply requirements in IFRS Standards to measure the hedging instrument and the hedged item and to recognise hedge ineffectiveness that may arise due to any consequential valuation adjustments required by IFRS 9 and IAS 39.

14. With regard to hedges of a group of items, the Board tentatively decided to amend IFRS 9 and IAS 39 so that, when items within a designated group are amended for modifications that are required as a direct consequence of IBOR reform and are done on an economically equivalent basis, an entity is permitted to:

(a) amend the hedge documentation to define the hedged items by way of two subgroups within the designated group of items—one referencing the original interest rate benchmark and the other, the alternative benchmark rate;

(b) perform the proportionality test separately for each subgroup of items designated in the hedging relationship;

(c) treat the hedge designation as a single hedging relationship and amend the hypothetical derivative to reflect the combination of the subgroups of items; and

(d) treat IBOR and its alternative benchmark rate as if they share similar risk characteristics (but only in relation to a group of items designated under IAS 39).

15. Appendix A includes a flowchart summarising the Board's discussions and tentative decisions reached at the October and December 2019 Board meetings and staff recommendations at this meeting with respect to areas of classification and measurement of financial instruments and hedge accounting.

Next steps

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

(a) End of Phase 2 proposed amendments;

(b) Voluntary vs mandatory application;

(c) Effective date and transition; and

(d) Due process steps.

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

Appendix A

This flowchart summarises the Board's discussions and tentative decisions reached at the October and December 2019 Board meetings and staff recommendations at this meeting with respect to areas of classification and measurement of financial instruments and hedge accounting.