

Interest Rate Benchmark Reform

Proposed amendments to AASB 9 and AASB 139

Comments to the AASB by 31 May 2019



Australian Government

**Australian Accounting
Standards Board**

How to Comment on this AASB Exposure Draft

Constituents are strongly encouraged to respond to the AASB and the IASB. The AASB is seeking comment by 31 May 2019. This will enable the AASB to consider Australian constituents' comments in the process of formulating its own comments to the IASB, which are due by 17 June 2019.

Formal Submissions

Submissions should be lodged online via the “Work in Progress – Open for Comment” page of the AASB website (www.aasb.gov.au/comment) as a PDF document and, if possible, a Word document (for internal use only).

Other Feedback

Other feedback is welcomed and may be provided via the following methods:

E-mail: standard@asb.gov.au
Phone: (03) 9617 7600

All submissions on possible, proposed or existing financial reporting requirements, or on the standard-setting process, will be placed on the public record unless the Chair of the AASB agrees to submissions being treated as confidential. The latter will occur only if the public interest warrants such treatment.

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AASB REQUEST FOR COMMENTS

The Australian Accounting Standards Board's (AASB's) policy is to incorporate International Financial Reporting Standards (IFRS Standards) into Australian Accounting Standards. Accordingly, the AASB is inviting comments on:

- (a) any of the proposals in the attached International Accounting Standards Board (IASB) Exposure Draft, including the specific questions on the proposals as listed in the Invitation to Comment section of the attached IASB Exposure Draft; and
- (b) the 'AASB Specific Matters for Comment' listed below.

AASB Specific Matters for Comment

The AASB would particularly value comments on the following:

- 1. whether there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals, particularly any issues relating to:
 - (a) not-for-profit entities; and
 - (b) public sector entities, including GAAP/GFS implications;
- 2. whether, overall, the proposals would result in financial statements that would be useful to users;
- 3. whether the proposals are in the best interests of the Australian economy; and
- 4. unless already provided in response to specific matters for comment 1 – 3 above, the costs and benefits of the proposals relative to the current requirements, whether quantitative (financial or non-financial) or qualitative. In relation to quantitative financial costs, the AASB is particularly seeking to know the nature(s) and estimated amount(s) of any expected incremental costs, or cost savings, of the proposals relative to the existing requirements.

May 2019

IFRS[®] Standards
Exposure Draft ED/2019/1

Interest Rate Benchmark Reform

Proposed amendments to IFRS 9 and IAS 39

Comments to be received by 17 June 2019

IASB[®]

 IFRS[®]

Interest Rate Benchmark Reform

Proposed amendments to IFRS 9 and IAS 39

Comments to be received by 17 June 2019

Exposure Draft ED/2019/1 *Interest Rate Benchmark Reform* is published by the International Accounting Standards Board (Board) for comment only. The proposals may be modified in the light of comments received before being issued in final form. Comments need to be received by 17 June 2019 and should be submitted in writing to the address below, by email to commentletters@ifrs.org or electronically using our 'Open for comment' page at: <http://go.ifrs.org/open-for-comment>.

All comments will be on the public record and posted on our website at www.ifrs.org unless the respondent requests confidentiality. Such requests will not normally be granted unless supported by good reason, for example, commercial confidence. Please see our website for details on this and how we use your personal data.

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Introduction

Why is the Board publishing this Exposure Draft?

Interest rate benchmarks such as interbank offer rates (IBORs) play an important role in global financial markets. These interest rate benchmarks index trillions of dollars and other currencies in a wide variety of financial products, from derivatives to residential mortgages. However, cases of attempted market manipulation of some interest rate benchmarks, together with the post-crisis decline in liquidity in interbank unsecured funding markets, have undermined confidence in the reliability and robustness of some existing interest rate benchmarks. Against this background, the G20 asked the Financial Stability Board (FSB) to undertake a fundamental review of major interest rate benchmarks. Following the review, the FSB published a report¹ setting out its recommendations to reform some major interest rate benchmarks such as IBORs. Public authorities in many jurisdictions have since taken steps to implement those recommendations. In some jurisdictions, there is already clear progress towards replacing the existing interest rate benchmarks with alternative, nearly risk-free interest rates that are based, to a greater extent, on transaction data (alternative interest rates). This has, in turn, led to uncertainty about the long-term viability of some existing interest rate benchmarks. In this Exposure Draft, interest rate benchmark reform refers to this market-wide replacement of an existing interest rate benchmark, such as IBOR, with an alternative interest rate based on the FSB's recommendations (the reform).

In 2018, the International Accounting Standards Board (Board) noted the increasing level of uncertainty about the long-term viability of some interest rate benchmarks and decided to add a project to its agenda to consider the financial reporting implications of the reform. Based on outreach with stakeholders, the Board identified two groups of issues that could have financial reporting implications. These are:

- (a) issues affecting financial reporting in the period before the replacement of an existing interest rate benchmark with an alternative interest rate (pre-replacement issues); and
- (b) issues that might affect financial reporting when an existing interest rate benchmark is replaced with an alternative interest rate (replacement issues).

The proposals set out in this Exposure Draft address only the pre-replacement issues. More specifically, for this Exposure Draft the Board considered the implications for specific hedge accounting requirements in IFRS 9 *Financial Instruments* and IAS 39 *Financial Instruments: Recognition and Measurement*, which require forward-looking analysis. 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 the existing interest rate benchmark is replaced with an alternative interest rate. Until decisions are made with respect to what the alternative interest rate is and when that replacement will occur, uncertainties will exist regarding the timing and the amount of future cash flows of the hedged items and the hedging instruments. The Board noted that the hedge accounting requirements in IFRS 9 and IAS 39 provide a clear basis to account for such uncertainties. These uncertainties about the timing and the amount of future

¹ The report, 'Reforming Major Interest Rate Benchmarks' was published in July 2014. The report is available at http://www.fsb.org/wp-content/uploads/r_140722.pdf.

cash flows could affect an entity's ability to meet specific forward-looking hedge accounting requirements in the periods before replacement. In some cases, solely due to such uncertainties, entities could be required to discontinue hedge accounting for hedging relationships that would otherwise qualify for hedge accounting. Also, IFRS Standards may prevent entities from designating new hedging relationships that would otherwise qualify for hedge accounting. Discontinuation of hedge accounting would require an entity to recognise gains or losses in profit or loss. In the Board's view, discontinuation of hedge accounting solely due to such uncertainties before the reform's economic effects are known would not provide useful information to users of financial statements. Therefore, the Board decided to propose exceptions to specific hedge accounting requirements in IFRS 9 and IAS 39 to provide relief during this period of uncertainty.

The Board has not yet considered whether and, if so, how to address any issues that might affect financial reporting when an existing interest rate benchmark is replaced with an alternative interest rate, ie replacement issues. The Board noted that a range of issues could arise at different points in time due to the uneven timing of the replacement coupled with different approaches to replacement and different interest rate benchmarks being considered in different markets. At the time of the Board discussions leading to this Exposure Draft, the specific conditions and details of the replacement of existing interest rate benchmarks with alternatives have yet to be finalised. The Board, therefore, decided to monitor developments in this area. As more information becomes available, the Board will assess the potential financial reporting implications of the replacement and determine whether it should take any action and, if so, what.

Who will be affected by the proposals in this Exposure Draft?

The Board expects that interest rate benchmark reform will affect many preparers, given the extensive use of interest rate benchmarks in global financial markets. The proposals in this Exposure Draft will affect entities that apply the hedge accounting requirements of IFRS 9 or IAS 39 to hedges of interest rate risk affected by interest rate benchmark reform, and those who use their financial statements.

A summary of the proposals in this Exposure Draft

The proposals in this Exposure Draft modify specific hedge accounting requirements so that entities would apply those hedge accounting requirements assuming that the interest rate benchmark on which the hedged cash flows and cash flows of the hedging instrument are based is not altered as a result of interest rate benchmark reform. The Board proposes to amend the hedge accounting requirements only as specified in this Exposure Draft. The proposals are not intended to provide relief from any other consequences arising from interest rate benchmark reform. Also, if a hedging relationship no longer meets the requirements for hedge accounting for reasons other than those specified by this Exposure Draft, then discontinuation of hedge accounting is still required.

Next steps

The Board will consider the comments that it receives on the proposals and will decide whether to proceed with the proposed amendments to IFRS 9 and IAS 39. The Board plans to complete any resulting amendments to IFRS 9 and IAS 39 in 2019.

Invitation to comment

The Board invites comments on the Exposure Draft *Interest Rate Benchmark Reform*, which proposes amendments to IFRS 9 and IAS 39, particularly on the questions set out below. Comments are most helpful if they:

- (a) address the questions as stated;
- (b) indicate the specific paragraph(s)/item/proposal to which they relate;
- (c) contain a clear rationale;
- (d) identify any wording in the proposals that is difficult to translate; and
- (e) include any alternative the Board should consider, if applicable.

The Board is requesting comments only on matters addressed in this Exposure Draft.

Questions for respondents

Question 1 [paragraphs 6.8.4–6.8.6 of IFRS 9 and paragraphs 102D–102F of IAS 39]
<p>Highly probable requirement and prospective assessments</p> <p>For hedges of interest rate risk that are affected by interest rate benchmark reform, the Board proposes amendments to IFRS 9 and IAS 39 as described below.</p> <ul style="list-style-type: none"> (a) For the reasons set out in paragraphs BC8–BC15, the Board proposes exceptions for determining whether a forecast transaction is highly probable or whether it is no longer expected to occur. Specifically, the Exposure Draft proposes that an entity would apply those requirements assuming that the interest rate benchmark on which the hedged cash flows are based is not altered as a result of interest rate benchmark reform. (b) For the reasons set out in paragraphs BC16–BC23, the Board proposes exceptions to the hedge accounting requirements in IFRS 9 and IAS 39 so that an entity would assume that the interest rate benchmark on which the hedged cash flows are based, and/or the interest rate benchmark on which the cash flows of the hedging instrument are based, are not altered as a result of interest rate benchmark reform when the entity determines whether: <ul style="list-style-type: none"> (i) there is an economic relationship between the hedged item and the hedging instrument applying IFRS 9; or (ii) the hedge is expected to be highly effective in achieving offsetting applying IAS 39. <p>Do you agree with these proposals? Why or why not? If you agree with only parts of the proposals, please specify what you agree and disagree with. If you disagree with the proposals, please explain what you propose instead and why.</p>

Question 2 [paragraph 6.8.7 of IFRS 9 and paragraph 102G of IAS 39]

Designating a component of an item as the hedged item

For the reasons set out in paragraphs BC24–BC27, the Board proposes amendments to the hedge accounting requirements in IFRS 9 and IAS 39 for hedges of the benchmark component of interest rate risk that is not contractually specified and that is affected by interest rate benchmark reform. Specifically, for such hedges, the Exposure Draft proposes that an entity applies the requirement – that the designated risk component or designated portion is separately identifiable – only at the inception of the hedging relationship.

Do you agree with this proposal? Why or why not? If you disagree with the proposal, please explain what you propose instead and why.

Question 3 [paragraphs 6.8.8–6.8.10 of IFRS 9 and paragraphs 102H–102J of IAS 39]

Mandatory application and end of application

- (a) For the reasons set out in paragraphs BC28–BC31, the Board proposes that the exceptions are mandatory. As a result, entities would be required to apply the proposed exceptions to all hedging relationships that are affected by interest rate benchmark reform.
- (b) For the reasons set out in paragraphs BC32–BC42, the Board proposes that the exceptions would apply for a limited period. Specifically, an entity would prospectively cease applying the proposed amendments 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, or if paragraph 6.8.9 of IFRS 9 or paragraph 102I of IAS 39 applies, when the entire amount accumulated in the cash flow hedge reserve with respect to that hedging relationship is reclassified to profit or loss.
- (c) For the reasons set out in paragraph BC43, the Board is not proposing an end of application in relation to the separate identification requirement.

Do you agree with these proposals? Why or why not? If you agree with only parts of the proposals, please specify what you agree and disagree with. If you disagree with the proposals, please explain what you propose instead and why.

Question 4 [paragraph 6.8.11 of IFRS 9 and paragraph 102K of IAS 39]

Disclosures

For the reasons set out in paragraph BC44, the Board proposes that entities provide specific disclosures about the extent to which their hedging relationships are affected by the proposed amendments.

Do you agree with these proposed disclosures? Why or why not? If not, what disclosures would you propose instead and why?

Question 5 [paragraphs 7.1.9 and 7.2.26(d) of IFRS 9 and paragraph 108G of IAS 39]

Effective date and transition

For the reasons set out in paragraphs BC45–BC47, the Board proposes that the amendments would have an effective date of annual periods beginning on or after 1 January 2020. Earlier application would be permitted. The Board proposes that the amendments would be applied retrospectively. No specific transition provisions are proposed.

Do you agree with these proposals? Why or why not? If you disagree with the proposals, please explain what you propose instead and why.

How and by when to comment

We would prefer to receive your comments electronically; however, comments can be submitted using any of the following methods:

Electronically	Visit the 'Open for comment' page at: http://go.ifrs.org/open-for-comment
By email	Send email comments to: commentletters@ifrs.org
By post	IFRS Foundation Columbus Building 7 Westferry Circus Canary Wharf London E14 4HD United Kingdom

The Board will consider all comments received in writing by 17 June 2019 (45 days).

Unless confidentiality is specifically requested, all comments will be posted on our website. Requests for confidentiality will not normally be granted unless supported by a good reason, for example, commercial confidence. Please see our website for details on this policy, and on how we use your personal data.

[Draft] Amendments to IFRS 9 *Financial Instruments*

Paragraphs 6.8.1–6.8.11 and 7.1.9 are added, and paragraph 7.2.26 is amended. A new heading is added before paragraph 6.8.1. A new subheading is added before paragraphs 6.8.4, 6.8.5, 6.8.6, 6.8.7, 6.8.8 and 6.8.11. New text is underlined.

Chapter 6 Hedge accounting

...

6.8 Temporary exceptions from applying specific hedge accounting requirements

- 6.8.1 An entity shall apply paragraphs 6.8.4–6.8.11 and paragraphs 7.1.9 and 7.2.26(d) to all hedging relationships of interest rate risk that are affected by interest rate benchmark reform. These paragraphs apply only to such hedging relationships. For the purpose of applying these paragraphs, interest rate benchmark reform refers to the market-wide replacement of an existing interest rate benchmark with an alternative interest rate that results from the recommendations set out in the Financial Stability Board’s July 2014 report, ‘Reforming Major Interest Rate Benchmarks’.²
- 6.8.2 A hedging relationship is affected by interest rate benchmark reform if the reform gives rise to uncertainties about the timing and/or the amount of the interest rate benchmark-based cash flows of the hedged item and/or of the hedging instrument.
- 6.8.3 For the avoidance of doubt, paragraphs 6.8.4–6.8.11 provide exceptions only to the requirements specified in these paragraphs. An entity shall continue to apply all other hedge accounting requirements to hedging relationships of interest rate risk.

Highly probable requirement for cash flow hedges

- 6.8.4 If the hedged item is a forecast transaction (or a component thereof), 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.

Reclassification of the amount in the cash flow hedge reserve to profit or loss

- 6.8.5 For the purpose of applying the requirement in paragraph 6.5.12(b) to determine whether the hedged cash flows are no longer expected to occur, an entity shall assume 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.

² The report, ‘Reforming Major Interest Rate Benchmarks’ is available at http://www.fsb.org/wp-content/uploads/r_140722.pdf.

Assessment of the economic relationship between the hedged item and the hedging instrument

- 6.8.6 For the purpose of applying the requirements in paragraphs 6.4.1(c)(i) and B6.4.4–B6.4.6, an entity shall assume that the interest rate benchmark on which the hedged cash flows (contractual or non-contractually specified) are based, and/or the interest rate benchmark on which the cash flows of the hedging instrument are based, are not altered as a result of interest rate benchmark reform.

Designation of a component of an item as a hedged item

- 6.8.7 For a hedge of a benchmark component of interest rate risk that is affected by interest rate benchmark reform, an entity shall apply the requirement in paragraphs 6.3.7(a) and B6.3.8—that the risk component is separately identifiable—only at the inception of the hedging relationship.

End of application

- 6.8.8 An entity shall prospectively cease applying paragraph 6.8.4 to a hedged item at the earlier of:

- (a) 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 the hedged item; and
- (b) when the hedging relationship that the hedged item is part of is discontinued.

- 6.8.9 An entity shall prospectively cease applying paragraph 6.8.5 to a hedging relationship at the earlier of:

- (a) 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 the hedged item; and
- (b) when the entire amount accumulated in the cash flow hedge reserve with respect to that hedging relationship is reclassified to profit or loss.

- 6.8.10 An entity shall prospectively cease applying paragraph 6.8.6:

- (a) to a hedged item, 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 the hedged item; and
- (b) to a hedging 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 the hedging instrument.

If the hedging relationship that the hedged item and the hedging instrument are part of is discontinued earlier than the date specified in (a) or the date specified in (b), the entity shall prospectively cease applying paragraph 6.8.6 to that hedging relationship at the date of discontinuation.

Disclosures

6.8.11 An entity shall disclose separately the information required by paragraphs 24A(a), 24A(c)–(d), 24B(a)(i)–(ii), 24B(a)(iv) and 24B(b) of IFRS 7 *Financial Instruments: Disclosures* for hedging relationships to which the entity applies any of the requirements in paragraphs 6.8.4–6.8.10.

Chapter 7 Effective date and transition

7.1 Effective date

...

7.1.9 [Draft] *Interest Rate Benchmark Reform*, which amended IFRS 9 and IAS 39, issued in [the publication date of the final amendments], added Section 6.8 and amended paragraph 7.2.26. An entity shall apply these amendments for annual periods beginning on or after 1 January 2020. Earlier application is permitted. If an entity applies these amendments for an earlier period, it shall disclose that fact.

7.2 Transition

...

Transition for hedge accounting (Chapter 6)

...

7.2.26 As an exception to prospective application of the hedge accounting requirements of this Standard, an entity:

...

(d) shall apply [Draft] *Interest Rate Benchmark Reform* retrospectively.

[Draft] Amendments to IAS 39 *Financial Instruments: Recognition and Measurement*

Paragraphs 102A–102K and 108G are added. A new heading is added before paragraph 102A. A new subheading is added before paragraphs 102D, 102E, 102F, 102G, 102H and 102K. New text is underlined.

Temporary exceptions from applying specific hedge accounting requirements

102A An entity shall apply paragraphs 102D–102K and 108G to all hedging relationships of interest rate risk that are affected by interest rate benchmark reform. These paragraphs apply only to such hedging relationships. For the purpose of applying these paragraphs, interest rate benchmark reform refers to the market-wide replacement of an existing interest rate benchmark with an alternative interest rate that results from the recommendations set out in the Financial Stability Board’s July 2014 report, 'Reforming Major Interest Rate Benchmarks'.³

102B A hedging relationship is affected by interest rate benchmark reform if the reform gives rise to uncertainties about the timing and/or the amount of the interest rate benchmark-based cash flows of the hedged item and/or of the hedging instrument.

102C For the avoidance of doubt, paragraphs 102D–102K provide exceptions only to the requirements specified in these paragraphs. An entity shall continue to apply all other hedge accounting requirements to hedging relationships of interest rate risk.

Highly probable requirement for cash flow hedges

102D If the hedged item is a forecast transaction (or a portion thereof), 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.

Reclassification of the amount in the cash flow hedge reserve to profit or loss

102E For the purpose of applying the requirement in paragraph 101(c) to determine whether the forecast transaction is no longer expected to occur, an entity shall assume 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.

³ The report, 'Reforming Major Interest Rate Benchmarks' is available at http://www.fsb.org/wp-content/uploads/r_140722.pdf.

Prospective assessment

102F For the purpose of applying paragraph AG105(a), an entity shall assume that the interest rate benchmark on which the hedged cash flows (contractual or non-contractually specified) are based, and/or the interest rate benchmark on which the cash flows of the hedging instrument are based, are not altered as a result of interest rate benchmark reform.

Designation of financial items as hedged items

102G For a hedge of a benchmark portion of interest rate risk that is affected by interest rate benchmark reform, an entity shall apply the requirement in paragraphs 81 and AG99F—that the designated portion is separately identifiable—only at the inception of the hedge.

End of application

102H An entity shall prospectively cease applying paragraph 102D to a hedged item at the earlier of:

- (a) 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 the hedged item; and
- (b) when the hedging relationship that the hedged item is part of is discontinued.

102I An entity shall prospectively cease applying paragraph 102E to a hedging relationship at the earlier of:

- (a) 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 the hedged item; and
- (b) when the entire amount accumulated in the cash flow hedge reserve with respect to that hedging relationship is reclassified to profit or loss.

102J An entity shall prospectively cease applying paragraph 102F:

- (a) to a hedged item, 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 the hedged item; and
- (b) to a hedging 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 the hedging instrument.

If the hedging relationship that the hedged item and the hedging instrument are part of is discontinued earlier than the date specified in (a) or the date specified in (b), the entity shall prospectively cease applying paragraph 102F to that hedging relationship at the date of discontinuation.

Disclosures

102K An entity shall disclose separately the information required by paragraphs 24A(a), 24A(c)–(d), 24B(a)(i)–(ii), 24B(a)(iv) and 24B(b) of IFRS 7 *Financial Instruments: Disclosures for hedging relationships* to which the entity applies any of the requirements in paragraphs 102D–102J.

Effective date and transition

...

108G [Draft] *Interest Rate Benchmark Reform*, which amended IFRS 9 and IAS 39, issued in [the publication date of the final amendments], added paragraphs 102A–102K. An entity shall apply those paragraphs for annual periods beginning on or after 1 January 2020. An entity shall apply those amendments retrospectively in accordance with IAS 8. Earlier application is permitted. If an entity applies those amendments for an earlier period it shall disclose that fact.

Approval by the Board of Exposure Draft *Interest Rate Benchmark Reform* published in May 2019

The Exposure Draft *Interest Rate Benchmark Reform*, which proposes amendments to IFRS 9 and IAS 39, was approved for issue by all 14 members of the International Accounting Standards Board.

Hans Hoogervorst Chairman

Suzanne Lloyd Vice-Chair

Nick Anderson

Martin Edelmann

Françoise Flores

Amaro Luiz de Oliveira Gomes

Gary Kabureck

Jianqiao Lu

Takatsugu Ochi

Darrel Scott

Thomas Scott

Chungwoo Suh

Ann Tarca

Mary Tokar

Basis for Conclusions on Exposure Draft *Interest Rate Benchmark Reform*

This Basis for Conclusions accompanies, but is not part of, the proposed amendments. It summarises the considerations of the International Accounting Standards Board (Board) when developing the proposed amendments. Individual Board members gave greater weight to some factors than to others.

Background and scope

- BC1 Interest rate benchmarks such as interbank offer rates (IBORs) play an important role in global financial markets. These interest rate benchmarks index trillions of dollars and other currencies in a wide variety of financial products, from derivatives to residential mortgages. However, cases of attempted market manipulation of some interest rate benchmarks, together with the post-crisis decline in liquidity in interbank unsecured funding markets, have undermined confidence in the reliability and robustness of some existing interest rate benchmarks. Against this background, the G20 asked the Financial Stability Board (FSB) to undertake a fundamental review of major interest rate benchmarks. Following the review, the FSB published a report setting out its recommendations to reform some major interest rate benchmarks such as IBORs. Public authorities in many jurisdictions have since taken steps to implement those recommendations. In some jurisdictions, there is already clear progress towards replacing the existing interest rate benchmarks with alternative, nearly risk-free interest rates that are based, to a greater extent, on transaction data (alternative interest rates). This has in turn led to uncertainty about the long-term viability of some existing interest rate benchmarks. In this Exposure Draft, interest rate benchmark reform refers to this market-wide replacement of an existing interest rate benchmark, such as IBOR, with an alternative interest rate based on the FSB's recommendations (the reform).
- BC2 In 2018, the International Accounting Standards Board (Board) noted the increasing level of uncertainty about the long-term viability of some interest rate benchmarks and decided to add a project to its agenda to consider the financial reporting implications of the reform. Based on outreach with stakeholders, the Board identified two groups of issues that could have financial reporting implications. These are:
- (a) issues affecting financial reporting in the period before the replacement of an existing interest rate benchmark with an alternative interest rate (pre-replacement issues); and
 - (b) issues that might affect financial reporting when an existing interest rate benchmark is replaced with an alternative interest rate (replacement issues).
- BC3 The proposals set out in this Exposure Draft address only the pre-replacement issues. The Board has not yet considered whether and, if so, how to address any issues that might affect financial reporting when an existing interest rate benchmark is replaced with an alternative interest rate. The Board noted that a range of issues could arise at different points in time because of the uneven timing of the replacement coupled with different approaches to replacement

and different interest rate benchmarks being considered in different markets. At the time of the Board's discussions leading to this Exposure Draft, the specific conditions and details of the replacement of existing interest rate benchmarks with alternative interest rates have yet to be finalised. The Board, therefore, decided to monitor developments in this area. As more information becomes available, the Board will assess the potential financial reporting implications of the replacement and determine whether it should take any action, and if so, what.

Proposed amendments to IFRS 9 and IAS 39

- BC4 As part of the pre-replacement phase, the Board considered the implications for specific hedge accounting requirements in IFRS 9 *Financial Instruments* and IAS 39 *Financial Instruments: Recognition and Measurement*, which require forward-looking analysis. 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 that existing interest rate benchmark is replaced with an alternative interest rate—in this Exposure Draft, contractual cash flows encompass both contractually specified and non-contractually specified cash flows. Until decisions are made with respect to what the alternative interest rate is and when that replacement will occur, uncertainties will exist regarding the timing and the amount of future cash flows of the hedged item and the hedging instrument. The Board noted that the hedge accounting requirements in IFRS 9 and IAS 39 provide a clear basis to account for such uncertainties. These uncertainties about the timing and the amount of future cash flows could affect an entity's ability to meet specific forward-looking hedge accounting requirements in the periods before replacement. In some cases, solely due to such uncertainties, entities could be required to discontinue hedge accounting for hedging relationships that would otherwise qualify for hedge accounting. Also, IFRS Standards may prevent entities from designating new hedging relationships that would otherwise qualify for hedge accounting. Discontinuation of hedge accounting would require an entity to recognise gains or losses in profit or loss. In the Board's view, discontinuation of hedge accounting solely due to such uncertainties before the reform's economic effects are known would not provide useful information to users of financial statements. Therefore, the Board decided to propose exceptions to specific hedge accounting requirements in IFRS 9 and IAS 39 to provide relief during this period of uncertainty.
- BC5 The proposals in this Exposure Draft would provide exceptions during this period of uncertainty to specific hedge accounting requirements such that entities would apply those hedge accounting requirements assuming the interest rate benchmark on which the hedged cash flows and cash flows of the hedging instrument are based is not altered as a result of interest rate benchmark reform. The exceptions apply only to the hedge accounting requirements specified in this Exposure Draft. The proposals are not intended to provide relief from all consequences arising from the reform.

- BC6 Since these hedge accounting issues arise in the context of interest rate benchmark reform, the exceptions proposed in this Exposure Draft apply only to hedging relationships of interest rate risk that are affected by interest rate benchmark reform.
- BC7 The Board decided to propose amendments to IAS 39 as well as IFRS 9 because IFRS 9 allows entities, when they first apply IFRS 9, to choose as an accounting policy to continue to apply the hedge accounting requirements of IAS 39. The Board understands that a significant number of IFRS preparers—financial institutions in particular—have made such an accounting policy choice.

Highly probable requirement

Financial reporting consequences in the absence of any exception

- BC8 Applying IFRS 9 and IAS 39, if a forecast transaction is designated as the hedged item in a cash flow hedge, that transaction must be highly probable (the highly probable requirement). For example, assume that an entity designates as the hedged item cash flows that are contractually linked to an interest rate benchmark, such as IBOR, and that these cash flows are expected to occur after interest rate benchmark reform has taken place. At some point in time, those forecast IBOR-based cash flows may no longer meet the highly probable requirement. This is because the underlying contracts are expected to be amended with the result that the cash flows will be based on an alternative interest rate, rather than on IBOR.
- BC9 IFRS 9 and IAS 39 require an entity to discontinue hedge accounting prospectively when the hedging relationship no longer meets the qualifying criteria—one of which is the highly probable requirement. Once an entity discontinues hedge accounting, the changes in the fair value of the derivative (ie the hedging instrument before discontinuation) are recognised in profit or loss, instead of the cash flow hedge reserve in other comprehensive income.
- BC10 Furthermore, IFRS 9 and IAS 39 have specific requirements for determining when the amounts accumulated in the cash flow hedge reserve are reclassified to profit or loss for a cash flow hedge that is discontinued. If the hedged future cash flows are still expected to occur, the amount accumulated in the cash flow hedge reserve is reclassified to profit or loss when the hedged future cash flows affect profit or loss. If the hedged future cash flows are no longer expected to occur, that amount is immediately reclassified to profit or loss. The Board observed that, in the light of interest rate benchmark reform, entities may conclude at some point that the hedged future cash flows are no longer expected to occur. Such a conclusion would require entities to immediately reclassify to profit or loss the amount accumulated in the cash flow hedge reserve related to those affected hedging relationships.
- BC11 The affected hedging relationships described in paragraph BC10 could include hedging relationships that are discontinued for any reason. For example, assume a hedging relationship was discontinued because the hedging instrument is derecognised. In this scenario, the amount accumulated in the cash flow hedge reserve would be reclassified to profit or loss when the hedged future cash flows affect profit or loss (ie it is not immediately

reclassified). However, as described in paragraph BC10, it is possible that such hedged cash flows will no longer be expected to occur because of interest rate benchmark reform. This would require immediate reclassification to profit or loss.

The effects of the proposed exceptions

- BC12 The highly probable requirement ensures that changes in the fair value of designated hedging instruments are recorded in the cash flow hedge reserve in other comprehensive income only for those hedged forecast transactions for which there is a high probability of occurrence. This requirement plays an important role in ensuring there is discipline in applying hedge accounting to forecast transactions. The Board noted that the requirements in IFRS 9 and IAS 39 provide a clear basis to account for the effects of interest rate benchmark reform—that is, if the effects of the reform are such that the hedged cash flows are no longer highly probable, then hedge accounting would be discontinued. Nevertheless, the Board noted that uncertainty exists regarding how the reform will affect the hedged cash flows because the details of the replacement of interest rate benchmarks are unknown. As set out in paragraph BC4, in the Board’s view, discontinuing all affected hedging relationships solely due to such uncertainty would not provide useful information to users of financial statements.
- BC13 Therefore, the Board decided to propose amendments to IFRS 9 and IAS 39 to provide an exception in relation to the highly probable requirement that would provide relief during this period of uncertainty. More specifically, if the hedged future cash flows are based on an existing interest rate benchmark that would be altered by the reform, an entity would assume that the interest rate benchmark on which the hedged cash flows are based is not altered when assessing whether the future cash flows are highly probable. For example, an entity may designate as the hedged item highly probable future contractually specified LIBOR cash flows of an existing floating-rate liability. By applying the proposed exception, the entity would assume that no amendments will be made to the contractual terms that reference LIBOR as a result of interest rate benchmark reform. If the hedged future cash flows are based on a highly probable forecast transaction that is not yet recognised on the entity’s statement of financial position—for example, a future issuance of a LIBOR-referenced debt instrument—then the entity would assume that no amendments will be made to the LIBOR references in the future contract when performing the assessment of the highly probable requirement for that forecast transaction.
- BC14 The Board observed that the proposed exception does not necessarily mean that an entity will determine that the hedged cash flows are highly probable. For example, an entity may designate as the hedged item highly probable future LIBOR cash flows of an existing floating-rate liability. As outlined in paragraph BC13, applying the proposed exception, when determining whether those hedged cash flows are highly probable, the entity would assume that no amendments will be made as a result of interest rate benchmark reform to the hedged item’s contractual terms that reference LIBOR. However, if the entity decides to redeem the liability before its contractual maturity date due to

uncertainty arising from the reform, then the hedged future cash flows are no longer highly probable (and are no longer expected to occur). The proposed exceptions would not permit or require the entity to assume otherwise. In this case, the entity would conclude that the LIBOR-based cash flows are not highly probable (and are no longer expected to occur). The decision by the entity to redeem the liability eliminates the uncertainty regarding the timing and the amount of future cash flows and, therefore, the proposed exception is not applicable.

- BC15 The Board is also proposing an exception for discontinued hedging relationships (as described in paragraph BC11). Applying the proposed exception, any amount remaining in the cash flow hedge reserve would be reclassified to profit or loss in the same period or periods during which the hedged cash flows affect profit or loss, assuming that the interest rate benchmark on which the hedged cash flows are based is not altered as a result of interest rate benchmark reform. If, however, the hedged future cash flows are no longer expected to occur for other reasons, then the entity must immediately reclassify to profit or loss any amount remaining in the cash flow hedge reserve. In addition, the proposed exception would not exempt entities from reclassifying the amount that is not expected to be recovered into profit or loss as required by paragraph 6.5.11(d)(iii) of IFRS 9 and paragraph 97 of IAS 39.

Prospective assessments

Financial reporting consequences in the absence of any exception

- BC16 In this Exposure Draft, the requirements in paragraph 6.4.1(c)(i) of IFRS 9 (the existence of an economic relationship) and paragraph AG105(a) of IAS 39 (whether the hedge is expected to be highly effective) are collectively referred to as 'prospective assessments'.
- BC17 Prospective assessments apply to both fair value hedges and cash flow hedges. Applying IFRS 9, a hedging relationship qualifies for hedge accounting only if there is an economic relationship between the hedged item and the hedging instrument. In this context, paragraph B6.4.4 of IFRS 9 states that an economic relationship exists when there is an expectation that the value of the hedging instrument and the value of the hedged item will generally move in opposite directions because of the same risk, which is the hedged risk. IFRS 9 requires entities to discontinue hedge accounting if the prospective assessment is not met. IAS 39 also requires prospective assessment of hedging relationships. More specifically, paragraph 88(b) of IAS 39 states that 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'. According to paragraph AG105 of IAS 39, a hedge is regarded as highly effective only if both the requirements relating to retrospective and prospective assessments are met. If an entity fails either of these assessments, then paragraphs 91(b) and 101(b) of IAS 39 require the entity to discontinue hedge accounting.

- BC18 Demonstrating the existence of an economic relationship applying IFRS 9 or the expectation that the hedge will be highly effective in achieving offsetting applying IAS 39 requires the estimation of future cash flows because both assessments are prospective in nature. For hedging relationships that may go beyond the timing of interest rate benchmark reform, the reform could affect the prospective assessments. That is because, applying the existing requirements in IFRS 9 or IAS 39, entities would have to consider possible changes to future cash flows of hedged items and hedging instruments in making these assessments. Consequently, at some point in time, it is possible that entities would not be able to demonstrate the existence of an economic relationship in accordance with IFRS 9 or the prospective effectiveness of hedging relationships in accordance with IAS 39 solely due to uncertainties arising from interest rate benchmark reform.
- BC19 When an entity fails the prospective assessments, paragraph 6.5.6 of IFRS 9 and paragraphs 91(b) and 101(b) of IAS 39 require the entity to discontinue hedge accounting prospectively. Once hedge accounting is discontinued, the entity is required to recognise in profit or loss the changes in the fair value of the derivatives (ie the hedging instruments before discontinuation), in the same way as trading derivatives. In addition, in the case of fair value hedges, changes in the fair value of these derivatives would not be offset by adjustments for hedging gains or losses.
- BC20 The Board considered the usefulness of the information that would result from the potential discontinuation of all affected hedging relationships and decided to propose amendments to IFRS 9 and IAS 39—for the same reasons discussed in paragraph BC12 of this Exposure Draft.

The effects of the proposed exceptions

- BC21 Applying the proposed exceptions, entities would assess whether the economic relationship required by IFRS 9 exists, or whether the hedge is expected to be highly effective in achieving offsetting as required by IAS 39, assuming the interest rate benchmark on which the hedged item and the hedging instrument are based is not altered as a result of interest rate benchmark reform. Similarly, if an entity designates a highly probable forecast transaction as the hedged item, the entity would perform the prospective assessments assuming no amendments will be made to future contracts as a result of interest rate benchmark reform with respect to the interest rate benchmark of those forecast transactions.
- BC22 The Board noted that the existence of offset between the hedged item and the hedging instrument is a fundamental principle of the hedge accounting model in both IFRS 9 and IAS 39 and, therefore, considered it critical to maintain this principle. The proposals in this Exposure Draft are intended to address only the uncertainties arising from interest rate benchmark reform. For example, if a hedging relationship fails the prospective assessments for other reasons, then the entity must discontinue hedge accounting as required by IFRS 9 or IAS 39. In addition, the proposals in this Exposure Draft are not intended to change the measurement of hedge effectiveness or to change how hedges are reflected in the financial statements. Entities are required to continue

measuring hedge effectiveness reflecting fair value changes using cash flows based on the existing designated interest rate benchmark and other relevant market parameters, such as market yields. If the yields on instruments that are linked to the existing interest rate benchmark are affected by the reform, for example, due to decreased liquidity, then the entity cannot ignore such a change in the yields in its measurement of hedge effectiveness. In the Board's view, disregarding the effects of interest rate benchmark reform in measuring the outcome of a hedging relationship could conceal the effect of actual changes in the economics of a financial instrument and would go beyond the objectives of the proposed exceptions.

- BC23 For similar reasons to those set out in paragraph BC22, the Board decided not to propose any exception for the effects of interest rate benchmark reform on 'retrospective assessments' required by IAS 39. Those assessments are based on the actual results of the hedging relationship. For retrospective assessments, changes in fair values of the hedged item and the hedging instrument is determined based on actual market movements. When applicable, in estimating the change in fair values at the reporting date, the cash flows used are determined based on the contractual terms without considering the impact of possible future amendments to the contract (including any resulting from interest rate benchmark reform). Since such measurement is already based on existing contractual terms and market inputs, for example, market yield, the Board decided that no amendment to the Standards with respect to retrospective assessment was necessary as existing IFRS Standards already provide an adequate basis for such measurement.

Hedges of risk components and portions

- BC24 An entity may designate an item in its entirety or a component of an item—expressed as a portion in IAS 39—as the hedged item in a hedging relationship. Paragraph 6.3.7(a) of IFRS 9 and paragraph 81 of IAS 39 allow entities to designate only changes in the cash flows or fair value of an item attributable to a specific risk or risks (risk component). For example, assuming an entity issues a 5-year floating-rate debt instrument that bears interest at 3-month LIBOR + 1%, the entity could designate as the hedged item either the entire debt instrument (ie all of the cash flows) or the 3-month LIBOR risk component of the floating-rate debt instrument. While there are some differences between IFRS 9 and IAS 39 with respect to this requirement, both Standards require that the risk component be separately identifiable and reliably measurable in order to be eligible for hedge accounting.
- BC25 The Board observed that an entity's ability to conclude that an interest rate benchmark is a separately identifiable component could be affected by interest rate benchmark reform. For example, if the outcome of the reform affects the market structure of an interest rate benchmark, it could affect an entity's assessment of whether a non-contractually specified LIBOR component is separately identifiable and, therefore, an eligible hedged item in a hedging relationship. In this context, the Board considered only those risk

components that are non-contractually specified because the same issue does not arise for risk components that are contractually specified.

- BC26 For the reasons outlined in paragraph BC4, the Board noted that discontinuation of hedging relationships at this stage due to uncertainty arising from interest benchmark reform would not provide useful information. Consequently, the Board decided to propose amendments to IFRS 9 and IAS 39 so that entities do not discontinue hedge accounting solely because the hedged item is no longer separately identifiable as interest rate benchmark reform progresses. The Exposure Draft proposes that the separate identification requirement for hedges of the benchmark component of interest rate risk is applied only at the inception of those hedging relationships affected by interest rate benchmark reform.
- BC27 The Board decided not to allow entities to designate the benchmark component of interest rate risk as the hedged item in a new hedging relationship if the risk component is not separately identifiable at the inception of the hedging relationship. In the Board's view, allowing hedge accounting for risk components in these circumstances would go beyond the objective of the proposed exception. The Board noted that such circumstances are different from allowing continued designation as the hedged item for components that had met the requirement at the inception of the hedge relationship. The Board is not proposing any exception from the requirement about the reliable measurement.

Mandatory application

- BC28 The Board proposes that entities must apply the exceptions in this Exposure Draft to all hedging relationships to which the exceptions are applicable. In other words, an entity must apply the exceptions to all hedging relationships that are affected by the uncertainties arising from interest rate benchmark reform and continue to apply the exceptions until such time specified in paragraphs 6.8.8–6.8.10 of IFRS 9 and paragraphs 102H–102J of IAS 39.
- BC29 The Board considered but rejected alternatives that would have allowed entities to apply the exceptions on a voluntary basis. The Board noted that voluntary application of these proposals could give rise to selective discontinuation of hedge accounting and selective reclassification of the amounts recorded in other comprehensive income related to previously discontinued hedging relationships. In addition, the Board does not expect that requiring entities to apply the exceptions would entail significant cost for preparers and other affected parties because the exceptions do not introduce new accounting requirements. Rather, the exceptions require entities to assume that the interest rate benchmark on which the hedged cash flows and cash flows of the hedging instrument are based is not altered as a result of interest rate benchmark reform. Also, as part of the process to amend contracts affected by interest rate benchmark reform, entities will need to undertake a comprehensive review of hedged items and hedging instruments. The Board expects that process would enable entities to identify the hedging relationships that are in the scope of the proposed amendments without significant additional cost and effort.

- BC30 The Board observed that there could be circumstances in which the exceptions proposed in this Exposure Draft are not applicable. For example, if a particular interest rate benchmark is not subject to replacement with an alternative interest rate, there is no uncertainty affecting the timing or the amount of the interest rate benchmark-based cash flows arising from a hedged item or a hedging instrument. The exceptions proposed in this Exposure Draft would not be applicable to such hedging relationships.
- BC31 Furthermore, for a particular hedging relationship, it is possible that some but not all aspects of the exceptions are applicable. For example, if an entity designates a hedged item that is based on an alternative interest rate against a LIBOR-based hedging instrument (assuming the entity can demonstrate that hedging relationship meets the qualifying criteria for hedge accounting in IFRS 9 or IAS 39), then the exception to the prospective assessments would apply for the hedging instrument because there is uncertainty related to its future cash flows. However, there is no uncertainty regarding how the reform would impact the cash flows of the hedged item and, therefore, the exception proposed for the highly probable assessment is not applicable. Similarly, the exception applicable to non-contractually specified components would not be relevant for hedging relationships that do not involve the designation of non-contractually specified risk components.

End of application

- BC32 As described in paragraph BC4, the Board decided to propose amendments to IFRS 9 and IAS 39 to address particular aspects of hedge accounting affected by current uncertainties around when the existing interest rate benchmark will be changed to an alternative interest rate (the timing) and what the cash flows, including their frequency of reset, based on the alternative benchmark will be (the amount). Therefore, the exceptions proposed in this Exposure Draft are intended to be available only while these uncertainties are present. The Board considered whether to propose a specific end date for the proposed exceptions but decided not to do so at this time. This is because interest rate benchmark reform is likely to follow different timelines in different markets and jurisdictions and, therefore, at this stage, it is not possible to define a period of applicability for the proposed exceptions.
- BC33 The Board proposes that an entity ceases applying the proposed exceptions 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.⁴ The proposed exceptions require entities to apply specific hedge accounting requirements assuming the interest rate benchmark on which the hedged cash flows or the cash flows of the hedging instrument are based is not altered as a result of interest rate benchmark reform. The end of application of the exceptions means that

⁴ For the purpose of applying the exception in paragraph 6.8.5 of IFRS 9 or 102E of IAS 39 to a discontinued hedging relationship, an entity ceases applying the exception at the earlier of (a) as described above and (b) when the entire amount accumulated in the cash flow hedge reserve with respect to the hedging relationship is reclassified to profit or loss. See paragraph 6.8.9 of IFRS 9 and paragraph 102I of IAS 39.

entities would apply all hedge accounting requirements in IFRS 9 or IAS 39 without applying the exceptions proposed in this Exposure Draft.

- BC34 In the Board’s view, for uncertainty regarding the timing and the amount of cash flows arising from a change in an interest rate benchmark 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. However, the Board noted that, in some cases, although a contract is amended, the amendment may not eliminate the uncertainty regarding the timing and the amount of interest rate benchmark-based cash flows. To illustrate how a contractual amendment could remove the uncertainty in some circumstances while not in others, the Board considered a number of scenarios in which a contract is amended in anticipation of interest rate benchmark reform.
- BC35 Scenario A—a contract is amended to include a clause that specifies both (a) the date the existing interest rate benchmark will be replaced by an alternative interest rate and (b) the alternative interest rate on which the cash flows will be based. In this case, the uncertainty regarding the timing and the amount of cash flows for this contract is eliminated when the contract is amended to include this clause. Therefore, consistent with the principle that the exceptions should cease when uncertainty is no longer present, the entity would no longer apply the proposed exceptions once the contract is amended, even if the date of the contract amendment is before the date the changes in the contractual terms take effect.
- BC36 Scenario B—a contract is amended to include a clause that specifies neither the date the existing interest rate benchmark will be replaced nor the exact alternative interest rate on which the amended cash flows will be based. In this case, the uncertainty regarding the timing and the amount of cash flows for this contract has not been eliminated by amending the contract to include this clause. Therefore, the entity would be required to continue to apply the exceptions until uncertainty of the amount and timing of the cash flows is no longer present.
- BC37 Scenario C—a contract is amended to include a clause that does not provide conditions that specify the amount and timing of cash flows that would arise if the clause was triggered but instead states, for example, that those conditions will be determined by a central authority at some point in the future. In this case, the uncertainty regarding the timing and the amount of cash flows for this contract has not been eliminated by including this clause in the contract. Uncertainty regarding both the timing and the amount of cash flows for this contract will be present until the central authority irrevocably specifies when the existing interest rate benchmark will be replaced by an alternative interest rate and what that new interest rate will be. Therefore, the entity would be required to continue to apply the exceptions until the central authority determines the timing and the amount of contractual cash flows.

- BC38 Scenario D—a contract is amended to include a clause in anticipation of the reform that specifies the date the existing interest rate benchmark will be amended but does not specify the alternative interest rate on which the cash flows will be based. In this case, by amending the contract to include this clause, uncertainty regarding the timing has been eliminated but uncertainty with respect to the amount remains. Therefore, the entity would be required to continue to apply the exceptions until uncertainty regarding the amount is no longer present.
- BC39 Scenario E—a contract is amended to include a clause in anticipation of the reform that specifies the alternative interest rate on which the cash flows will be based but does not specify the date the existing interest rate benchmark will be replaced by the alternative interest rate. In this case, by amending the contract to include this clause, uncertainty regarding the amount has been eliminated but uncertainty with respect to timing remains. Therefore, the entity would be required to continue to apply the exceptions until the uncertainty regarding timing is no longer present.
- BC40 The Board observed that a possible variation of Scenario E could include circumstances in which contracts are amended for both the hedged item and the hedging instrument to specify the alternative interest rate on which the cash flows will be based, but not the date the existing interest rate benchmark will be replaced by the alternative interest rate. Although the timing of the change in cash flows is unknown, the certainty of the amount of future cash flows implies that the strength of the economic link between the hedged item and the hedging instrument will significantly deteriorate from an uncertain future date—that is, it becomes evident that the hedge will be ineffective in the future. The Board considered whether the exceptions should end in such scenarios. More specifically, the Board considered requiring additional analysis of the economic link between the hedged item and the hedging instrument in these circumstances to determine whether the exceptions should continue to apply. The Board noted that any such analysis would likely be quantitative in nature and would add significant complexity to the requirements. In view of this, the Board considered the likelihood of this scenario occurring and its potential impact. The Board expects a scenario in which there is significant divergence between hedged items and hedging instruments for an extended time period to be unlikely because entities must agree to amend both contracts before this divergence can arise. In addition, the Board noted the effect of allowing such hedges to continue is limited to a delay in reflecting the impact of failing the prospective assessments because, once the timing of the replacement is determined, the exceptions would cease to apply. Consequently, the Board decided not to propose requiring additional analysis in such instances and to allow the exceptions to continue to apply.
- BC41 For reasons similar to those described in paragraph BC31, the Board noted that particular elements of the exceptions could end at different times for a single hedging relationship. For example, assume an entity designates in a hedging relationship contractually specified LIBOR cash flows as the hedged item and a LIBOR interest rate swap as the hedging instrument. Assume also that the exceptions related to both the highly probable requirement and the

prospective assessment apply because uncertainties exist for both the hedged item and the hedging instrument. If the hedged item is subsequently amended to be based on an alternative interest rate such that the uncertainty regarding the timing and the amount of cash flows is eliminated, then the entity would stop applying the exception for the highly probable requirement. The entity would continue to apply the exception for the prospective assessment to the hedging instrument until the uncertainty is resolved for the hedging instrument. This means that the entity would perform the prospective assessment based on existing contractual terms for both the hedged item (ie using the new interest rate after the amendment) and the hedging instrument (ie based on the ‘pre-replacement’ interest rate benchmark using the exception). However, in the above instance, the entity would first consider whether the hedged item should be derecognised when its contractual terms are amended.⁵

- BC42 The Board decided to propose that the end of application requirement in paragraph 6.8.8 of IFRS 9 and paragraph 102H of IAS 39 would also apply to hedges of a forecast transaction. The Board noted that IFRS 9 and IAS 39 require an entity to identify and document a forecast transaction with sufficient specificity so that when the transaction occurs, the entity is able to determine whether the transaction is the hedged transaction. For example, if an entity designates a future issuance of a LIBOR-based debt instrument as the hedged item, although there may be no existing contract at the time of designation, the hedge documentation would refer specifically to LIBOR. Consequently, the Board noted that entities would be able to identify when the uncertainty regarding the timing and the amount of the resulting cash flows of a forecast transaction is no longer present.
- BC43 In addition, the Board decided not to propose an end of application requirement with respect to the proposed exception for the separately identifiable requirement set out in paragraph 6.8.7 of IFRS 9 and paragraph 102G of IAS 39. Applying the proposed exception, entities would continue hedge accounting when an existing interest rate benchmark meets the separately identifiable requirement at the inception of the hedging relationship (assuming all other hedge accounting requirements continue to be met). If the Board proposed an end date for this exception, an entity may be required to immediately discontinue hedge accounting because, at some point, as interest rate benchmark reform progresses, the component or the portion based on the existing interest rate benchmark may no longer be separately identifiable. Such immediate discontinuation of hedge accounting would be inconsistent with the objective of the proposed exception. The Board noted that linking the end of application for this exception with contract amendments would not achieve the Board’s intention because, by definition, non-contractually specified risk components are not explicitly stated in a contract and, therefore, these contracts may not necessarily be amended for interest rate benchmark reform. This is particularly relevant for fair value hedges of a fixed-rate debt instrument. In this case, the Board proposes that

⁵ The Board will consider the consequences of the actual amendment of financial instruments as a result of interest rate benchmark reform in the next phase of this project (ie the replacement phase).

the exception is no longer applicable only when the hedging relationship is discontinued applying IFRS 9 or IAS 39.

Disclosures

- BC44 The Board proposes that entities applying the exceptions in this Exposure Draft provide disclosures about the magnitude of the hedging relationships to which the exceptions apply. The Board noted that IFRS 7 already requires specific disclosures about hedge accounting and, for some specifically identified disclosures, information provided separately for hedging relationships to which the proposed exceptions apply, would provide useful information to users of financial statements. The Board expects that the cost of this disclosure proposal would not be onerous because it requires only disaggregating information that is already required to be disclosed by IFRS 7.

Effective date and transition

- BC45 Acknowledging the urgency of the matter, the Board proposes that the effective date of these amendments is annual periods beginning on or after 1 January 2020, with earlier application permitted.
- BC46 In addition, the Board proposes the amendments apply retrospectively. However, the Board highlights that retrospective application of the amendments would not allow reinstating hedge accounting that has already been discontinued. Nor would it allow designation in hindsight. If an entity had not designated a hedging relationship, the proposed exceptions, even though applied retrospectively, would not allow the entity to apply hedge accounting in prior periods to items that were not designated for hedge accounting. Doing so would be inconsistent with the requirement that hedge accounting applies prospectively. Retrospective application of the exceptions would enable entities to continue hedge accounting for a hedging relationship that the entity had previously designated and that qualifies for hedge accounting applying IFRS 9 or IAS 39.
- BC47 The Board does not propose any specific transition provisions because the proposed exceptions do not introduce new accounting requirements. An entity would apply the proposed amendments in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.



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