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IFRS® Standards
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Interest Rate Benchmark Reform—Phase 2

Proposed amendments to IFRS 9, IAS 39, IFRS 7,
IFRS 4 and IFRS 16

Comments to be received by 25 May 2020

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Phase 2**

**Proposed amendments to IFRS 9, IAS 39,
IFRS 7, IFRS 4 and IFRS 16**

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Exposure Draft ED/2020/1 *Interest Rate Benchmark Reform—Phase 2* 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 25 May 2020 and should be submitted in writing by email to commentletters@ifrs.org or electronically using our ‘Open for comment’ page at: <http://go.ifrs.org/open-for-comment>.

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Introduction

Why is the Board publishing this Exposure Draft?

The Exposure Draft sets out proposals for amendments to IFRS 9 *Financial Instruments*, IAS 39 *Financial Instruments: Recognition and Measurement*, IFRS 7 *Financial Instruments: Disclosures*, IFRS 4 *Insurance Contracts* and IFRS 16 *Leases*. The Exposure Draft follows *Interest Rate Benchmark Reform*, which was issued in September 2019. The Exposure Draft is the next phase of the project for the International Accounting Standards Board (Board) to consider, as a priority, the effects of interest rate benchmark reform on an entity's financial statements that arise when interest rate benchmarks are replaced with alternative, nearly risk-free interest rates that are based, to a greater extent, on transaction data (alternative benchmark rates).

In 2014, the Financial Stability Board recommended the reform of specified major interest rate benchmarks such as interbank offered rates (IBORs). Since then public authorities in many jurisdictions have taken steps to implement interest rate benchmark reform and have increasingly encouraged market participants to ensure timely progress towards the reform of interest rate benchmarks, including the replacement of interest rate benchmarks with alternative benchmark rates. The progress towards interest rate benchmark reform follows the general expectation that some major interest rate benchmarks will cease to be published by the end of 2021. In this Exposure Draft, the term 'interest rate benchmark reform' refers to the market-wide reform of an interest rate benchmark as described in paragraph 6.8.2 of IFRS 9 and paragraph 102B of IAS 39.

In 2018, the Board decided to add a project to its agenda to consider the financial reporting implications of interest rate benchmark reform. The Board identified two groups of issues that could have financial reporting implications:

- (a) issues affecting financial reporting in the period before the reform of an interest rate benchmark, including the replacement of an interest rate benchmark with an alternative benchmark rate (pre-replacement issues); and
- (b) issues that might affect financial reporting during the reform of an interest rate benchmark, including the replacement of an interest rate benchmark with an alternative benchmark rate (replacement issues).

In September 2019, the Board amended IFRS 9, IAS 39 and IFRS 7, to address as a priority the pre-replacement issues (Phase 1). These amendments provide temporary exceptions to specific hedge accounting requirements. As a result, entities would apply those specific hedge accounting requirements assuming the interest rate benchmark on which the hedged risk and/or cash flows of the hedged item or of the hedging instrument are based is not altered as a result of interest rate benchmark reform. Applying these exceptions prevents entities from being required to discontinue hedge accounting solely due to the uncertainty arising from interest rate benchmark reform.

Phase 2 of this project, and hence the proposals in this Exposure Draft, address replacement issues. The objective of Phase 2 is to assist entities with providing useful information to users of financial statements and to support preparers in applying IFRS Standards when changes are made to contractual cash flows or hedging relationships, as a result of the transition to alternative benchmark rates.

Proposals in this Exposure Draft

This Exposure Draft proposes amendments to specific requirements in IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16 relating to:

- (a) modifications of financial assets and financial liabilities, including lease liabilities;
- (b) hedge accounting; and
- (c) disclosures.

Who would be affected by the proposals?

The Board expects the proposals in this Exposure Draft to affect many entities given the extensive use of interest rate benchmarks in global financial markets. The proposals in this Exposure Draft will affect entities with financial assets and financial liabilities, including lease liabilities, that are referenced to an interest rate benchmark and have been or will be required to replace the interest rate benchmark with an alternative benchmark rate as a result of interest rate benchmark reform. In most cases, the replacement will require modifications of these entities' financial instruments or lease liabilities but could also be implemented through the activation of existing contractual terms such as 'fallback clauses'. The proposals will also affect entities that apply the hedge accounting requirements in IFRS 9 or IAS 39 to hedging relationships that are directly affected by interest rate benchmark reform and entities that provide disclosures applying the requirements in IFRS 7.

Next step

The Board will consider comments it receives on the proposals in this Exposure Draft and will decide whether to proceed with the proposed amendments. The Board plans to complete any resulting amendments in 2020.

Invitation to comment

The Board invites comments on the proposals in this Exposure Draft, 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) 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—Modifications of financial assets and financial liabilities (paragraphs 6.9.1–6.9.6 of the [Draft] amendments to IFRS 9, paragraphs 20R–20S and 50–51 of the [Draft] amendments to IFRS 4 and paragraphs 104–106 and C1A–C1B of the [Draft] amendments to IFRS 16)

Paragraphs 6.9.2–6.9.6 of the draft amendments to IFRS 9 propose that:

- (a) a financial asset or financial liability would be modified if the basis for determining the contractual cash flows is changed after the initial recognition of the financial instrument. In this context, a modification can arise even if the contractual terms of the financial instrument are not amended.
- (b) an entity would apply paragraph B5.4.5 of IFRS 9 as a practical expedient to account for a modification of a financial asset or financial liability that is required by interest rate benchmark reform.
- (c) a modification is required by interest rate benchmark reform if and only if (i) it is required as a direct consequence of interest rate benchmark reform; and (ii) the new basis for determining the contractual cash flows is economically equivalent to the previous basis (ie the basis immediately preceding the modification).
- (d) an entity would also apply the practical expedient proposed in paragraph 6.9.3 if an existing contractual term is activated that results in a change in the basis for determining the contractual cash flows of a financial asset or a financial liability, and particular other conditions are met.

Paragraphs BC10–BC36 of the Basis for Conclusions describe the Board’s reasons for these proposals.

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Question 1—Modifications of financial assets and financial liabilities (paragraphs 6.9.1–6.9.6 of the [Draft] amendments to IFRS 9, paragraphs 20R–20S and 50–51 of the [Draft] amendments to IFRS 4 and paragraphs 104–106 and C1A–C1B of the [Draft] amendments to IFRS 16)

- (e) The Exposure Draft proposes to make corresponding amendments to IFRS 4 that would require insurers applying the temporary exemption from IFRS 9 to apply the same practical expedient as described above.
- (f) The Exposure Draft proposes amendments to IFRS 16 that would require entities to apply paragraph 42 of IFRS 16 to account for a lease modification that is required by interest rate benchmark reform.

Paragraphs BC39–BC41 and paragraphs BC118–BC125 of the Basis for Conclusions describe the Board’s reasons for these proposals.

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 and why.

Question 2—Amendments to hedging relationships (paragraphs 6.9.7–6.9.10 of the [Draft] amendments to IFRS 9 and paragraphs 102O–102R of the [Draft] amendments to IAS 39)

Paragraphs 6.9.7–6.9.10 of the draft amendments to IFRS 9 and paragraphs 102O–102R of the draft amendment to IAS 39 propose that an entity would amend the formal designation of the hedging relationship only to make one or more of the changes specified in paragraph 6.9.7 and paragraph 102O as and when uncertainty arising from interest rate benchmark reform is no longer present with respect to the hedged risk and/or the timing and the amount of interest rate benchmark-based cash flows of the hedged item or of the hedging instrument.

Paragraphs BC42–BC50 of the Basis for Conclusions describe the Board’s reasons for these proposals.

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 and why.

Question 3—Accounting for qualifying hedging relationships and groups of items (paragraphs 6.9.11–6.9.15 of the [Draft] amendments to IFRS 9 and paragraphs 102S–102X of the [Draft] amendments to IAS 39)

Paragraphs 6.9.11–6.9.15 of the draft amendments to IFRS 9 and paragraphs 102S–102X of the draft amendments to IAS 39 propose that:

- (a) the requirements in IFRS 9 and IAS 39 would be applied when the designation of a hedging relationship is amended to remeasure the hedging instrument and the hedged item based on the alternative benchmark rate and recognise any resulting ineffectiveness in profit or loss.
- (b) the amount accumulated in the cash flow hedge reserve at the date the entity amends the description of the hedged item would be deemed to be based on the alternative benchmark rate on which the hedged future cash flows are determined.
- (c) when there is a change in the basis for determining the contractual cash flows of a financial asset or a financial liability previously designated as a hedged item in a hedging relationship that has been discontinued, the amount accumulated in the cash flow hedge reserve for the discontinued hedging relationship would be deemed to be based on the alternative benchmark rate on which the hedged future cash flows will be based.
- (d) when applying paragraph 6.9.7 or paragraph 102O to groups of items designated as hedged items, the hedged items would be allocated to sub-groups within the same hedging relationship based on the benchmark rate to which they are referenced and that the proportionality test would be applied to each sub-group separately.
- (e) for the purpose of assessing retrospective effectiveness as required by IAS 39, the cumulative fair value changes of the hedged item and hedging instrument would be reset to zero when paragraph 102G of IAS 39 ceases to apply.

Paragraphs BC51–BC79 of the Basis for Conclusions describe the Board's reasons for these proposals.

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 and why.

Question 4—Designation of risk components and portions (paragraphs 6.9.16–6.9.18 of the [Draft] amendments to IFRS 9 and paragraphs 102Y–102Z1 of the [Draft] amendments to IAS 39)

Paragraphs 6.9.16–6.9.18 of the draft amendments to IFRS 9 and paragraphs 102Y–102Z1 of the draft amendments to IAS 39 propose that:

- (a) an alternative benchmark rate designated as a non-contractually specified risk component that is not separately identifiable at the date it is designated, would be deemed to have met that requirement at that date, if and only if, the entity reasonably expects the alternative benchmark rate will be separately identifiable within a period of 24 months from the date the alternative benchmark rate is designated as a risk component.
- (b) if subsequently, an entity reasonably expects that the alternative benchmark rate will not be separately identifiable within 24 months from the date it was designated as a risk component, an entity would cease applying the requirement in paragraph 6.9.16 and paragraph 102Y and discontinue hedge accounting prospectively from the date of that reassessment.

Paragraphs BC87–BC97 of the Basis for Conclusions describe the Board’s reasons for these proposals.

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 and why.

Question 5—Effective date and transition (paragraphs 7.1.9 and 7.2.36–7.2.38 of the [Draft] amendments to IFRS 9 and paragraphs 108H–108J of the [Draft] amendments to IAS 39)

- (a) The Exposure Draft proposes that the amendments would have an effective date of annual periods beginning on or after 1 January 2021. Earlier application would be permitted.
- (b) The Exposure Draft proposes that the amendments would be applied retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, except as specified in (ii) below. An entity would:
- (i) reinstate a discontinued hedging relationship if and only if the entity discontinued that hedging relationship solely due to changes required by interest rate benchmark reform and, therefore, the entity would not have been required to discontinue that hedging relationship if the amendments had been applied at that time.
 - (ii) not be required to restate prior periods to reflect the application of these amendments. However, the entity may restate prior periods if, and only if, it is possible without the use of hindsight.

Paragraphs BC110–BC115 of the Basis for Conclusions describe the Board’s reasons for these proposals.

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 and why.

Question 6—Disclosures (paragraphs 24I–24J and paragraphs 44HH–44II of [Draft] amendments to IFRS 7)

The Exposure Draft proposes that entities provide specific disclosures in order to provide information about:

- (a) the nature and extent of risks arising from interest rate benchmark 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 that transition.

Paragraphs BC105–BC109 of the Basis for Conclusions describe the Board’s reasons for this proposal.

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

Deadline

The Board will consider all written comments received by **25 May 2020** (45 days).

How to comment

The IFRS Foundation's offices are closed temporarily in line with government measures to stem the coronavirus pandemic. However, we are working and will consider your views in finalising these proposed amendments. Please submit your comments electronically.

Online	Visit the 'Open for comment documents' page at: https://www.ifrs.org/projects/open-for-comment/
By email	Send to: commentletters@ifrs.org

Your comments will be on the public record and posted on our website unless you request confidentiality and we grant your request. We do not normally grant such requests unless they are 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 6.9.1–6.9.18, paragraphs 7.1.9 and 7.2.36–7.2.38 are added. A new heading is added before paragraph 6.9.1 and subheadings are added before paragraphs 6.9.1, 6.9.7, 6.9.11, 6.9.15, 6.9.16 and 7.2.36. For ease of reading these paragraphs have not been underlined.

6.9 Additional temporary exceptions arising from interest rate benchmark reform

Modifications of financial assets and financial liabilities

- 6.9.1 An entity shall apply paragraphs 6.9.2–6.9.6 and paragraphs 7.1.9 and 7.2.36–7.2.38 to all financial assets and financial liabilities that are modified, or have existing contractual terms activated that change the basis for determining the contractual cash flows of those financial assets and financial liabilities, as a result of interest rate benchmark reform. These paragraphs apply only to such financial assets and financial liabilities. For this purpose, the term ‘interest rate benchmark reform’ refers to the market-wide reform of an interest rate benchmark as described in paragraph 6.8.2.
- 6.9.2 For the purpose of applying paragraphs 6.9.3–6.9.4 and 6.9.6, a financial asset or financial liability is modified if the basis for determining the contractual cash flows is changed after the initial recognition of the financial instrument. In this context, a modification can arise even if the contractual terms of the financial instrument are not amended.
- 6.9.3 As a practical expedient, an entity shall apply paragraph B5.4.5 to account for a modification of a financial asset or financial liability that is required by interest rate benchmark reform. This practical expedient applies only to such modifications (but see also paragraph 6.9.5) and only to the extent the modification is required by interest rate benchmark reform (see also paragraph 6.9.6). For this purpose, a modification is required by interest rate benchmark reform if and only if both of the following conditions are met:
- (a) the modification is required as a direct consequence of interest rate benchmark reform; and
 - (b) the new basis for determining the contractual cash flows is economically equivalent to the previous basis (ie the basis immediately preceding the modification).
- 6.9.4 Examples of modifications required by interest rate benchmark reform include changes that are limited to:
- (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 (for example, replacing LIBOR with an alternative benchmark rate) or effecting such a reform of an interest rate benchmark by changing the method used to calculate the interest rate benchmark;

- (b) the addition of a fixed spread to compensate for a basis difference between an existing interest rate benchmark and an alternative benchmark rate;
 - (c) changes to the reset period, reset dates, or the number of days between coupon payment dates that are necessary to effect the reform of an interest rate benchmark; and
 - (d) the addition of a fallback provision to the contractual terms of a financial asset or financial liability to enable any of the changes described in (a)–(c) above to be effected.
- 6.9.5 An entity shall also apply the practical expedient in paragraph 6.9.3 if the following conditions are met even though these changes do not meet the description of a modification in paragraph 6.9.2 (see also paragraph 6.9.6):
- (a) the entity revises its estimates of future cash payments or receipts because an existing contractual term is activated and that contractual term changes the basis for determining the contractual cash flows (for example, an existing fallback clause is triggered);
 - (b) that activation of an existing contractual term that changes the basis for determining the contractual cash flows is required as a direct consequence of interest rate benchmark reform; and
 - (c) the new basis for determining the contractual cash flows is economically equivalent to the previous basis (ie the basis immediately preceding the activation).
- 6.9.6 If there are changes to the basis for determining the contractual cash flows of a financial asset or financial liability in addition to changes required by interest rate benchmark reform, an entity shall first apply the practical expedient in paragraph 6.9.3 to the changes required by interest rate benchmark reform. The entity shall then apply the applicable requirements in this Standard to the additional changes. This means, for example, an entity first applies the practical expedient to a modification that is required by interest rate benchmark reform (ie a modification that meets both conditions in paragraph 6.9.3). The entity then applies the applicable requirements in this Standard to the changes to which the practical expedient has not been applied. If the additional modification does not result in the derecognition of the financial asset or financial liability, the entity shall apply paragraph 5.4.3 to account for that additional modification of a financial asset or paragraph B5.4.6 to account for that additional modification of a financial liability. If the additional modification results in the derecognition of the financial asset or financial liability, the derecognition requirements apply.

Hedge accounting

- 6.9.7 As and when uncertainty arising from interest rate benchmark reform is no longer present with respect to the hedged risk and/or the timing and the amount of interest rate benchmark-based cash flows of the hedged item or of the hedging instrument (see paragraphs 6.8.9–6.8.12), an entity shall amend the formal designation of the hedging relationship as previously documented.

In this context, the hedge designation shall be amended only to make one or more of the following changes:

- (a) designating an alternative benchmark rate (contractually or non-contractually specified) as a hedged risk;
- (b) amending the description of the hedged item so that it refers to an alternative benchmark rate; or
- (c) amending the description of the hedging instrument so that it refers to an alternative benchmark rate.

6.9.8 If changes are made in addition to those changes required by interest rate benchmark reform to the financial asset or financial liability designated in a hedging relationship (as described in paragraph 6.9.3 or 6.9.5) or to the designation of the hedging relationship (as required by paragraph 6.9.7), an entity shall first apply the applicable requirements in this Standard to determine if those additional changes result in the discontinuation of hedge accounting. If the additional changes do not result in the discontinuation of hedge accounting, an entity shall amend the formal designation of the hedging relationship only as specified in paragraph 6.9.7.

6.9.9 For the avoidance of doubt, applying paragraph 6.9.7 to amend the formal designation of a hedging relationship constitutes neither the discontinuation of the hedging relationship nor the designation of a new hedging relationship.

6.9.10 Applying paragraph 6.9.7, depending on when uncertainty arising from interest rate benchmark reform is resolved (see paragraphs 6.8.9–6.8.12), an entity may amend the formal designation of different hedging relationships at different times, or may amend the formal designation of a particular hedging relationship more than once. When, and only when, such a change is made to the hedge designation, an entity shall apply paragraphs 6.9.11–6.9.17 to the extent relevant. Paragraphs 6.9.11–6.9.18 provide exceptions only to the requirements specified in those paragraphs. An entity shall apply all other hedge accounting requirements in this Standard to hedging relationships that were directly affected by interest rate benchmark reform.

Accounting for qualifying hedging relationships

Fair value hedges

6.9.11 For the purpose of applying paragraph 6.5.8 to account for a fair value hedge at the time that the hedge designation is amended applying paragraph 6.9.7, an entity shall:

- (a) remeasure the hedging instrument based on the alternative benchmark rate and recognise a corresponding gain or loss in profit or loss; and
- (b) remeasure the carrying amount of the hedged item based on the alternative benchmark rate designated as the hedged risk and recognise a corresponding gain or loss in profit or loss.

Cash flow hedges

- 6.9.12 For the purpose of applying paragraph 6.5.11 to account for a cash flow hedge at the time that the hedge designation is amended applying paragraph 6.9.7, the cash flow hedge reserve is remeasured to the lower of the following:
- (a) the cumulative gain or loss on the hedging instrument calculated based on the alternative benchmark rate; and
 - (b) the cumulative change in fair value of the hedged item calculated based on the alternative benchmark rate.
- 6.9.13 The amount accumulated in the cash flow hedge reserve at the date that the entity amends the description of the hedged item shall, therefore, be deemed to be based on the alternative benchmark rate on which the hedged future cash flows are determined.
- 6.9.14 When there is a change in the basis for determining the contractual cash flows of a financial asset or a financial liability previously designated as a hedged item in a hedging relationship that has been discontinued, the amount accumulated in the cash flow hedge reserve for a discontinued hedging relationship (see paragraph 6.5.12) shall be deemed to be based on the alternative benchmark rate on which the contractual cash flows will be based.

Groups of items

- 6.9.15 When an entity applies paragraph 6.9.7 to groups of items designated as hedged items in a hedging relationship, the entity shall allocate the hedged items to subgroups based on the benchmark rate being hedged, and designate the benchmark rate for each sub-group as the hedged risk. An entity shall assess whether the change in fair value for each individual item in the sub-group is expected to be approximately proportional to the overall change in fair value attributable to the hedged risk of the group of items, for each sub-group separately. For example, in a hedging relationship in which a group of items is hedged for changes in an interest rate benchmark subject to interest rate benchmark reform, some items in the group could be modified to reference an alternative benchmark rate before other items in the group. In this example, to apply paragraph 6.9.7, the entity would designate the alternative benchmark rate as the hedged risk for that relevant sub-group of hedged items. The entity would continue to designate the existing interest rate benchmark as the hedged risk for the other sub-group of hedged items until those items are modified to reference the alternative benchmark rate.

Designation of risk components

- 6.9.16 An alternative benchmark rate designated as a non-contractually specified risk component that is not separately identifiable at the date it is designated, shall be deemed to have met that requirement at that date, if and only if, the entity reasonably expects the alternative benchmark rate will be separately identifiable within a period of 24 months from the date the alternative benchmark rate is designated as a risk component.

- 6.9.17 If subsequently, an entity reasonably expects that the alternative benchmark rate will not be separately identifiable within 24 months from the date it was designated as a risk component, an entity shall cease applying the requirement in paragraph 6.9.16 and discontinue hedge accounting prospectively from the date of that reassessment.
- 6.9.18 In addition to those hedging relationships specified in paragraph 6.9.7, an entity shall apply the requirements in paragraphs 6.9.16–6.9.17 to new hedging relationships in which an alternative benchmark rate is designated as a non-contractually specified risk component applying paragraphs 6.3.7 and B6.3.8 when that component is not separately identifiable at the date it is designated as a consequence of interest rate benchmark reform.

7.1 Effective date

...

- 7.1.9 [Draft] *Interest Rate Benchmark Reform—Phase 2*, which amended IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16, issued in [Month] 2020, added Section 6.9 and paragraphs 7.2.36–7.2.38. An entity shall apply these amendments for annual periods beginning on or after [1 January 2021]. Earlier application is permitted. If an entity applies these amendments for an earlier period, it shall disclose that fact.

7.2 Transition

...

Transition for [draft] *Interest Rate Benchmark Reform—Phase 2*

- 7.2.36 An entity shall apply [draft] *Interest Rate Benchmark Reform—Phase 2* retrospectively in accordance with IAS 8, except as specified in paragraph 7.2.38.
- 7.2.37 Applying paragraph 7.2.36, an entity shall reinstate a discontinued hedging relationship if and only if the entity discontinued that hedging relationship solely due to changes required by interest rate benchmark reform and, therefore, the entity would not have been required to discontinue that hedging relationship if the amendments had been applied at that time.
- 7.2.38 An entity is not required to restate prior periods to reflect the application of these amendments. The entity may restate prior periods if, and only if, it is possible without the use of hindsight. If an entity does not restate prior periods, the entity shall recognise any difference between the previous carrying amount and the carrying amount at the beginning of the annual reporting period that includes the initial application of these amendments in the opening retained earnings (or other component of equity, as appropriate) of the annual reporting period that includes the date of initial application of these amendments.

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

Paragraphs 102O–102Z1 and 108H–108J are added. A new heading is added before paragraph 102O and subheadings are added before paragraphs 102O, 102S, 102X and 102Y. For ease of reading these paragraphs have not been underlined.

Paragraph 102M is amended. New text is underlined, and deleted text is struck through.

Temporary exceptions from applying specific hedge accounting requirements

...

End of application

102M An entity shall prospectively cease applying paragraph 102G 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 hedged risk and the timing and the amount of the interest rate benchmark-based cash flows of the hedged item ~~or~~ and of the hedging instrument; and
- (b) when the hedging relationship to which the exception is applied is discontinued.

...

Additional temporary exceptions arising from interest rate benchmark reform

Hedge accounting

102O As and when uncertainty arising from interest rate benchmark reform is no longer present with respect to the hedged risk and/or the timing and the amount of interest rate benchmark-based cash flows of the hedged item or of the hedging instrument (see paragraphs 102J–102N), an entity shall amend the formal designation of the hedging relationship as previously documented. In this context, the hedge designation shall be amended only to make one or more of the following changes:

- (a) designating an alternative benchmark rate (contractually or non-contractually specified) as a hedged risk;
- (b) amending the description of the hedged item so that it refers to an alternative benchmark rate;
- (c) amending the description of the hedging instrument so that it refers to an alternative benchmark rate; or
- (d) amending the description of how the entity will assess hedge effectiveness.

- 102P If changes are made in addition to those changes required by interest rate benchmark reform to the financial asset or financial liability designated in a hedging relationship (as described in paragraph 6.9.3 or 6.9.5 of the draft amendments to IFRS 9 proposed in this Exposure Draft) or to the designation of the hedging relationship (as required by paragraph 102O), an entity shall first apply the applicable requirements in this Standard to determine if those additional changes result in the discontinuation of hedge accounting. If the additional changes do not result in the discontinuation of hedge accounting, an entity shall amend the formal designation of the hedging relationship only as specified in paragraph 102O.
- 102Q For the avoidance of doubt, applying paragraph 102O to amend the formal designation of a hedging relationship constitutes neither the discontinuation of the hedging relationship nor the designation of a new hedging relationship.
- 102R Applying paragraph 102O, depending on when uncertainty arising from interest rate benchmark reform is resolved (see paragraphs 102J–102N), an entity may amend the formal designation of different hedging relationships at different times, or may amend the formal designation of a particular hedging relationship more than once. When, and only when, such a change is made to the hedge designation, an entity shall apply paragraphs 102S–102Z to the extent relevant. Paragraphs 102S–102Z1 provide exceptions only to the requirements specified in those paragraphs. An entity shall apply all other hedge accounting requirements in this Standard to hedging relationships that were directly affected by interest rate benchmark reform.

Accounting for qualifying hedging relationships

- 102S For the purpose of assessing the retrospective effectiveness of a hedging relationship applying paragraph 88(e) (and only for this purpose), an entity shall reset to zero the cumulative fair value changes of the hedged item and hedging instrument immediately after ceasing to apply paragraph 102G as required by paragraph 102M.

Fair value hedges

- 102T For the purpose of applying paragraph 89, to account for a fair value hedge at the time that the hedge designation is amended applying paragraph 102O, an entity shall:
- (a) remeasure the hedging instrument based on the alternative benchmark rate and recognise a corresponding gain or loss in profit or loss; and
 - (b) remeasure the carrying amount of the hedged item based on the alternative benchmark rate designated as the hedged risk and recognise a corresponding gain or loss in profit or loss.

Cash flow hedges

- 102U For the purpose of applying paragraph 96 to account for a cash flow hedge at the time that the hedge designation is amended applying paragraph 102O, the separate component of equity associated with the hedged item is remeasured to the lesser of the following:
- (a) the cumulative gain or loss on the hedging instrument calculated based on the alternative benchmark rate; and
 - (b) the cumulative change in fair value of the expected future cash flows on the hedged item calculated based on the alternative benchmark rate.
- 102V The cumulative gain or loss recognised in other comprehensive income at the date that the entity amends the description of the hedged item, shall therefore be deemed to be based on the alternative benchmark rate on which the hedged future cash flows are determined.
- 102W When there is a change in the basis for determining the contractual cash flows of a financial asset or a financial liability previously designated as a hedged item in a hedging relationship that has been discontinued, the amount accumulated in other comprehensive income for a discontinued hedging relationship (see paragraph 101(c)) shall be deemed to be based on the alternative benchmark rate on which the contractual cash flows will be based.

Groups of items

- 102X When an entity applies paragraph 102O to groups of items designated as hedged items in a hedging relationship, the entity shall allocate the hedged items to subgroups based on the benchmark rate being hedged, and designate the benchmark rate for each sub-group as the hedged risk. An entity shall assess whether the change in fair value for each individual item in the sub-group is expected to be approximately proportional to the overall change in fair value attributable to the hedged risk of the group of items, for each sub-group separately. For example, in a hedging relationship in which a group of items is hedged for changes in an interest rate benchmark subject to interest rate benchmark reform, some items in the group could be modified to reference an alternative benchmark rate before other items in the group. In this example, to apply paragraph 102O, the entity would designate the alternative benchmark rate as the hedged risk for that relevant sub-group of hedged items. The entity would continue to designate the existing interest rate benchmark as the hedged risk for the other sub-group of hedged items until those items are modified to reference the alternative benchmark rate.

Designating financial items as hedged items

- 102Y An alternative benchmark rate designated as a non-contractually specified risk portion that is not separately identifiable at the date it is designated, shall be deemed to have met that requirement at that date, if and only if, the entity reasonably expects the alternative benchmark rate will be separately identifiable within a period of 24 months from the date the alternative benchmark rate is designated as a risk portion.

- 102Z If subsequently, an entity reasonably expects that the alternative benchmark rate will not be separately identifiable within 24 months from the date it was designated as a risk portion, an entity shall cease applying the requirement in paragraph 102Y and discontinue hedge accounting prospectively from the date of that reassessment.
- 102Z1 In addition to those hedging relationships specified in paragraph 102O, an entity shall apply the requirements in paragraphs 102Y–102Z to new hedging relationships in which an alternative benchmark rate is designated as a non-contractually specified risk portion applying paragraphs 81 and AG99F when that component is not separately identifiable at the date it is designated as a consequence of interest rate benchmark reform.

Effective date and transition

- ...
- 108H [Draft] *Interest Rate Benchmark Reform—Phase 2*, which amended IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16, issued in [Month] 2020, added paragraphs 102O–102Z1 and paragraphs 108I–108J, and amended paragraph 102M. An entity shall apply these amendments for annual periods beginning on or after [1 January 2021]. Earlier application is permitted. If an entity applies these amendments for an earlier period, it shall disclose that fact. An entity shall apply these amendments retrospectively in accordance with IAS 8, except as specified in paragraph 108J.
- 108I Applying paragraph 108H, an entity shall reinstate a discontinued hedging relationship if and only if the entity discontinued that hedging relationship solely due to changes required by interest rate benchmark reform and, therefore, the entity would not have been required to discontinue that hedging relationship if the amendments had been applied at that time.
- 108J An entity is not required to restate prior periods to reflect the application of these amendments. The entity may restate prior periods if, and only if, it is possible without the use of hindsight. If an entity does not restate prior periods, the entity shall recognise any difference between the previous carrying amount and the carrying amount at the beginning of the annual reporting period that includes the initial application of these amendments in the opening retained earnings (or other component of equity, as appropriate) of the annual reporting period that includes the date of initial application of these amendments.

[Draft] Amendments to IFRS 7 *Financial Instruments: Disclosures*

Paragraphs 24I–24J and 44HH–44II are added and a subheading is added before paragraph 24I. These paragraphs have not been underlined for ease of reading.

Other disclosures

...

Additional disclosures related to interest rate benchmark reform

- 24I To enable users of financial statements to understand the effect of interest rate benchmark reform on an entity's financial instruments and risk management, an entity shall disclose information about:
- (a) the nature and extent of risks arising from interest rate benchmark reform to which the entity is exposed, and how the entity 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 that transition.
- 24J To meet the objectives in paragraph 24I, an entity shall disclose:
- (a) how the entity is managing the transition to alternative benchmark rates, its progress at the reporting date and the risks arising from the transition;
 - (b) disaggregated by significant interest rate benchmark, the carrying amount of non-derivative financial assets, the carrying amount of non-derivative financial liabilities and the nominal amount of derivatives, each shown separately, that continue to reference interest rate benchmarks subject to interest rate benchmark reform;
 - (c) for each significant alternative benchmark rate to which the entity is exposed, a description of how the entity determined the base rate and relevant adjustments to that rate, including any significant judgements the entity made to assess whether the conditions in paragraphs 6.9.3 and 6.9.5(b)–6.9.5(c) of the draft amendments to IFRS 9 proposed in this Exposure Draft were met; and
 - (d) to the extent that interest rate benchmark reform has resulted in changes to an entity's risk management strategy, a description of those changes and of how the entity is managing these risks.

...

Effective date and transition

...

- 44HH [Draft] *Interest Rate Benchmark Reform—Phase 2*, which amended IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16, issued in [Month] 2020, added paragraphs 24I–24J and 44II. An entity shall apply these amendments when it applies the amendments to IFRS 9, IAS 39, IFRS 4 or IFRS 16.
- 44II In the reporting period in which an entity first applies [draft] *Interest Rate Benchmark Reform—Phase 2*, issued in [Month] 2020, an entity is not required to present the quantitative information required by paragraph 28(f) of IAS 8.

[Draft] Amendments to IFRS 4 *Insurance Contracts*

Paragraphs 20R–20S and paragraphs 50–51 are added. A new subheading is added before paragraph 20R. For ease of reading these paragraphs have not been underlined.

Recognition and measurement

...

Modifications of financial assets and financial liabilities arising from interest rate benchmark reform

20R An insurer applying the temporary exemption from IFRS 9 shall apply the requirements in paragraphs 6.9.1–6.9.6 of the draft amendments to IFRS 9 proposed in this Exposure Draft and paragraphs 50–51 to financial assets and financial liabilities that are modified, or have existing contractual terms activated that change the basis for determining the contractual cash flows, as a result of interest rate benchmark reform. For this purpose, the term ‘interest rate benchmark reform’ refers to the market-wide reform of an interest rate benchmark as described in paragraph 102B of IAS 39.

20S For the purpose of applying paragraphs 6.9.3–6.9.6 of the draft amendments to IFRS 9 proposed in this Exposure Draft, the references to paragraph B5.4.5 of IFRS 9 shall be read as referring to paragraph AG7 of IAS 39. References to paragraphs 5.4.3 and B5.4.6 of IFRS 9 shall be read as referring to paragraph AG8 of IAS 39.

...

Effective date and transition

...

50 [Draft] *Interest Rate Benchmark Reform—Phase 2*, which amended IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16, issued in [Month] 2020, added paragraphs 20R–20S and paragraph 51. An entity shall apply these amendments for annual periods beginning on or after [1 January 2021]. Earlier application is permitted. If an entity applies these amendments for an earlier period, it shall disclose that fact. An entity shall apply these amendments retrospectively in accordance with IAS 8, except as specified in paragraph 51.

51 An entity is not required to restate prior periods to reflect the application of these amendments. The entity may restate prior periods if, and only if, it is possible without the use of hindsight. If an entity does not restate prior periods, the entity shall recognise any difference between the previous carrying amount and the carrying amount at the beginning of the annual reporting period that includes the initial application of these amendments in the opening retained earnings (or other component of equity, as appropriate) of the annual reporting period that includes the date of initial application of these amendments.

[Draft] Amendments to IFRS 16 Leases

Paragraphs 104–106 and C1A–C1B are added. A new heading is added before paragraph 104. For ease of reading these paragraphs have not been underlined.

Temporary exception arising from interest rate benchmark reform

- 104 A lessee shall apply paragraphs 105–106 and paragraphs C1A–C1B to all leases modified to change the basis for determining future lease payments as a result of interest rate benchmark reform (see paragraphs 6.9.1–6.9.4 of the draft amendments to IFRS 9 proposed in this Exposure Draft). These paragraphs apply only to such lease modifications. For this purpose, the term ‘interest rate benchmark reform’ refers to the market-wide reform of an interest rate benchmark as described in paragraph 6.8.2 of IFRS 9.
- 105 As a practical expedient, a lessee shall apply paragraph 42 to account for a lease modification that is required by interest rate benchmark reform. This practical expedient applies only to such modifications. For this purpose, a lease modification is required by interest rate benchmark reform if and only if both of the following conditions are met:
- (a) the modification is required as a direct consequence of interest rate benchmark reform; and
 - (b) the new basis for determining the lease payments is economically equivalent to the previous basis (ie the basis immediately preceding the modification).
- 106 However, if lease modifications are made in addition to those lease modifications required by interest rate benchmark reform, a lessee shall apply the applicable requirements in this Standard to account for all lease modifications made at the same time, including those required by interest rate benchmark reform.

...

Appendix C Effective date and transition

Effective date

- ...
- C1A [Draft] *Interest Rate Benchmark Reform—Phase 2*, which amended IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16, issued in [Month] 2020, added paragraphs 104–106 and C1B. An entity shall apply these amendments for annual reporting periods beginning on or after [1 January 2021]. Earlier application is permitted. If an entity applies these amendments for an earlier period, it shall disclose that fact. An entity shall apply these amendments retrospectively in accordance with IAS 8, except as specified in paragraph C1B.

INTEREST RATE BENCHMARK REFORM—PHASE 2

- C1B An entity is not required to restate prior periods to reflect the application of these amendments. The entity may restate prior periods if, and only if, it is possible without the use of hindsight. If an entity does not restate prior periods, the entity shall recognise any difference between the previous carrying amount and the carrying amount at the beginning of the annual reporting period that includes the initial application of these amendments in the opening retained earnings of the annual reporting period that includes the date of initial application of these amendments.

Approval by the Board of Exposure Draft *Interest Rate Benchmark Reform—Phase 2* published in April 2020

The Exposure Draft *Interest Rate Benchmark Reform—Phase 2*, which proposes amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16, was approved for issue by all 14 members of the International Accounting Standards Board.

Hans Hoogervorst	Chairman
Suzanne Lloyd	Vice-Chair
Nick Anderson	
Tadeu Cendon	
Martin Edelmann	
Françoise Flores	
Gary Kabureck	
Jianqiao Lu	
Darrel Scott	
Thomas Scott	
Chungwoo Suh	
Rika Suzuki	
Ann Tarca	
Mary Tokar	

Basis for Conclusions on Exposure Draft *Interest Rate Benchmark Reform—Phase 2*

This Basis for Conclusions accompanies, but is not part of, the Exposure Draft Interest Rate Benchmark Reform—Phase 2. It summarises the considerations of the International Accounting Standards Board (Board) when developing the Exposure Draft. Individual Board members gave greater weight to some factors than to others.

Introduction

BC1 The Exposure Draft sets out proposals for amendments to IFRS 9 *Financial Instruments*, IAS 39 *Financial Instruments: Recognition and Measurement*, IFRS 7 *Financial Instruments: Disclosures*, IFRS 4 *Insurance Contracts* and IFRS 16 *Leases*. The Exposure Draft follows *Interest Rate Benchmark Reform*, which was issued in September 2019. The Exposure Draft is the next phase of the Board's project to address, as a priority, the financial reporting issues that arise during the reform of an interest rate benchmark, including the replacement of an interest rate benchmark with alternative, nearly risk-free interest rates that are based, to a greater extent, on transaction data (alternative benchmark rates).

Background

BC2 In 2014, the Financial Stability Board recommended the reform of specified major interest rate benchmarks such as interbank offered rates (IBORs). Since then, public authorities in many jurisdictions have taken steps to implement interest rate benchmark reform and have increasingly encouraged market participants to ensure timely progress towards the reform of interest rate benchmarks, including the replacement of interest rate benchmarks with alternative benchmark rates. The progress towards interest rate benchmark reform follows the general expectation that some major interest rate benchmarks will cease to be published by the end of 2021. In this Exposure Draft, the term 'interest rate benchmark reform' refers to the market-wide reform of an interest rate benchmark as described in paragraph 6.8.2 of IFRS 9 and paragraph 102B of IAS 39 (the reform).

BC3 In 2018, the Board decided to add a project to its agenda to consider the financial reporting implications of the reform. The Board identified two groups of issues that could have financial reporting implications:

- (a) issues affecting financial reporting in the period before the reform of an interest rate benchmark, including the replacement of an interest rate benchmark with an alternative benchmark rate (pre-replacement issues); and
- (b) issues that might affect financial reporting during the reform of an interest rate benchmark, including the replacement of an interest rate benchmark with an alternative benchmark rate (replacement issues).

BC4 In September 2019, as part of the pre-replacement phase, the Board amended IFRS 9, IAS 39 and IFRS 7, to address as a priority the pre-replacement issues (Phase 1). The Phase 1 amendments provide temporary exceptions to specific hedge accounting requirements such that entities would apply those specific hedge accounting requirements assuming the interest rate benchmark on which the hedged risk and/or cash flows of the hedged item or of the hedging instrument are based is not altered as a result of the reform. Applying these exceptions prevents entities from being required to discontinue hedge accounting solely due to the uncertainty arising from the reform.

BC5 In September 2019, the Board commenced its deliberations to address replacement issues (Phase 2).

Objective and the scope

BC6 The objective of Phase 2 is to assist entities in providing useful information to users of financial statements and to support preparers in applying IFRS Standards when changes are made to contractual cash flows or hedging relationships, as a result of the transition to alternative benchmark rates. This is consistent with the overall objective of financial reporting as set out in the *Conceptual Framework for Financial Reporting (Conceptual Framework)*. The Board observed that for information about the effects of the transition to alternative benchmark rates to be useful, that information must be relevant to users of financial statements and faithfully represent the economic effects of that transition on the entity. This objective assisted the Board in assessing whether it should propose any amendments to IFRS Standards or whether the requirements in IFRS Standards provide an adequate basis to account for such effects.

BC7 As a result of research and outreach to stakeholders, the Board noted that the scope of Phase 2 is broader than Phase 1. That is because the transition to alternative benchmark rates is likely to have implications for the accounting for financial instruments beyond hedge accounting and is likely to affect financial instruments that are not designated in hedging relationships as well as the accounting for areas other than financial instruments. The Board therefore identified the following matters to be considered in Phase 2:

- (a) the modification of financial assets and financial liabilities, including lease liabilities;
- (b) specific hedge accounting requirements in IFRS 9 and IAS 39;
- (c) disclosure requirements in IFRS 7 to accompany the Board's proposals for classification and measurement of modified financial assets and financial liabilities and hedge accounting; and
- (d) the implications of replacement issues on IFRS Standards other than those related to the accounting for financial instruments.

BC8 In the light of the objective in paragraph BC6, the Board decided to propose additional temporary exceptions to specific requirements in IFRS Standards in order to address particular issues arising from the reform. Most exceptions in this Exposure Draft do not introduce new accounting requirements, but

instead propose the application of accounting requirements in the respective IFRS Standard to items that ordinarily would not have applied to those items.

- BC9 The Board also decided to limit the proposals in this Exposure Draft to changes in the basis for determining the contractual cash flows of financial assets and financial liabilities, as a result of the reform, to lease modifications required by the reform and to hedging relationships as specified in paragraphs 6.9.7, 6.9.18, 102O or 102Z1 of this Exposure Draft. The Board decided that these proposals should apply only for the circumstances specified and therefore did not propose other amendments to IFRS Standards.

Modifications of financial assets and financial liabilities

- BC10 During outreach to stakeholders and in the comment letters received on the Exposure Draft that led to the Phase 1 exceptions, stakeholders asked the Board to address, as a priority, issues relating to modifications of financial instruments resulting from the reform. In particular, they requested the Board clarify how entities would account for changes resulting from the reform to financial instruments, including which changes constitute a modification of a financial asset or a financial liability applying IFRS 9.
- BC11 As a result of research and outreach to stakeholders, the Board noted that changes to financial assets or financial liabilities arising from the reform could be made by:
- (a) amending the contractual terms of a financial asset or a financial liability;
 - (b) changing the basis for determining the contractual cash flows of the financial instrument, after the financial instrument is initially recognised, without amending its contractual terms; and
 - (c) activating existing contractual terms, which change the basis for determining the contractual cash flows of the financial instrument.
- BC12 To meet the objective of Phase 2, the Board concluded that the scope of potential proposals would need to include changes to financial instruments as a result of the reform, regardless of the legal form triggering those changes. The substance of situations outlined in paragraph BC11 is in each case a change, resulting from the reform, to the basis for determining the contractual cash flows of the financial instruments.

What constitutes a ‘modification’ of financial assets and financial liabilities (paragraph 6.9.2)

- BC13 As set out in paragraph 6.9.2 of this Exposure Draft, for the purpose of applying these proposals, a financial asset or a financial liability is modified if the basis for determining the contractual cash flows changes after the financial instrument is initially recognised.

- BC14 The Board noted that IFRS 9 does not describe what constitutes a ‘modification’ of a financial asset or financial liability. Paragraph 5.4.3 of IFRS 9 refers to the ‘modification or renegotiation of the contractual cash flows’ of a financial asset, while paragraph 3.3.2 of IFRS 9 refers to the ‘modification of the terms’ of an existing financial liability. The Board noted that although these paragraphs use slightly different words, both refer to a change in the contractual cash flows or contractual terms after the initial recognition of the financial instrument. In both cases, such a change was not specified or contemplated in the contract at initial recognition.
- BC15 In the Board’s view, determining whether a modification of a financial instrument has occurred will be straightforward in most cases, for example, when the contractual terms of a financial instrument are amended to replace the interest rate benchmark with an alternative benchmark rate. However, it may be less straightforward if the basis for determining the contractual cash flows changes after the initial recognition of the financial instrument, without an amendment to the contractual terms of that financial instrument. For example, this may be the case when, to effect the reform, the method for calculating the interest rate benchmark changes. Although the contractual terms of the financial instrument may not be amended, the change in method may alter the basis for determining the contractual cash flows of that financial instrument compared to the prior basis (ie the basis immediately preceding the modification).
- BC16 The Board acknowledged that the lack of a description of what constitutes a ‘modification’ and the use of different wording in IFRS 9 to describe a modification of a financial asset or a financial liability could lead to diversity in practice when entities determine whether a change resulting from the reform should be treated as a modification applying the requirements in IFRS 9.
- BC17 The Board considered that if the requirements in IFRS 9 for the modification of financial instruments were applied only to cases in which the contractual terms are amended, the form rather than the substance of the change would determine the appropriate accounting treatment. This could cause the economic effects of a change in the basis for determining the contractual cash flows to be hidden or obscured by the form of the change and not reflected in the financial statements, and result in changes with equivalent economic effects being accounted for differently.
- BC18 In the Board’s view, accounting for a change in the basis for determining the contractual cash flows as a modification, even if the contractual terms of the financial instrument are not amended, would reflect the economic substance of such a change and would therefore provide useful information to users of financial statements.
- BC19 Consequently, for the purpose of applying the proposals in this Exposure Draft, the Board decided to propose that a financial asset or financial liability is modified if the basis for determining the contractual cash flows is changed, after the initial recognition of that financial instrument. In this context, a

modification would arise even if the contractual terms of the financial instrument are not amended.

- BC20 The Board acknowledged that extending the scope of this amendment to all modifications (ie not limited to changes made as a result of the reform) could assist entities in determining whether a change in the cash flows of a financial asset or a financial liability is accounted for as a modification. However, the objective for Phase 2 focuses on the effects of the reform (as described in paragraph BC6). Therefore, the Board tentatively decided, for the purposes of this Exposure Draft, to limit the scope of the proposed amendment described in paragraph BC19 to changes made as a result of the reform. The Board will consider proposing a separate, narrow-scope amendment to the requirements in IFRS 9 for all modifications.

Modifications of financial assets and financial liabilities required by the reform (paragraphs 6.9.3–6.9.4)

- BC21 As set out in paragraph 6.9.3 of this Exposure Draft, the Board proposes a practical expedient that would require an entity to account for the modification of a financial asset or a financial liability required by the reform applying paragraph B5.4.5 of IFRS 9. In reaching that decision, the Board considered the usefulness of the information that would result from applying the current requirements in IFRS 9 to these modifications.
- BC22 When a financial asset or financial liability is modified, an entity applying IFRS 9 is required to determine whether the modification results in the derecognition of the financial instrument. Different accounting for the modification is specified depending on whether derecognition is required. IFRS 9 sets out separate requirements for derecognition of financial assets and derecognition of financial liabilities.
- BC23 The Board noted that because alternative benchmark rates are intended to be nearly risk-free while many existing interest rate benchmarks are not, it is likely that a fixed spread will be added to compensate for a basis difference between an existing interest rate benchmark and an alternative benchmark rate in order to avoid a transfer of economic value between the parties to the financial instrument. If this is the only change effected, the Board considers that it would be unlikely that the transition to an alternative benchmark rate alone would result in the derecognition of that financial instrument.
- BC24 Paragraph 5.4.3 of IFRS 9 applies to modifications of financial assets that do not result in derecognition of those assets. Applying that paragraph, a modification gain or loss is determined by recalculating the gross carrying amount of the financial asset as the present value of the renegotiated or modified contractual cash flows that are discounted at the financial asset's original effective interest rate. Any resulting modification gain or loss is recognised in profit or loss at the date of the modification. The accounting for modified financial liabilities that do not result in the derecognition of those liabilities (see paragraph B5.4.6 of IFRS 9) is consistent with the accounting for modified financial assets that do not result in derecognition.

- BC25 Thus, in absence of the practical expedient proposed in paragraph 6.9.3 of this Exposure Draft, an entity that only modifies the contractual terms as described in paragraph BC23 would apply the requirements in paragraphs 5.4.3 or B5.4.6 of IFRS 9 to a modification of a financial asset or financial liability required by the reform, by recalculating the carrying amount of the financial instrument with any modification gain or loss recognised in profit or loss. In addition, an entity would be required to use the original effective interest rate (ie the interest rate benchmark preceding the transition to the alternative benchmark rate) to recognise interest revenue or interest expense over the remaining life of the financial instrument.
- BC26 In the Board’s view, in the context of the reform, such an outcome would not necessarily provide useful information to users of financial statements. In reaching this view, the Board considered a situation in which a financial instrument was amended to only replace an interest rate benchmark with an alternative benchmark rate. Using the interest rate benchmark-based effective interest rate to calculate interest revenue or interest expense in this situation would not reflect the economic effects of the modified financial instrument. Also, maintaining the original effective interest rate could be difficult, and perhaps impossible, if that rate is no longer available.
- BC27 The Board therefore considered whether providing a practical expedient that requires an entity to apply paragraph B5.4.5 of IFRS 9 to account for financial assets and financial liabilities modified as a result of the reform would provide more useful information to users of financial statements in circumstances when the modification is limited to changes required by the reform. It is proposed that a modification is required by the reform, if and only if, the modification 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 (ie the basis immediately preceding the modification).
- BC28 Consistent with the objective of Phase 2 described in paragraph BC6, the Board only considered modifications required as a direct consequence of the reform. Furthermore, because the objective of the reform is limited to transition to alternative benchmark rates ie it does not encompass other changes that would lead to value transfer between parties to the financial instrument, the Board decided that the scope of the practical expedient set out in paragraph 6.9.3 of this Exposure Draft would apply only to modifications that satisfy both conditions – they are 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.
- BC29 In discussing whether the concept of economic equivalence was appropriate, the Board considered circumstances in which an entity makes modifications required as a direct consequence of the reform in a way so that the overall contractual cash flows (including the interest rate) of the financial instrument are substantially similar before and after the modification. For example, a modification would be economically equivalent if it only involved replacing an interest rate benchmark with an alternative benchmark rate plus a fixed spread that compensated for the basis difference between the interest rate benchmark preceding replacement, and the alternative benchmark rate. The

Board observed that in this situation, applying either paragraph B5.4.5 of IFRS 9 (that is, revising the effective interest rate at the same time as cash flows are re-estimated) or paragraphs 5.4.3 or B5.4.6 of IFRS 9 (that is, recognising a modification gain or loss) would result in similar accounting outcomes, as it is unlikely that the resulting modification gain or loss would be significant.

BC30 Applying the practical expedient proposed in paragraph 6.9.3 of this Exposure Draft, an entity would account for a modification required by the reform as being akin to a ‘movement in the market rates of interest’ applying paragraph B5.4.5 of IFRS 9. As a result, applying the practical expedient, an entity would not derecognise the financial asset or financial liability and would not apply paragraphs 5.4.3 or B5.4.6 of IFRS 9 to account for a modified financial instrument that is not derecognised. In other words, modifications required by the reform (as described in paragraph BC27) would not result in an adjustment to the carrying amount of the financial asset or the financial liability or recognition of a modification gain or loss. The Board concluded that this accounting would provide useful information about the effect of the reform on an entity’s financial instruments in the circumstances to which the practical expedient applies.

BC31 The Board acknowledged that modifications can vary significantly across jurisdictions, product types and contracts. Developing a comprehensive list of modifications considered to be required by the reform and hence qualify for the practical expedient would not be feasible. Nevertheless, the Board decided to include in paragraph 6.9.4 of this Exposure Draft some examples of modifications that, in its view, may be considered to be required by the reform. Those examples illustrate the scope of the proposals and assist preparers in applying them. These examples are not exhaustive; other modifications could also be required by the reform. The Board therefore concluded that adding such examples would support the understandability of the proposed amendments.

Changes arising from existing contractual terms (paragraph 6.9.5)

BC32 The Board noted that some entities may effect the reform through the activation of contractual terms that exist in the contract, such as fallback provisions. A fallback provision could specify the hierarchy of rates to which an interest rate benchmark would revert in case the existing benchmark rate ceases to exist. The proposed practical expedient in paragraph 6.9.3 of this Exposure Draft would not apply, because no ‘modification’ would have been made according to the proposed description of that term in paragraph 6.9.2 of this Exposure Draft. That is because the fallback provisions, and an associated change in the basis for determining contractual cash flows, are specified and would have been contemplated in the existing contract. For the reasons noted in paragraph BC26, the Board decided that extending the application of the practical expedient to these situations would equally result in more useful information.

- BC33 Furthermore, applying the practical expedient to changes arising from existing contractual terms would avoid differences in accounting outcomes simply because the changes in the basis for determining contractual cash flows were triggered by an existing contractual term instead of by a modification of the financial asset or financial liability. Such diversity in accounting outcomes would reduce the usefulness of information to users of financial statements and be burdensome to preparers. Therefore, the Board decided to propose in paragraph 6.9.5 of this Exposure Draft that the practical expedient also applies to revisions to an entity's estimates of future cash payments or receipts arising from the activation of existing contractual terms that are required by the reform.
- BC34 In other words, this proposal would apply to the changes in the basis for determining the contractual cash flows of a financial asset or a financial liability that arise from the activation of an existing contractual term. Consistent with paragraphs BC28-BC29, such changes are required to satisfy the two conditions—changes are 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 (ie the basis immediately preceding the activation). The Board decided that comparability would be increased by limiting application of the practical expedient proposed in paragraph 6.9.3 of this Exposure Draft to changes with the same characteristics.

Changes that are not required by the reform (paragraph 6.9.6)

- BC35 The Board noted that during negotiations with counterparties to agree changes to the contractual cash flows required by the reform, entities could at the same time make changes to the contractual terms that are not a direct consequence of the reform or are not economically equivalent to the previous terms and conditions. If there are changes to the basis for determining the contractual cash flows of a financial asset or financial liability in addition to those required by the reform, an entity would apply the relevant requirements in IFRS 9 to determine if those other changes to that financial instrument result in the derecognition of the financial instrument. If the entity determines that the other changes do not result in derecognition, the Board proposes that an entity would first account for changes determined to be required by the reform (ie meeting the conditions in paragraph 6.9.3 of this Exposure Draft) by updating the effective interest rate based on the alternative benchmark rate. Then the entity would account for changes to the financial asset or the financial liability not required by the reform by applying, respectively, paragraph 5.4.3 of IFRS 9 or paragraph B5.4.6 of IFRS 9.
- BC36 In the Board's view, the approach described in paragraph BC35 would provide useful information to users of financial statements about the economic effects of any changes to financial instruments that are not required by the reform while consistently accounting for those changes required by the reform.

Other classification and measurement issues

- BC37 In anticipation of the potential financial reporting implications of changes to financial instruments as a result of the reform, including the potential derecognition of existing financial instruments and the recognition of new financial instruments, some stakeholders asked the Board to consider additional matters with respect to the classification and measurement of financial assets and financial liabilities applying IFRS 9. These matters included:
- (a) whether, in the context of the reform, once a determination is made that derecognition of a financial asset or financial liability is required, IFRS 9 provides an adequate basis to account for the derecognition of a financial asset or a financial liability in the statement of financial position and the recognition of the resulting gain or loss in the statement of profit or loss;
 - (b) determining whether derecognition of a financial asset following modifications resulting from the reform affects the entity's business model for managing its financial assets;
 - (c) assessing the contractual cash flow characteristics of a financial asset that refers to an alternative benchmark rate;
 - (d) assessing whether the potential derecognition of an existing financial asset and the recognition of a new financial asset, as a result of the reform, would affect the recognition of expected credit losses; and
 - (e) determining potential effects on the accounting for embedded derivatives for financial liabilities in the context of the reform.
- BC38 The Board discussed these matters and concluded that IFRS 9 provides an adequate basis to determine the required accounting for each of these matters and therefore proposed no amendments considering the objective of Phase 2.

Insurance companies applying the temporary exemption from IFRS 9 (paragraphs 20R–20S of IFRS 4)

- BC39 The Board noted that paragraph 20A of IFRS 4 *Insurance Contracts* permits an insurer that meets specific criteria to apply IAS 39 rather than IFRS 9 for annual periods beginning before the effective date of IFRS 17 (temporary exemption from applying IFRS 9).
- BC40 In deciding to provide a temporary exemption from applying IFRS 9 (see paragraph 20A of IFRS 4), the Board noted that, because of its temporary nature, a version of IAS 39 (except for its hedge accounting requirements) would not be maintained and updated for any subsequent amendments to other IFRS Standards. This would mean that an insurer applying the temporary exemption would be required to apply the requirements in IAS 39 when accounting for modifications of financial instruments required by the reform and would therefore not be able to apply the amendments in paragraphs 6.9.1–6.9.6 of this Exposure Draft.

- BC41 The Board noted that the financial assets and financial liabilities of such an insurer would be affected by the reform in the same way as those for other entities. The Board therefore considered whether to propose amendments to the modification requirements in IAS 39 comparable to those being proposed for IFRS 9. The Board noted that proposing amendments to the superseded paragraphs in IAS 39 would be inconsistent with previous decisions that IAS 39 (except for its hedge accounting requirements) would not be maintained. However, the Board decided to propose an amendment to IFRS 4 to require insurers applying the temporary exemption from IFRS 9 to apply requirements that are comparable to paragraphs 6.9.1–6.9.6 of this Exposure Draft to financial assets and financial liabilities that are modified as a result of the reform. The Board noted that this decision was due to the significance of the potential effect of the reform on insurers and reaffirmed its overall position that it will not update the classification and measurement requirements of IAS 39.

Hedge accounting

Amendments to hedging relationships (paragraphs 6.9.7–6.9.10 and paragraphs 102O–102R)

- BC42 Proposals in this Exposure Draft relating to the hedge accounting requirements in IFRS 9 and IAS 39 apply to those hedging relationships directly affected by the reform as and when the uncertainty arising from the reform is no longer present with respect to the hedged risk and/or the timing and the amount of interest rate benchmark-based cash flows of the hedged item or of the hedging instrument as specified in paragraphs 6.8.9–6.8.12 of IFRS 9 and paragraphs 102J–102N of IAS 39. The scope of the hedging relationships to which the proposed Phase 2 exceptions would apply is therefore the same as the scope to which the Phase 1 exceptions applied, except for the proposed exception to the separately identifiable requirement, which also applies to the designation of new hedging relationships (see paragraphs 6.9.16–6.9.18 and paragraphs 102Y–102Z1 of this Exposure Draft).
- BC43 As part of the Phase 1 exceptions, the Board acknowledged that, in most cases, in order for uncertainty regarding the timing and the amount of interest rate benchmark-based cash flows arising from a change in an interest rate benchmark to no longer be present, the underlying financial instruments designated in the hedging relationship would have to be modified or changed to specify the timing and the amount of interest rate benchmark-based cash flows by reference to the alternative benchmark rate.
- BC44 However, the Board noted that, applying the hedge accounting requirements in IFRS 9 and IAS 39, changes to the basis for determining the contractual cash flows of a financial asset or a financial liability designated in a hedging relationship (see paragraphs 6.9.2–6.9.6 of this Exposure Draft), would affect the designation of a hedging relationship in which an interest rate benchmark has been designated as a hedged risk.

- BC45 The Board observed that amending the formal designation of a hedging relationship to reflect changes required by the reform would result in the hedging relationship being discontinued. This is because both IFRS 9 and IAS 39 require the formal designation of a hedging relationship to be documented at inception as part of the qualifying criteria for hedge accounting to be applied. The hedge documentation includes identification of the hedging instrument, the hedged item, the nature of the risk being hedged and how the entity will assess hedge effectiveness. Although in limited circumstances IFRS 9 permits the hedge documentation to be updated without resulting in the discontinuation of hedge accounting, IAS 39 requires hedge accounting to be discontinued when any amendments are made to the hedge designation as documented at the inception of the hedging relationship.
- BC46 The Board therefore noted that, in general, the hedge accounting requirements in IFRS 9 and IAS 39 are sufficiently clear about how to account for hedging relationships affected by the reform after the requirements in paragraphs 6.8.4–6.8.8 of IFRS 9 and paragraphs 102D–102I of IAS 39 cease to apply. However, consistent with the objectives for Phase 2 as set out in paragraph BC6 and the objectives for Phase 1 (see paragraph BC6.550 of IFRS 9 and paragraph BC227 of IAS 39), the Board considered that discontinuing hedge accounting solely due to effects of the reform would not always reflect the economic effects of the changes to a hedging relationship and therefore would not always provide useful information to users of financial statements.
- BC47 Accordingly, the Board decided that if a change in the basis for determining the contractual cash flows for a financial asset or a financial liability designated in a hedging relationship is required by the reform (ie it is within the scope of the proposed practical expedient in paragraph 6.9.3 of this Exposure Draft), it would be consistent with the Board’s objectives for Phase 2 to require the hedging relationship to be amended to reflect those changes without requiring discontinuation of that hedging relationship. For these reasons the Board decided to propose that, as and when the respective Phase 1 requirements cease to apply, an entity is required to amend the formal designation of the hedging relationship as previously documented to make one or more of the following changes:
- (a) designating the alternative benchmark rate (contractually or non-contractually specified) as a hedged risk;
 - (b) amending the description of the hedged item so it refers to the alternative benchmark rate;
 - (c) amending the description of the hedging instrument so it refers to the alternative benchmark rate; or
 - (d) amending the description of how the entity will assess hedge effectiveness (for IAS 39 only).
- BC48 However, as noted in paragraph BC35, the Board noted that changes might be made to the basis for determining the contractual cash flows of a financial asset or a financial liability in addition to those required by the reform. Similarly, the Board noted that changes to the hedging relationship, in

addition to those listed in paragraph BC47, might be made. The Board considered that the effect of such a change to the formal hedge designation on the application of the hedge accounting requirements would depend on whether those changes are required by the reform and, therefore, fall within the scope of the requirements in paragraphs 6.9.3–6.9.5 of this Exposure Draft or whether those changes result in the derecognition of the underlying financial instrument (see paragraph 6.9.6 of this Exposure Draft).

BC49 The Board therefore decided to require an entity to first apply the applicable requirements in IFRS 9 and IAS 39 to determine if those additional changes result in discontinuation of hedge accounting, for example, if the financial asset or financial liability designated as a hedged item is derecognised as a result of modifications in addition to those required by the reform. Equally, if an entity amends the hedge designation beyond what is described in paragraph 6.9.7 and paragraph 102O of this Exposure Draft (for example, if it extends the term of the hedging relationship), the entity would first determine if those additional changes to the hedge designation result in the discontinuation of hedge accounting. If the additional changes do not result in discontinuation of hedge accounting, the designation of the hedging relationship would be amended only as required by paragraph 6.9.7 and paragraph 102O of this Exposure Draft.

BC50 The proposals in this Exposure Draft would be applied to the specific element of a hedging relationship directly affected by the reform as and when the respective Phase 1 exceptions cease to apply. As the Phase 1 exceptions may cease to apply to different hedging relationships and to the different elements within a hedging relationship at different times, the applicable Phase 2 exceptions proposed in this Exposure Draft may therefore need to be applied at different times, resulting in the designation of a particular hedging relationship being amended more than once. The proposals apply only to the specific amendments proposed in IFRS 9 and IAS 39 and all other hedge accounting requirements in IFRS 9 and IAS 39 would be applied where relevant.

Accounting for qualifying hedging relationships (paragraphs 6.9.11–6.9.14 and 102S–102W)

Retrospective assessment (paragraph 102S)

BC51 The Board proposes a specific amendment to IAS 39 that would require an entity, for the purpose of the retrospective assessment only, to reset to zero the cumulative fair value changes of the hedging instruments when the exception from the retrospective assessment ceases to apply as required by paragraph 102M of IAS 39. However, the Board does not propose any exception from the measurement requirements in IFRS 9 and IAS 39.

BC52 Applying the Phase 1 exception in paragraph 102G of IAS 39, hedge accounting is not discontinued if the actual results of the hedge do not meet the requirements in paragraph AG105(b) of IAS 39. An entity would cease applying this exception when the uncertainty is no longer present with respect to the hedged risk and the timing and the amount of the interest rate

benchmark-based cash flows of the hedged item and hedging instrument, unless the hedging relationship is discontinued before that date. As with the other Phase 1 exceptions, at the date the exception ceases to apply, an entity must apply the requirements in IAS 39 without the exception. An entity would therefore apply paragraph AG105(b) of IAS 39 at that time, to assess whether the actual results of the hedge are within a range of 80–125 per cent and, if the results are outside that range, discontinue hedge accounting.

BC53 The Board considered that when an entity first applies the requirement in paragraph AG105(b) of IAS 39 to assess the retrospective effectiveness of a hedging relationship when paragraph 102G of IAS 39 ceases to apply, the hedging relationship could fail the retrospective assessment if the entity assesses hedge effectiveness on a cumulative basis. In the Board’s view, discontinuing hedge accounting solely as a consequence of this would be inconsistent with the Board’s objectives for Phase 1. As explained in paragraph BC52, the objective of the exception was to prevent the discontinuation of hedge accounting solely due to the effects of the uncertainties arising from the reform on the actual results of a hedge while recognising all ineffectiveness in the financial statements.

BC54 To address the issue described in paragraph BC53, the Board proposes the amendment in paragraph 102S of this Exposure Draft. However, the Board proposes that this amendment would be limited to the assessment of retrospective effectiveness on a cumulative basis. Measurement and recognition of hedge ineffectiveness would continue to be based on the comparison of the actual gains or losses on the hedged item to those of the hedging instrument as required by IFRS 9 and IAS 39.

Prospective assessments

BC55 Consistent with the Phase 1 exceptions, the collective term ‘prospective assessments’ is used to refer to the requirements in paragraph 6.4.1(c)(i) of IFRS 9 (the existence of an economic relationship between the hedged item and the hedging instrument) and paragraph 88(b) of IAS 39 (the expectation that the hedge will be highly effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk).

BC56 The Phase 1 exceptions in paragraph 6.8.6 of IFRS 9 and paragraph 102F of IAS 39 require an entity to assume that, for the purpose of the prospective effectiveness assessments, the interest rate benchmark on which the hedged cash flows and/or the hedged risk (contractually or non-contractually specified) are based, is not altered as a result of the reform. As noted in paragraph 6.8.11 of IFRS 9 and paragraph 102L of IAS 39 those exceptions cease to apply to the hedged item and the hedging instrument, respectively, at the earlier of when there is no longer uncertainty about the hedged risk or the timing and the amount of the interest rate benchmark-based cash flows; and when the hedging relationship that the hedged item and the hedging instrument are a part of is discontinued.

BC57 In line with the Board’s considerations on the highly probable requirement (see paragraphs BC64–BC65), the Board considered that, following an amendment to the formal designation of the hedging relationship (see paragraphs 6.9.7 and 102O of this Exposure Draft), the prospective assessments should be performed based on the alternative benchmark rate on which the hedged cash flows and/or the hedged risk will be based. The Board is therefore not proposing any exceptions from the prospective assessments for the period after the Phase 1 exceptions to prospective assessments cease to apply.

Remeasurement of the hedged item and hedging instrument (paragraphs 6.9.11–6.9.12 and paragraphs 102T–102U)

BC58 In *Interest Rate Benchmark Reform*, issued in September 2019, the Board noted in paragraphs BC6.568 of the Basis for Conclusions on IFRS 9 and BC254 of the Basis for Conclusions on IAS 39 that no exceptions are made to the measurement requirements for hedged items or hedging instruments. The Board concluded that the most useful information would be provided to users of financial statements if requirements for recognition and measurement of hedge ineffectiveness remain unchanged (see paragraphs BC6.567 of the Basis for Conclusions on IFRS 9 and BC253 of the Basis for Conclusions on IAS 39). This is because recognising ineffectiveness in the financial statements based on the actual results of a hedging relationship faithfully represents the economic effects of the reform, thereby providing useful information to users of financial statements.

BC59 Applying the hedge accounting requirements in IFRS 9 and IAS 39, a gain or loss arising on the hedged item that is attributable to the hedged risk or from remeasuring the hedging instrument is reflected when measuring and recognising hedge ineffectiveness.

BC60 During the deliberations on the proposals in this Exposure Draft, the Board noted that, when the formal designation of a hedging relationship is amended (see paragraphs 6.9.7 and 102O of this Exposure Draft), measurement adjustments could arise as a result of replacing an interest rate benchmark with an alternative benchmark rate. Such measurement adjustments could arise due to the changes made to:

- (a) designating an alternative benchmark rate as a hedged risk; and
- (b) amending the description of the hedged item and hedging instrument so that it refers to an alternative benchmark rate.

BC61 The Board considered whether to provide an exception from the requirement to include in hedge ineffectiveness such measurement differences when they arise. In particular, the Board considered, but rejected, the following approaches:

- (a) *recognising the measurement adjustment in profit or loss over time.* Applying this approach, the measurement adjustment would be recognised in profit or loss over time as the hedged item affects profit or loss. The Board rejected this approach because it would require an offsetting entry to be recognised either in the statement of financial position or

as an adjustment to the carrying amount of the hedged item or hedging instrument. Such an offsetting entry would fail to meet the definition of an asset or a liability applying the *Conceptual Framework*. Adjusting the carrying amount of the hedged item or hedging instrument would result in a net measurement adjustment of zero being recognised and would be inconsistent with the Board's decision that no exceptions should be made to the measurement of hedged items or hedging instruments. The Board also noted that such an approach is likely to result in additional operational complexity because the adjustments are expected to occur at different times and entities would need to track these adjustments for the purpose of amortising in the period(s) in which the hedged item affects profit or loss.

- (b) *recognising the measurement adjustment as an adjustment to retained earnings.* Applying this approach, the measurement adjustment would be recognised as an adjustment to retained earnings during the period in which the measurement difference arises. However, the Board rejected this approach because the changes to the hedged risk might be driven by amendments to hedging relationships that may occur in different reporting periods. Therefore, recognising adjustments to retained earnings over a period of time would be inconsistent with the Board's previous decisions (throughout IFRS Standards) that an adjustment to retained earnings only applies on transition to new requirements in IFRS Standards. Furthermore, the Board noted that the measurement adjustment would meet the definition of income or expense in the *Conceptual Framework* and therefore should be recognised in the statement of profit or loss. The Board also noted that recognising measurement adjustments directly in retained earnings would be inconsistent with the decision that no exceptions should be made to the measurement of hedged items or hedging instruments.

BC62 The Board confirmed its previous decision not to propose any exception to the requirements in IFRS 9 and IAS 39 regarding the measurement and recognition of hedge ineffectiveness. Therefore, an entity would apply the requirements in IFRS 9 and IAS 39 for the remeasurement of the hedged item and hedging instrument, and would recognise as part of hedge ineffectiveness any measurement adjustments arising from the amendments to the designation of the hedging relationship as required by the proposals in this Exposure Draft. Doing otherwise would be inconsistent with the Board's proposal to continue applying hedge accounting for such amended hedging relationships (see paragraphs 6.9.7 and 1020 of this Exposure Draft). In the Board's view, recognising those measurement adjustments applicable to hedged items and hedging instruments reflects the economic effects of the amendments to the formal designation of a hedging relationship and therefore, provides useful information to users of financial statements.

- BC63 The Board therefore proposes that for the purpose of applying the hedge accounting requirements in IFRS 9 and IAS 39 to a fair value hedge, the hedged item and hedging instrument in a fair value hedge are remeasured as if the items had been based on the alternative benchmark rate and a corresponding gain or loss is recognised in profit or loss. The Board also proposes that for a cash flow hedge, the cumulative amount recognised in the cash hedge reserve is remeasured to the lower of:
- (a) the cumulative gain or loss on the hedging instrument calculated taking into consideration the change to the alternative benchmark rate; and
 - (b) the cumulative change in fair value of the hedged cash flows on the hedged item (ie the 'hypothetical derivative') as if the hedged cash flows had been based on the alternative benchmark rate.

Cash flow hedges (paragraphs 6.9.13–6.9.14 and paragraphs 102V–102W)

- BC64 During the period in which a hedging relationship is affected by uncertainty arising from the reform, paragraph 6.8.4 of IFRS 9 and paragraph 102D of IAS 39 require an entity to assume that the interest rate benchmark on which the hedged cash flows (contractually or non-contractually specified) are based is not altered for the purpose of determining whether a forecast transaction (or a component thereof) is highly probable. An entity is required to cease applying this requirement at the earlier of the date the uncertainty arising from the 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 the date the hedging relationship of which the hedged item is part of is discontinued.
- BC65 The Board noted that uncertainty about the timing and the amount of the hedged cash flows would no longer be present when the interest rate benchmark on which the hedged cash flows are based is altered as required by the reform. In other words, uncertainty would no longer be present when there is a change in the basis for determining the contractual cash flows of the future transaction designated as the hedged item. Thereafter, applying the requirement in paragraph 6.3.3 of IFRS 9 and paragraph 88(c) of IAS 39, the assessment of whether the hedged cash flows are still highly probable to occur would be based on the contractual cash flows determined by reference to the alternative benchmark rate.
- BC66 The Board also noted that the proposals in paragraphs 6.9.7 and 102O of this Exposure Draft to amend the formal designation of some hedging relationships would lead to changes in the 'hypothetical derivative', ie a derivative that would have terms matching the critical terms of the designated cash flows and the hedged risk and that is commonly used in cash flow hedges to represent the forecast transaction.

- BC67 Consequently, as hedge accounting would not be discontinued for changes required by the reform applying the proposals in this Exposure Draft, the Board decided to propose that an entity deems the amount accumulated in the cash flow hedge reserve to be based on the alternative benchmark rate. Therefore, in applying paragraph 6.5.11(d) of IFRS 9 or paragraph 97 of IAS 39, the amount accumulated 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 based on the alternative benchmark rate affect profit or loss.
- BC68 The approach described in paragraph BC67 is consistent with the Board’s view that, when a hedging relationship is affected by changes required by the reform, more useful information would be provided to users of financial statements if hedge accounting is not discontinued and amounts are not reclassified to profit or loss solely due to the changes required by the reform. This is because such an approach will more faithfully reflect the economic effects of changes required by the reform.
- BC69 Consistent with the requirements in paragraphs 6.8.5 and 6.8.10 of IFRS 9 and paragraphs 102E and 102K of IAS 39, the Board considered whether to propose similar relief for hedging relationships that have been discontinued. The Board observed that although a hedging relationship may have been discontinued, the amount accumulated in the cash flow hedge reserve arising from that hedging relationship remains in the reserve if the hedged future cash flows are still expected to occur. The Board noted that if the hedged future cash flows are still expected to occur, the previously designated hedged item will be subject to a change in the basis for determining the contractual cash flows as required by the reform, even if the hedging relationship has been discontinued.
- BC70 The Board therefore decided to propose that, similar to the proposal for continuing hedging relationships, an entity deems the amount accumulated in the cash flow hedge reserve to be based on the alternative benchmark rate. That amount is reclassified to profit or loss in the same period(s) in which the hedged future cash flows based on the alternative benchmark rate affect profit or loss.

Groups of items (paragraph 6.9.15 and paragraph 102X)

- BC71 IFRS 9 and IAS 39 have specific requirements for the designation of a group of items as the hedged item in a hedging relationship. The eligibility criteria for designating a group of items in a hedging relationship in IAS 39 include the requirement that the individual items within the group have similar risk characteristics and share the risk exposure that is designated as being hedged. IFRS 9 and IAS 39 both require the proportionality test for hedges of group of items, except for fair value hedges of interest rate risk associated with a portfolio of financial assets or financial liabilities.
- BC72 The Board noted that the proportionality test plays an important role in ensuring discipline around designation of a group of items, particularly in the case of cash flow hedges. The proportionality test is the requirement that the change in fair value attributable to the hedged risk for each individual item in

the group is expected to be approximately proportional to the overall change in fair value attributable to the hedged risk of the group of items.

- BC73 The proportionality test is important in this context because, in measuring hedge ineffectiveness, entities usually define a derivative with terms that match the critical terms of the designated group of items (ie the hypothetical derivative) to calculate the change in the value of the designated group of items that is attributable to the hedged risk. Requiring the items within a group to share similar risk characteristics allows a single hypothetical derivative to match those terms. If items within the group had different risk characteristics, the entity would need to designate different groups of items based on common risk characteristics and define a hypothetical derivative separately for each designated group of items, so that the hypothetical derivative appropriately captures changes in fair value attributable to such different risks.
- BC74 However, the Board noted that even though both interest rate benchmark-based financial instruments and alternative benchmark rate-based financial instruments within a designated group of items may continue to be managed together on a group basis for interest rate risk management purposes, failure to meet the requirements in IFRS 9 and IAS 39 (see paragraph BC73) would require an entity to discontinue hedge accounting prospectively for that group of items.
- BC75 The Board considered that for cash flow hedges of groups of items, the hedged items could consist of items still referenced to the interest rate benchmark as well as items that are already referenced to the alternative benchmark rate. Therefore, when amending the description of the hedged items applying paragraph 6.9.7 and paragraph 1020 of this Exposure Draft, the entity would allocate the hedged items to subgroups based on the benchmark rate to which they are referenced and designate the benchmark rate for each sub-group as the hedged risk. The entity would apply the proportionality test to each sub-group separately.
- BC76 In the Board's view, by performing the proportionality test separately for each sub-group referencing a different benchmark rate (subject to the hedging relationship satisfying the other qualifying criteria for hedge accounting), the 'hypothetical derivative' used to measure the change in the fair value of the hedged items would be representative of the hedged cash flows of the group of hedged items.
- BC77 The Board also considered that, for the purpose of applying the requirement in paragraph 83 of IAS 39, that items within a group share the risk exposure that is designated as being hedged, an entity would apply the requirement to each sub-group separately.
- BC78 The Board acknowledged that such an approach is an exception to the hedge accounting requirements in IFRS 9 and IAS 39. However, as the requirements for groups of items are applied to each sub-group separately, the robustness of the hedge accounting requirements are maintained. The Board noted that this is because all other hedge accounting requirements are applied to the hedging relationship in its entirety, therefore if any sub-group fails to meet the

requirements despite this proposed relief, hedge accounting for the hedging relationship in its entirety would be discontinued. The Board concluded that this accounting outcome would be appropriate since the basis for designating the hedged item on a group basis is that the entity is managing the designated hedge for the group as a whole.

- BC79 The Board acknowledged that preparers may incur additional costs to assess each sub-group in the hedging relationship separately, and track items moving from one sub-group to another. However, the Board concluded that entities are likely to have such information available because IFRS 9 and IAS 39 require an entity to identify and document hedged items designated within a hedging relationship with sufficient specificity. Therefore, the Board concluded that the benefits of avoiding the discontinuation of hedge accounting and the resulting accounting impacts outweigh the associated costs.

Designation of risk components and portions (paragraphs 6.9.16–6.9.18 and 102Y–102Z1)

End of application of the Phase 1 exception

- BC80 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. Paragraphs 6.3.7(a) and B6.3.8 of IFRS 9 and paragraphs 81 and AG99F 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).
- BC81 When developing the Phase 1 exceptions, the Board observed that identification of risk components that are implicit in the fair value or the cash flows of an item of which they are a part (non-contractually specified risk components) requires an entity to assess the relevant facts and circumstances within the context of the particular market structure to which the risk relates and in which the hedging activity takes place—hence there is no ‘bright line’ to determine eligible risk components.
- BC82 The Board noted that an entity’s ability to conclude that an interest rate benchmark is a separately identifiable component applying paragraph 6.3.7(a) and B6.3.8 of IFRS 9 or paragraphs 81 and AG99F of IAS 39 requires a continuous assessment over the duration of the hedging relationship. An entity’s assessment of whether a risk component continues to meet the requirement to be separately identifiable could therefore be affected by the uncertainties arising from the reform.
- BC83 The Board therefore decided to amend IFRS 9 and IAS 39 so that an entity would not discontinue hedge accounting solely because the risk component is no longer separately identifiable as a result of the reform. The Phase 1 exception requires an entity to apply the separately identifiable requirement for hedges of the benchmark component of interest rate risk but only when an item is initially designated as a hedged item in a hedging relationship. Subject to meeting the other qualifying criteria for hedge accounting, a hedged item that has been assessed as separately identifiable at the time of its initial designation in the hedging relationship is not reassessed for the

separately identifiable requirement subsequently or, in the case of a hedge of a group of items, at any subsequent redesignation of the item in the same hedging relationship.

- BC84 When issuing the Phase 1 exceptions, the Board decided not to require end of application with respect to the exception for the separately identifiable requirement. Including an end date for that exception could require an entity to immediately discontinue hedge accounting at a point in time because, as the reform progresses, a risk component based on the interest rate benchmark may no longer be separately identifiable (for example, as the market for the alternative benchmark rate is established). In the Board's view, discontinuing hedge accounting before an entity is able to designate an alternative benchmark rate as a risk component would be inconsistent with the objective of the Phase 1 exceptions. Therefore, the Board decided that an entity should cease applying the Phase 1 exception to a hedging relationship only when that hedging relationship is discontinued applying the requirements in IFRS 9 or IAS 39.
- BC85 Having considered the interaction between the Phase 1 exception from the separately identifiable requirement (see paragraphs 6.8.7–6.8.8 of IFRS 9 and paragraphs 102H–102I of IAS 39) and the proposals in this Exposure Draft, the Board observed that it might be unclear when an entity shall cease to apply the Phase 1 exception from the separately identifiable requirement.
- BC86 The Board noted that continuing to apply the Phase 1 exceptions after the uncertainty arising from the reform is no longer present would not faithfully represent the actual characteristics of the elements of the hedging relationship in which the uncertainty has been eliminated nor the economic effects of the reform. The Board therefore proposes that the Phase 1 exception from the separately identifiable requirement ceases to apply at the earlier of:
- (a) when changes required by the reform are made to the hedging relationship as proposed in paragraph 6.9.7 or paragraph 102O of this Exposure Draft; or
 - (b) when the hedging relationship is discontinued.

Application of 'separately identifiable' requirement to an alternative benchmark rate (paragraphs 6.9.16–6.9.18 and 102Y–102Z1)

- BC87 In developing the proposals in this Exposure Draft, the Board noted that considerations similar to those discussed in paragraphs BC80–BC82 apply to the designation of an alternative benchmark rate as a non-contractually specified risk component in either a cash flow hedge or a fair value hedge. This is because an entity's ability to conclude that the alternative benchmark rate meets the requirements in paragraphs 6.3.7(a) and B6.3.8 of IFRS 9 and paragraphs 81 and AG99F of IAS 39 that a risk component must be separately identifiable and reliably measurable could be affected in the early stages of the reform, when a particular market might not yet be sufficiently developed for a term structure of zero coupon interest rates to be available.

INTEREST RATE BENCHMARK REFORM—PHASE 2

- BC88 The Board noted that both IFRS 9 and IAS 39 require risk components to be separately identifiable to qualify for hedge accounting. IFRS 9 sets out specific requirements and examples in paragraphs B6.3.9–B6.3.10 and paragraph B6.3.14. Paragraph 81 of IAS 39 also sets out relevant requirements. The Board noted that, although there are differences in the wording in IFRS 9 and IAS 39, the concepts and principles for the separately identifiable requirement are very similar.
- BC89 The Board acknowledged that, considering the objective of the reform is to modify some interest rate benchmarks or replace them with alternative benchmark rates, an entity might expect that even though it may not be the case at the point of designation, within a reasonable period of time, the volume and liquidity of debt instruments referenced to an alternative benchmark rate in a particular market or jurisdiction will be sufficient to meet the requirements in IFRS 9 and IAS 39.
- BC90 Consequently, the Board decided to propose the amendments in paragraphs 6.9.16 and 102Y of this Exposure Draft, so that if an alternative benchmark rate designated as a non-contractually specified risk component does not meet the requirement to be separately identifiable at the date it is designated, that alternative benchmark rate would be deemed to have met the requirement at that date if and only if an entity reasonably expects that the alternative benchmark rate will be separately identifiable within a period of 24 months from the date it is designated as a risk component.
- BC91 Consistent with the requirement in IFRS 9 and IAS 39 to continuously assess the separately identifiable requirement, an entity's ability to conclude that an alternative benchmark rate is a separately identifiable component requires a continuous assessment including during the qualifying 24-month period.
- BC92 However, in order to avoid the complexity of finely balanced judgements during the 24-month period, the Board is further proposing that an entity must cease to apply the requirement during the 24-month period if and only if the entity reasonably expects that the alternative benchmark rate will not meet the separately identifiable requirement within the 24-month period. When an entity reasonably expects that an alternative benchmark rate will not meet the separately identifiable requirement, either during, or at the end of, the 24-month period, the entity must discontinue hedge accounting prospectively.
- BC93 The Board emphasised that the proposed amendments apply only for the separately identifiable requirement and not the reliably measurable requirement. Therefore, if the component is not reliably measurable, either when it is designated or thereafter, the alternative benchmark rate does not meet the qualifying criteria to be designated as a risk component in a hedging relationship. Similarly, if the hedging relationship fails to meet any other criteria to apply hedge accounting as set out in IFRS 9 or IAS 39, either at the date the alternative benchmark rate is designated or during the 24-month period, the entity must discontinue hedge accounting. The Board decided that proposing an amendment only for the separately identifiable requirement would achieve the objective described in paragraph BC6.

- BC94 The Board acknowledged that a period of 24 months may seem like an arbitrary period. However, the Board is of the view that a clearly defined end point is necessary given the temporary nature of the proposed amendment. This is a significant relief from one of the requirements that is a basis for the robustness of the hedge accounting requirements, so is intentionally short-lived. The Board considered that a period of 24 months will support entities applying the hedge accounting requirements in IFRS 9 and IAS 39 particularly during the early stages of the transition to alternative benchmark rates when the relevant markets have not yet sufficiently developed. Therefore, the Board decided that a period of 24 months, from the date an alternative benchmark rate is designated as a risk component, would enable entities to implement the reform and comply with any regulatory requirements, while avoiding potential short-term disruption as the liquidity of the alternative benchmark rates is established.
- BC95 While developing the proposals in this Exposure Draft, the Board considered proposing that the relief in paragraphs 6.9.16 and 102Y of this Exposure Draft would be applied only for a period of 12 months from the date that the alternative benchmark rate is designated as a risk component. A 12-month period would approximately align with the target date for the discontinuation of some major interest rate benchmarks. However, the Board acknowledged diversity in the approaches to the reform or replacement of interest rate benchmarks and the timing of the expected completion across various jurisdictions. The Board was concerned that a period of 12 months would not provide sufficient time across all jurisdictions, particularly for hedging relationships that are changed rapidly.
- BC96 The Board also acknowledged that the proposed 24-month period may seem inconsistent with the Phase 1 exception for which the Board did not require a specific end date. However, the Board noted that the Phase 1 exception from the separately identifiable requirement, applied to hedging relationships in which the non-contractually specified risk component had met the separately identifiable requirement, both at inception and during the life of the hedging relationship until the Phase 1 exceptions were applied.
- BC97 The Phase 2 proposal is different from the Phase 1 exception because the alternative benchmark rates have not yet satisfied the separately identifiable requirement as a non-contractually specified risk component. In other words, whereas the population of hedging relationships to which the Phase 1 relief applied had already satisfied the qualifying criteria for hedge accounting to be applied, the same is not true for the hedging relationships to which the proposals in this Exposure Draft will apply. The Board therefore considered that any relief from the separately identifiable requirement should be temporary in nature.

Mandatory application

- BC98 The Board decided to propose mandatory application of the proposed amendments. As with Phase 1, the Board considered that allowing voluntary application of these amendments could lead to selective application to achieve specific accounting results. The Board also noted that the proposed amendments are, to a large extent, interlinked and need to be applied consistently. Voluntary application, even if only possible by area or type of financial instruments, would reduce comparability of information provided in the financial statements between entities.
- BC99 In addition, the Board does not expect that mandatory application of the proposed amendments would result in significant additional costs for preparers and other affected parties because the proposed amendments are designed to ease the operational burden on preparers, while providing useful information to users of financial statements, and would not require significantly more effort by preparers in addition to what is already required to implement the changes required by the reform.

End of application

- BC100 The Board is not proposing specific end of application requirements for the amendments proposed in this Exposure Draft. Unlike the Phase 1 exceptions, which are applied during the period of uncertainty arising from the reform, the application of the proposed amendments in Phase 2 is associated with the point at which changes to financial instruments or hedging relationships occur as a result of the reform. Therefore, by design the application of these proposed amendments has a natural end.
- BC101 The Board noted that, in a simple scenario, the proposed amendments will only be applied once to each financial instrument or element of a hedging relationship. However, the Board acknowledged that because of differences in the approach to the reform applied in different jurisdictions and differences in timing, there could be situations in which more than one change to the basis for determining the contractual cash flows of a financial asset or a financial liability is required by the reform. This could be the case, for example, when a central authority in its capacity as the administrator of an interest rate benchmark undertakes a multi-step process to replace an interest rate benchmark with an alternative benchmark rate. As each change to the basis for determining the contractual cash flows of the instrument is made as required by the reform, an entity would be required to apply the proposed amendments in paragraphs 6.9.3–6.9.6 of this Exposure Draft to account for that change.
- BC102 As noted in paragraphs 6.9.10 and 102R of this Exposure Draft, the Board considered that an entity may amend the formal designation of different hedging relationships at different times, or may amend the formal designation of a hedging relationship more than once. For example, an entity may first make changes required by the reform to a derivative that has been designated as a hedging instrument, while only making changes required by the reform to the financial instrument designated as the hedged item at a

later date. In applying the proposed amendments, the entity would be required to amend the hedge documentation to amend the description of the hedging instrument so that it refers to an alternative benchmark rate. The hedge documentation of the hedging relationship would then have to be amended again at a later date to change the description of the hedged item and/or hedged risk so that they refer to the alternative benchmark rate.

- BC103 The proposed amendment for hedges of risk components proposed in paragraphs 6.9.16 and 102Y of this Exposure Draft would apply only at the designation date if an entity's ability to conclude that an alternative benchmark rate is separately identifiable is directly affected by the reform. Thus, an entity could not apply the proposed amendment in other circumstances in which the entity is not able to conclude that an alternative benchmark rate is a separately identifiable risk component.
- BC104 The proposed amendment in paragraph 102S of this Exposure Draft, which would require that the cumulative fair value changes be reset to zero for the purpose of the retrospective assessment in IAS 39 (and only for this purpose), only applies at the date the exception to the retrospective assessment in paragraph 102G of IAS 39 ceases to apply.

Disclosures

- BC105 In deciding whether proposals for disclosures should accompany the proposed amendments, the Board acknowledged that it was important to balance the benefits of providing useful information to users of financial statements with the costs for preparers to provide the information. To achieve this balance, the Board sought to develop disclosure proposals that would provide useful information to users of financial statements about the effects of the reform on an entity's financial instruments and risk management without requiring disclosures for which the cost of providing that information would outweigh the benefits of the proposed amendments.
- BC106 In assessing whether it needs to add disclosure requirements for Phase 2, the Board considered the extent to which current presentation and disclosure requirements would require information to be provided about the effects of the reform on an entity's financial statements. The Board also considered the information needed by users of financial statements to understand the effects of the reform on an entity's financial statements and the incremental costs for preparers to disclose additional information and how those costs balance with the benefits of the relief the Board is proposing to provide. Further, the Board considered the potential interaction with disclosures that were required as part of Phase 1.
- BC107 The Board observed that although entities would be required to provide some information about the reform applying disclosure requirements such as those in IFRS 7, some information may not be captured by current disclosure requirements. For example, the requirement to disclose gains or losses recognised on derecognition of financial assets in paragraph 20A of IFRS 7 would not provide information about the effects of the reform because applying the proposals in this Exposure Draft to financial instruments directly

affected by the reform would not result in the derecognition of a financial asset or financial liability and therefore the recognition of a resulting gain or loss in the entity's financial statements.

- BC108 The Board decided not to propose requiring quantitative disclosures of what the effects of the reform would have been in the absence of the proposed amendments because the cost of providing such information could outweigh the benefits provided by the proposed amendments (see paragraph BC105). For the same reason, the Board decided not to propose requiring entities to provide the disclosure required by paragraph 28(f) of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.
- BC109 The Board decided to propose limited additional disclosure requirements as set out in paragraphs 24I–24J of this Exposure Draft. Given the objectives of the disclosure requirements as set out in paragraph 24I of IFRS 7, the Board's view is that entities should provide this information in the reporting period(s) when they apply the proposed amendments to IFRS 9, IAS 39, IFRS 4 or IFRS 16 set out in this Exposure Draft.

Effective date and transition

- BC110 Acknowledging the urgency of the amendments proposed in this Exposure Draft, the Board decided to propose that the effective date of the proposed amendments is annual periods beginning on or after 1 January 2021, with earlier application permitted.
- BC111 The Board proposes that the amendments apply retrospectively in accordance with IAS 8. The Board acknowledged that there could be situations in which an entity amended a hedging relationship as proposed in paragraphs 6.9.7 and 102O of this Exposure Draft in the period before the entity first applies the proposed amendments, and that currently effective requirements of IFRS 9 and IAS 39 would require the entity to discontinue hedge accounting. The Board noted that the reasons for the proposed amendment in paragraphs 6.9.7 and 102O of this Exposure Draft (see paragraphs BC46–BC47), apply equally in such situations. The Board therefore considered that discontinuation of hedge accounting solely because of amendments an entity made in hedge documentation to appropriately reflect the changes required by the reform, regardless of when those changes occurred, would not provide useful information to users of financial statements.
- BC112 The Board acknowledged that the reinstatement of discontinued hedging relationships is inconsistent with the Board's previous decisions in respect to hedge accounting in IFRS 9 and IAS 39. This is because hedge accounting is applied prospectively and applying it retrospectively to hedging relationships that have been discontinued usually requires the use of hindsight. However, the Board considered that in the specific circumstances of the reform, an entity would typically be able to reinstate a discontinued hedging relationship without the use of hindsight. The Board noted this would apply to a very targeted population for a short period of time—that is, for hedging relationships that would not have been discontinued if these proposed amendments had been applied at the point of discontinuation. The Board

therefore decided to propose that hedging relationships that were discontinued solely due to changes required by the reform before an entity first applies the proposed amendments are required to be reinstated as specified in paragraph 7.2.37 or paragraph 108I of this Exposure Draft.

- BC113 The Board decided to propose retrospective application of the proposed amendments because prospective application would have resulted in entities applying the amendments only if transition to alternative benchmark rates occurred after the effective date of the amendments.
- BC114 Consistent with the transition requirements for Phase 1, the Board decided to propose that an entity not be required to restate comparative information. However, an entity may choose to restate prior periods if, and only if, it is possible without the use of hindsight.
- BC115 The Board did not consider amending IFRS 1 *First-time Adoption of International Financial Reporting Standards*. Entities adopting IFRS Standards for the first time as required by IFRS 1 would apply IFRS Standards including the amendments proposed in this Exposure Draft and the transition requirements in IFRS 1 as applicable.

Potential effects of the reform when applying other IFRS Standards

- BC116 In developing the proposals in this Exposure Draft, the Board also considered the potential effects of the reform on an entity's financial statements when applying the requirements of IFRS Standards, other than IFRS 9 and IAS 39. The Board specifically considered the potential effects arising from applying the requirements in the context of IFRS 16 *Leases*, IFRS 17 *Insurance Contracts* and IFRS 13 *Fair Value Measurement*.
- BC117 The Board also noted that when applying some fair value measurement techniques, entities generally apply a discount rate derived from yield curves observed at commonly quoted intervals. In practice, many of these yield curves are based on the yields on financial instruments referenced to interest rate benchmarks. The reform could therefore have an indirect effect on discount rates in general and, consequently, could have an impact on fair value measurements.

IFRS 16 Leases (paragraphs 104–106)

- BC118 Some leases include lease payments that are referenced to an interest rate benchmark that is subject to the reform as described in paragraph 6.8.2 of IFRS 9. IFRS 16 requires a lessee to include variable lease payments referenced to an interest rate benchmark in the measurement of the lease liability.
- BC119 Applying IFRS 16, modifying a lease contract to change the basis for determining the variable lease payments meets the definition of a lease modification because a change in the calculation of the lease payments would change the original terms and conditions determining the consideration for the lease.

- BC120 IFRS 16 requires that an entity accounts for a lease modification by remeasuring the lease liability by discounting the revised lease payments using a revised discount rate. That revised discount rate would be determined as the interest rate implicit in the lease for the remainder of the lease term, if that rate can be readily determined, or the lessee's incremental borrowing rate at the effective date of the modification, if the interest rate implicit in the lease cannot be readily determined.
- BC121 However, in the Board's view, reassessing the lessee's entire incremental borrowing rate when the modification is limited to what is required by the reform would not reflect the economic effects of the modified lease. Such a requirement might also impose additional cost on preparers, particularly when leases that are referenced to a benchmark rate that is subject to the reform are expected to be amended at different times. This is because preparers would have to determine a new incremental borrowing rate at the effective date of each lease modification.
- BC122 For the reasons set out in paragraph BC26, the Board proposes a practical expedient to account for a lease modification required by the reform applying paragraph 42 of IFRS 16. The proposed practical expedient requires remeasurement of the lease liability using a discount rate that reflects the change to the basis for determining the variable lease payments as required by the reform. This practical expedient would apply to all lease modifications that change the basis for determining future lease payments as a result of the reform (see paragraphs 6.9.1–6.9.4 of this Exposure Draft). For this purpose, consistent with the draft amendments to IFRS 9, a lease modification required by the reform is a lease modification that satisfies both conditions—the modification is required as a direct consequence of the reform and the new basis for determining the lease payments is economically equivalent to the previous basis (ie the basis immediately preceding the modification).
- BC123 The proposed practical expedient to lease modifications applies only to the lease modifications required by the reform. If lease modifications in addition to those required by the reform are made, an entity is required to apply the requirements in IFRS 16 to account for all modifications made at the same time, including those required by the reform.
- BC124 In contrast to the proposals for the practical expedient for modification of financial assets and financial liabilities (see paragraphs 6.9.3–6.9.6 of this Exposure Draft), the Board decided not to specify the order of accounting for lease modifications required by the reform and other lease modifications. The accounting outcome would not differ regardless of the order in which an entity accounts for lease modifications required by the reform and other lease modifications.
- BC125 The Board also considered that, from the perspective of a lessor, lease payments included in the measurement of the net investment in a finance lease may include variable lease payments that are referenced to an interest rate benchmark. The Board decided not to propose any changes to the requirements for accounting for modifications to lease contracts from the lessor's perspective. The Board is not proposing such changes because, for

finance leases, a lessor is required to apply the requirements in IFRS 9 to a lease modification, so the proposed amendments in paragraphs 6.9.3–6.9.6 of this Exposure Draft would apply when those modifications are required by the reform. For operating leases, the Board decided that applying the requirements in IFRS 16 for lessors will adequately reflect the modification in terms and conditions required by the reform in the light of the mechanics of the operating lease accounting model.

IFRS 17 *Insurance Contracts*

- BC126 The Board observed that some insurance contracts include interest rate benchmark-based cash flows, for example premiums received from policyholders or payments made to policyholders under interest-rate guarantees, which might be affected by the reform.
- BC127 Applying IFRS 17, an insurance contract is required to be derecognised when the obligation specified in the insurance contract is extinguished or when the specific conditions in paragraph 72 of IFRS 17 are met. These conditions include situations in which the modification to the terms of an existing contract would have significantly changed the accounting for the contract if the new terms had always existed (for example, if the original contract met the definition of an insurance contract with direct participation features, but the modified contract no longer meets that definition, or vice versa).
- BC128 The Board observed that, if the only modifications to an insurance contract are those required by the reform, such modifications would not result in the extinguishment of the insurance obligation and therefore would not lead to derecognition of that contract.
- BC129 The Board therefore considered whether applying the requirements in IFRS 17 to modifications required by the reform is likely to result in a different accounting outcome for the insurance contract if the modified terms were present at contract's inception, that is, whether the conditions for derecognition in paragraph 72 of IFRS 17 would be met. In the Board's view since the requirement for modifications required by the reform, as defined in this Exposure Draft, is that such modifications result in cash flows that are economically equivalent to the cash flows immediately before the modification, those modifications should not result in derecognition.
- BC130 Accordingly, entities would apply paragraph 73 of IFRS 17 in accounting for modifications that do not result in derecognition by changing the estimates of fulfilment cashflows of the relevant group of insurance contracts. The Board does not expect the estimated fulfilment cashflows to change significantly at the time of a modification required by the reform. After the modification, the entity would re-estimate the fulfilment cashflows based on the alternative benchmark rate at the end of each reporting period as required by IFRS 17.
- BC131 The Board is not proposing an amendment to IFRS 17 to account for modifications to insurance contracts required by the reform because it does not expect that the estimated fulfilment cashflows would change significantly at the time of a modification required by the reform. However, the Board noted that if an entity renegotiates other terms of the insurance contract with

the policyholder in addition to making modifications required by the reform, those other modifications could be made in a way that results in derecognition of the contract applying paragraph 72 of IFRS 17. The Board concluded that applying the relevant requirements in IFRS 17 in accounting for all modifications including those required by the reform, would faithfully represent the economic effects of the reform and therefore, decided that no amendment to IFRS 17 is necessary.

IFRS 13 *Fair Value Measurement*

BC132 The Board noted that the reform could affect the observability of the inputs used to measure the fair value of financial assets or financial liabilities as interest rate benchmarks become less liquid, which in turn, could result in interest rate benchmark-based instruments being transferred to a lower level within the fair value hierarchy applying IFRS 13. During deliberations leading to the proposals in this Exposure Draft, the Board was made aware of stakeholders' concerns about the potential effect of more instruments classified as Level 3 in the fair value hierarchy on the amount of regulatory capital that regulated entities, such as banks, are required to hold. When the risk weighting of Level 3 instruments is higher it results in a higher capital charge.

BC133 The Board noted that the classification of instruments in the fair value hierarchy required by IFRS 13 provides useful information to users of financial statements about the valuation techniques and inputs used to develop fair value measurements and the significance of unobservable inputs in the valuation. A reclassification as a consequence of changes in the observability of inputs reflects an economic difference. The Board concluded that proposing any amendments to the requirements relating to the fair value hierarchy would result in a loss of useful information being provided to users of financial statements and would therefore be inconsistent with the objective of Phase 2. The Board is therefore not proposing amendments to the requirements in IFRS 13.

Discount rates

BC134 As stated in paragraph BC117, the Board noted that the reform could have an indirect effect on the calculation of discount rates as required by IFRS Standards in general and could therefore have consequential effects on fair value measurements. Similarly, interest rate benchmarks are often a key component of the discount rate required by IFRS Standards and a change in the calculation of discount rates resulting from the reform might affect valuations other than fair value. Examples of potential areas that might be affected include provisions applying IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, defined benefit obligations applying IAS 19 *Employee Benefits*, and value-in-use models for the impairment assessment of non-financial assets applying IAS 36 *Impairment of Assets*.

- BC135 In the Board's view, applying the requirements in IAS 8 for accounting for changes in estimates when there is a change in a discount rate as a result of the reform provides an appropriate basis to determine the appropriate accounting treatment and provides useful information to users of financial statements. Consequently, the Board is not proposing any amendments to the requirements pertaining to discount rates in IFRS Standards.



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