STAFF PAPER

February 2020

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 project IBOR Reform and its Effects on Financial Reporting–Phase 2. This paper is structured as follows:
   (a) Objective of this project (paragraphs 3–4);
   (b) Project plan and current stage (paragraphs 5–8);
   (c) High-level project timeline (paragraphs 9–10); and
   (d) The Board's tentative decisions to date (paragraphs 11–22).
2. This paper accompanies the following agenda papers:
   (a) Agenda Paper 14A *Sweep issue—Modification of financial instruments*, which considers a sweep issue related to a tentative decision that the Board made at its October 2019 meeting with respect to what constitutes a modification of a financial instrument.
   (b) Agenda Paper 14B *Hedges of risk components—separately identifiable requirement*, which considers the end of application for the exception in Phase 1 related to the requirement for a risk component to be separately

identifiable in IFRS 9 *Financial Instruments* and IAS 39 *Financial Instruments: Recognition and Measurement* and whether the Board should provide a further exception from the requirement as part of Phase 2.

(c) Agenda Paper 14C *End of Phase 2 amendments and voluntary versus mandatory application*, discusses the end of application for the proposed amendments in Phase 2 and whether those amendments should be applied voluntarily or mandatorily.

(d) Agenda Paper 14D *Effective date and transition requirements*, discusses the proposed effective date and transition requirements for the Board's tentative decisions in Phase 2 of the project.

(e) Agenda Paper 14E *Due Process Steps* discusses, the relevant due process requirements including the proposed comment period for the Exposure Draft and seeks the Board's permission to begin the process for balloting the Exposure Draft.

Objective of this project

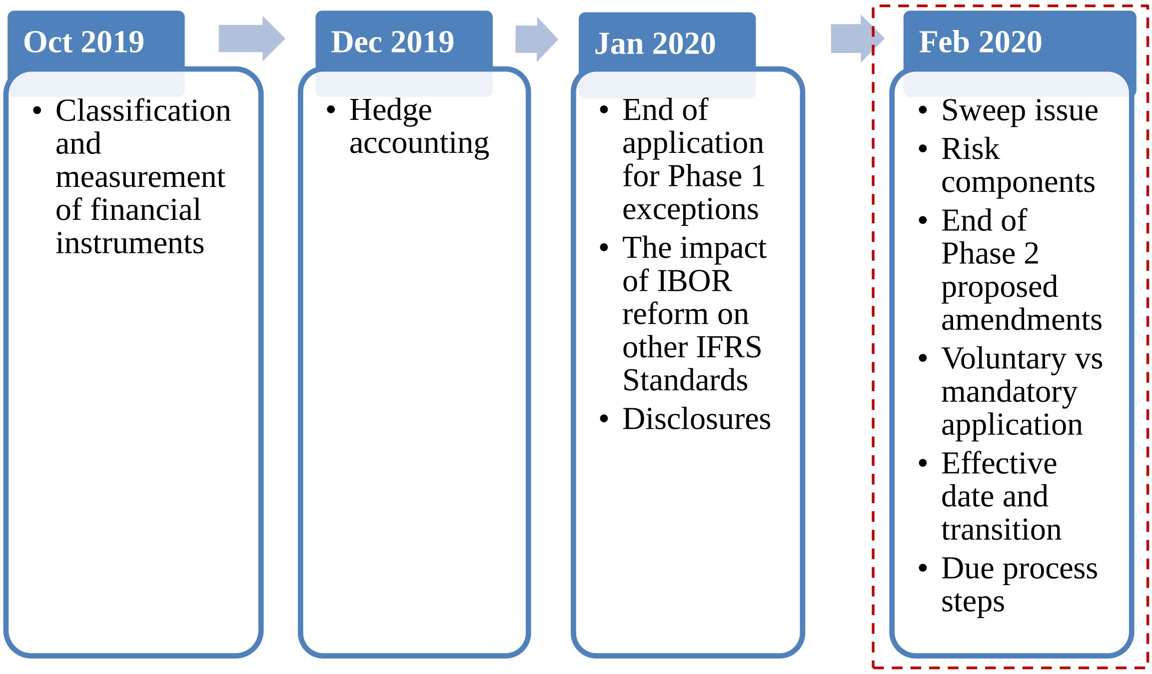
3. Consistent with the overall objective of financial reporting as set out in the *Conceptual Framework*, the objective of Phase 2 project is to provide useful information about the effects of the transition to alternative benchmark rates on an entity's financial statements and support preparers in applying 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. 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.

7. Following this project plan, at the October 2019, December 2019 and January 2020 meetings, the Board discussed and tentatively decided to make amendments to:

   (a) IFRS 9 for specific aspects of classification and measurement of financial instruments;

   (b) IFRS 9 and IAS 39 for specific aspects of hedge accounting including the end of application for Phase 1 exceptions;

   (c) IFRS 16 *Leases* for particular aspects of lessee accounting;

(d) IFRS 4 *Insurance Contracts* to require insurers that apply the temporary exemption from IFRS 9 to apply some of the amendments resulting from the Board's tentative decisions in Phase 2; and

(e) IFRS 7 *Financial Instruments: Disclosures* to require disclosures about the effect on an entity's financial statements arising from the transition to alternative benchmark rates.

8. At this meeting the Board will discuss the remainder of the issues as described in paragraph 2.

High-level project timeline

9. If the Board decides to proceed with the proposed amendments described in the agenda papers listed in paragraph 2, the staff consider that the proposals for Phase 2 should be published as quickly as possible.

10. We have prepared a high-level project timeline assuming a comment period of 45 days. The staff plan to seek the Due Process Oversight Committee (DPOC)'s approval for a comment period of no less than 30 days at its February 2020 meeting.

Timeline	**Project plan**
February/March 2020	Board finishes deliberations, including the comment period, due process steps and permission to ballot. Proceed with drafting those amendments.
April 2020	Publish an Exposure Draft
May 2020	Comment period ends
June 2020 and thereafter	Provide feedback to the Board Board re-deliberations Issue final amendments

The Board's tentative decisions to date

11. 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 for 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.

12. At the October 2019 meeting, the Board also noted that, although not a modification as described above, the practical expedient described in paragraph 11(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).

13. 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.

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

14. 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 changes in hedging relationships and hedge documentation necessary to reflect modifications to the hedged item or hedging instruments 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. Examples of such changes could include:

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

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

(iii) changing the method used for assessing hedge effectiveness when, due to IBOR reform, it is not appropriate to continue using the same method defined at the inception of the hedging relationship.

15. 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 14(b)(i), to assume that all items included in the portfolio of financial assets or financial liabilities share the risk being hedged.

16. Apart from the specific exceptions from the hedge accounting requirements tentatively agreed, 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.

17. 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 subgroups within the designated group of items based on the original interest rate benchmark and 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 constitution of the subgroups of hedged items; and

(d) assume that the interest rate benchmark and the alternative benchmark rate share similar risk characteristics (but only in relation to a group of items designated under IAS 39).

18. At its January 2020 meeting, with respect to end of application requirements for Phase 1 exceptions, the Board tentatively decided to:

    (a) amend IAS 39, only for the purpose of assessing retrospective effectiveness, to require the cumulative fair value changes of the hedging instrument and the hedged item to reset to zero at the date the exception to the retrospective assessment in paragraph 102G of IAS 39 ceases to apply; and

    (b) make no amendments to the end of application requirements for the Phase 1 exceptions to the highly probable requirement for cash flow hedges and prospective assessments in IFRS 9 and IAS 39.

19. At the January 2020 meeting, with respect to the potential effects of IBOR reform on IFRS Standards other than those related to financial instruments accounting, the Board also tentatively decided to amend:

    (a) IFRS 16 to require a lessee to apply paragraphs 42(b) and 43 of IFRS 16 to account for lease modifications to the interest rate benchmark on which lease payments are based that are required as a direct consequence of IBOR reform and done on an economically equivalent basis (modifications directly required by IBOR reform).

    (b) IFRS 4 to require insurers that apply the temporary exemption from IFRS 9 to apply the amendments resulting from the Board's tentative decisions in Phase 2 of the project in accounting for modifications directly required by IBOR reform.

20. At the same meeting, the Board tentatively decided that no amendments are made in the context of IBOR reform to:

    (a) IFRS 13 *Fair Value Measurement* because it provides sufficient guidance to determine if and when a financial asset or financial liability should be transferred to a different level within the fair value hierarchy. These transfers reflect the economic effects of IBOR reform, therefore providing useful information to users of financial statements.

    (b) IFRS 17 *Insurance Contracts* because it provides an adequate basis for an entity to account for insurance contract modifications in the context of the

IBOR reform. Such accounting results in useful information to users of financial statements.

(c) the current requirements in IFRS Standards with respect to discount rates as they already provide adequate guidance to determine the appropriate accounting treatment for the potential effects of changes to the discount rates resulting from the replacement of interest rate benchmarks.

21. Regarding disclosures for Phase 2, at its January 2020 meeting, the Board tentatively decided to amend IFRS 7 to require an entity to provide disclosures that enable users of financial statements to understand:

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

(b) the entity's progress in completing the transition from interest rate benchmarks to alternative benchmark rates, and how the entity is managing the transition.

22. To achieve this objective, an entity would disclose information about:

(a) how it is managing the transition from interest rate benchmarks to alternative benchmark rates and the progress made at the reporting date, and the risks arising from this transition;

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

(c) for each significant alternative benchmark rate to which the entity is exposed, an explanation of how the entity determined the base rate and relevant adjustments to the rate to assess whether the modifications to contractual cash flows were required as a direct consequence of IBOR reform and have been done on an economically equivalent basis; and

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