



# Interest Rate Benchmark Reform – Phase II

(Amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and  
IFRS 16)

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# IBOR reform – Phase II

## Amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16

The International Accounting Standards Board (“IASB”) published Interest Rate Benchmark Reform *Amendments to IFRS 9, IAS 39 and IFRS 7* representing the finalisation of Phase II of the project on 27 August 2020 to address issues that might affect financial reporting when an existing interest rate benchmark is replaced with an alternative benchmark interest rate, i.e. **replacement issues**.

The accounting issues arising before an existing interest rate benchmark is replaced with an alternative risk free rate, i.e. **pre-replacement issues**, have been considered previously by the IASB and were addressed in *Interest Rate Benchmark Reform (Amendments to IFRS 9, IAS 39 and IFRS 7)*, published in September 2019 (“Phase I amendments”). These Phase I amendments provide temporary exceptions to specific hedge accounting requirements, to avoid entities having to discontinue hedging relationships solely due to the uncertainty arising from the reform.

The Phase II amendments discussed in following slides compliment, do not supersede, the Phase I amendments. The Phase II amendments apply to all entities and are not optional and effective for annual periods beginning on or after 1 January 2021 with early application permitted . The amendments are applied retrospectively and include the potential reinstatement of hedge relationships that were discontinued solely due to changes directly required by the reform.



# IBOR reform – Phase II

## Overview of the amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16



### Changes in the basis for determining the contractual cash flows as a result of IBOR reform under IFRS 9

For the purpose of the Phase II amendments, a change in the basis for determining the contractual cash flows is required by the IBOR reform only if:

- It is required as a direct consequence of the reform; and
- The new basis for determining the contractual cash flows is economically equivalent to the previous basis.
- Such a change can arise even if the contractual terms of the financial instrument are not amended but the basis for determining contractual cash flows changes (e.g. altering the method for calculating the interest rate benchmark without amending the contractual terms of the financial instrument or triggering the activation of an existing contractual term such as a fall-back clause.)
- As a practical expedient, the amendments require an entity to apply IFRS 9:B5.4.5, such that the change in the basis for determining the contractual cash flows is applied prospectively by revising the effective interest rate. All other changes to the contractual terms of a financial asset or liability are accounted for using the current IFRS requirements.



### Hedge accounting under IFRS 9 and IAS 39

#### Hedge designations:

- Hedge accounting would not discontinue solely because of the IBOR reform.
- Hedging relationships (and related documentation) must be amended to reflect changes to the hedged item, hedging instrument and hedged risk.
- Any valuation adjustments resulting from the amendments are recognised as part of ineffectiveness.
- Amended hedging relationship should meet all qualifying criteria in order to apply hedge accounting, including effectiveness requirements.

#### End of relief:

- No specific end-of-application requirements.



### Other IFRS

- For insurers that apply IAS 39 (instead of IFRS 9) the practical expedient discussed above also applies.
- A lessee will apply IFRS 16:42 as a practical expedient to account for a lease modification that is required by the IBOR reform – i.e. when re-measuring the lease liability, it will use a revised discount rate that reflects the change in the interest rate benchmark.



### Disclosures under IFRS 7

- Additional disclosure requirements have been developed.

# Changes in the basis for determining the contractual cash flows as a result of IBOR reform



# IBOR reform – Phase II

## Changes in the basis for determining the contractual cash flows as a result of IBOR reform

### Financial assets or liabilities

The Phase II amendments provide specific guidance on how to treat financial assets and financial liabilities where the **basis for determining the contractual cash flows changes as a result of IBOR reform**. This can include cases where **the contractual terms are amended**, cases where the **contractual terms are not amended but for example where the method for calculating the interest rate benchmark is altered**, and cases where **an existing contractual term is activated such as when a fall-back clause is triggered**.

**Practical expedient:** The Phase II amendments require an entity to apply IFRS 9:B5.4.5, such that the change in the basis for determining the contractual cash flows is applied **prospectively** by revising the effective interest rate. This practical expedient only applies when the change in the basis for determining the contractual cash flows is **necessary as a direct consequence of IBOR reform and the new basis for determining the contractual cash flows is economically equivalent to the previous basis** (i.e. the basis immediately preceding the change).

The amendments provide a non-exhaustive list of examples of changes that give rise to a new basis for determining the contractual cash flows that is economically equivalent to the previous basis:

- a) The replacement of an existing interest rate benchmark used to determine the contractual cash flows of a financial asset or financial liability with an alternative benchmark rate or implementation of a reform of an interest rate benchmark by changing the method used to calculate the interest rate benchmark, with the **addition of a fixed spread necessary to compensate for the basis difference between the existing interest rate benchmark and the alternative benchmark rate**;
- b) Changes to the reset period, reset dates or the number of days between coupon payment dates in order to implement the reform of an interest rate benchmark; and
- c) The **addition of a fall-back provision** to the contractual terms of a financial asset or financial liability to enable any of the changes described in a. and b. above to be implemented.

After an entity applies the practical expedient to the changes required by the IBOR reform, it would **separately assess any other changes to the contractual terms that are not necessary as a direct consequence of the IBOR reform, to determine if they result in derecognition of a financial instrument**. If they do not result in derecognition, the entity would adjust the carrying amount of a financial instrument and recognise an immediate gain or loss in the statement of profit or loss.

### Derecognition of a financial asset or liability

The IASB considered that existing requirements in IFRS 9 provide adequate basis to account for accounting implications arising from derecognition of a modified financial instrument and recognition of a new modified financial instrument in the context of IBOR reform.

# IBOR reform – Phase II

## Changes in the basis for determining the contractual cash flows as a result of IBOR reform (continued)



### Insurance contract accounted for under IFRS 4

The amendments to IFRS 4 require insurers who apply the temporary exemption from IFRS 9 to apply the amendments in IFRS 9 for changes in the basis for determining the contractual cash flows of a financial asset or financial liability that are a result of IBOR reform. **In other words, even though an insurer is applying IAS 39 instead of IFRS 9, for the purpose of accounting for financial assets and financial liabilities that change in response to the IBOR reform, it applies the relevant paragraphs in IFRS 9 (i.e. the practical expedient discussed above).** This ensures that all entities, including insurers, are accounting for the impact of the reform using the same requirements



### Modification of lease liabilities

Given the similarity of financial liabilities in IFRS 9 and lease liabilities in IFRS 16, the IASB has provided a similar practical expedient in IFRS 16. **The practical expedient applies when the interest rate benchmark on which lease payments are based is changed as a direct consequence of IBOR reform and the change is done on an economically equivalent basis.**

Similarly to the practical expedient in IFRS 9, the change in the contractual cash flows is applied **prospectively by applying IFRS 16:42**. If additional modifications are made to lease contracts that are not required by IBOR reform, a lessee shall apply the applicable requirements in IFRS 16 to account for all lease modifications made at the same time, including those required by IBOR reform.

The IASB decided not to amend the requirements for accounting for lease modifications from the lessor's perspective. **For a finance lease, the lessor is required to apply IFRS 9 (including the amendments) to lease modifications.** For operating leases, the Board considers that the current requirements in IFRS 16 will provide useful information about the modification in terms and conditions required by the reform in the light of the mechanics of the operating lease accounting model.

# Hedge accounting



# IBOR reform – Phase II

## Hedge accounting under IFRS 9 and IAS 39

### Relief from discontinuation

- Following **updates to hedging documentation to reflect changes** that are required as a direct consequence of IBOR reform **do not result in the discontinuation** of the hedge accounting:
  - a) Designating an alternative benchmark rate (contractually or non-contractually specified) as a hedged risk;
  - b) Amending the description of the hedged item, including the description of the designated portion of the cash flows or fair value being hedged; or
  - c) Amending the description of the hedging instrument; and
  - d) For those applying IAS 39, amending the description of how the entity will assess hedge effectiveness
- In regard to transition of hedging instruments to an alternative interest rate benchmark the IASB concluded that **entering into an equal and offsetting derivative to economically cancel the original derivative and entering into a new benchmark interest rate derivative on an economically equivalent basis as the original derivative is deemed to be the same as amending the description of the hedging instrument** in (c) above.
- If changes are made in addition to those changes required by IBOR reform to the financial asset or liability designated in a hedging relationship or if changes are made to the hedging designation other than those listed above, **the entity first applies the requirements of IFRS 9 to determine if those additional changes result in hedge discontinuation**; if the additional changes do not result in the discontinuation of the hedge, the entity applies the exception introduced by the amendments.

### Separately identifiable risk components

- When an entity changes the designation to an alternative benchmark interest rate, and that rate is not a separately identifiable component at the date it is designated, **the separately identifiable requirement is deemed to be met at that date if the entity reasonably expects the rate will be separately identifiable within a period of 24 months from the date it is designated..**
- The 24-month period applies to each alternative benchmark interest rate separately (i.e. on a **rate-by-rate basis**) and **starts from the date the entity designates the alternative benchmark interest rate as a non-contractually specified risk component for the first time.**
- If, subsequently, it is no longer reasonable to expect the alternative benchmark interest rate to be separately identifiable within 24 months from the date it was designated as a risk component, **hedge accounting is discontinued prospectively from the date of that reassessment to all hedging relationships in which the alternative benchmark interest rate was designated as a risk component.**
- The 24-month provision **also applies to new hedging relationships** in which an alternative benchmark interest rate is designated as a non-contractually specified risk component when, because of IBOR reform, that risk component is not separately identifiable at the date it is designated.



# IBOR reform – Phase II

## Hedge accounting under IFRS 9 and IAS 39 (continued)

### Cash flow hedges

- The amount accumulated in the cash flow hedge reserve at the date that the entity amends the description of the hedged item is **deemed to be based on the alternative benchmark interest rate on which the hedged future cash flows are determined.**
- For **hedge relationships that have been discontinued**, when the interest rate benchmark on which the hedged future cash flows were based is changed as required by IBOR reform, **the amount accumulated in the cash flow hedge reserve is deemed to be based on the alternative benchmark rate on which the hedged future cash flows will be based.**
- The provisions for cash flow hedges ensure that **amounts previously recognised in the cash flow hedge reserve are not immediately reclassified** to profit or loss simply because of IBOR reform.

### Groups of items

- When a group of items is designated as a hedged item and an item in the group is amended to reflect the changes that are required by the IBOR reform, **an entity will allocate the hedged items to sub groups based on the benchmark rate being hedged, and designate the benchmark rate for each sub-group as the hedged risk.**
- An entity will assess each sub-group **separately** to determine whether the sub-group is eligible to be a hedged item. If any sub group is not eligible to be a hedged item, the **hedging relationship is discontinued prospectively in its entirety.**
- **In addition, all other hedge requirements – including the requirements for hedge ineffectiveness – are applied to the hedging relationship in its entirety.**

### Highly effective test in IAS 39

- For the purposes of assessing the retrospective effectiveness of a hedging relationship on a cumulative basis, an entity **may elect to reset the cumulative fair value changes of the hedged item and hedging instrument to zero.**
- This election is made separately for each hedging relationship (i.e. **on an individual hedging relationship basis**). This election was introduced to minimise the risk that entities would fail the retrospective effectiveness assessment of a hedging relationship when they transition to alternative benchmark interest rates.

# Disclosures, effective date and transition



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## Disclosures, effective date and transition

### Disclosures

- The amendments to IFRS 7 require that an entity provide disclosures that **enable a user to understand the nature and extent of risks arising from IBOR reform, how the entity is managing those risks, its progress in completing the transition from interest rate benchmarks to alternative benchmark interest rates and how it is managing the transition. To achieve this objective, an entity is required to disclose:**
  - How it is managing the transition to alternative benchmark rates, its progress at the reporting date and the risks to which it is exposed arising from financial instruments because of the transition;
  - Disaggregated by significant interest rate benchmark subject to IBOR reform, quantitative information about financial instruments that have yet to transition to an alternative benchmark rate as at the end of the reporting period, showing separately: non-derivative financial assets, non-derivative financial liabilities and derivatives; and
  - If the reform has resulted in changes to an entity's risk management strategy, a description of those changes.

### Effective date and transition

- The Phase II amendments are applied for annual periods beginning on or after **1 January 2021 with earlier application being permitted (subject to EU endorsement).**
- An entity applies the amendments **retrospectively, except that it will reinstate a discontinued hedging relationship if the following conditions are met:**
  - The hedging relationship was **discontinued solely due to changes required by IBOR reform** and if the amendments had been applied at that time it would not have [been](#) required to discontinue that hedging relationship.
  - At the beginning of the reporting period in which the entity first applies these amendments, that discontinued hedging relationship continues **to meet all qualifying criteria for hedge accounting having taken into account the Phase II amendments.**
- An entity is **not required to restate prior periods to reflect the application of the amendments.** However, the entity **may restate prior periods if it is possible without the use of hindsight.**
- The IASB **did not include a fixed date** when the requirements introduced by the Phase II amendments cease to apply as the amendments are associated with the point at which changes to financial instruments or hedging relationships occur as a result of IBOR reform. Therefore, **by design, the application of the Phase II amendments has a natural end.**

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