

International Financial Reporting Standard

Interest Rate Benchmark Reform—Phase 2

August 2020

BASES FOR CONCLUSIONS – AMENDMENTS

[IFRS 4, 7, 9 & 16 and IAS 39]

[Related to AASB 2020-8]

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Amendments to the Basis for Conclusions on IFRS 9 *Financial Instruments*

This Basis for Conclusions accompanies, but is not part of, IFRS 9.

Paragraphs BC5.287–BC5.320, BC6.604–BC6.660 and BC7.86–BC7.99 are added. Headings are added before paragraphs BC5.287, BC6.604 and BC7.86. For ease of reading new text is not underlined.

Measurement (Chapter 5)

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Amendments for *Interest Rate Benchmark Reform—Phase 2 (August 2020)*

Background

- BC5.287 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, nearly risk-free interest rates that are based, to a greater extent, on transaction data (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. 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 (the reform).
- BC5.288 In September 2019 the IASB amended IFRS 9, IAS 39 and IFRS 7, to address as a priority 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 (Phase 1 amendments). The Phase 1 amendments provide temporary exceptions to specific hedge accounting requirements due to the uncertainty arising from the reform. Paragraphs BC6.546–BC6.603 discuss the background to the Phase 1 amendments.
- BC5.289 After the issuance of the Phase 1 amendments, the IASB commenced its Phase 2 deliberations. In Phase 2 of its project on the reform, the IASB addressed issues that might affect financial reporting during the reform of an interest rate benchmark, including changes to contractual cash flows or hedging relationships arising from the replacement of an interest rate benchmark with an alternative benchmark rate (replacement issues).

- BC5.290 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 because of the transition to alternative benchmark rates. The IASB observed that for information about the effects of the transition to alternative benchmark rates to be useful, the information has to be relevant to users of financial statements and faithfully represent the economic effects of that transition on the entity. This objective assisted the IASB in assessing whether it should amend IFRS Standards or whether the requirements in IFRS Standards already provided an adequate basis to account for such effects.
- BC5.291 In April 2020 the IASB published the Exposure Draft *Interest Rate Benchmark Reform—Phase 2 (2020 Exposure Draft)*, which proposed amendments to specific requirements in IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16 *Leases* to address replacement issues.
- BC5.292 Almost all respondents to the 2020 Exposure Draft welcomed the IASB’s decision to address replacement issues and agreed that the proposed amendments would achieve the objective of Phase 2. Many respondents highlighted the urgency of these amendments, especially in some jurisdictions that have progressed towards the reform or the replacement of interest rate benchmarks with alternative benchmark rates.
- BC5.293 In August 2020 the IASB amended IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16 by issuing *Interest Rate Benchmark Reform—Phase 2 (Phase 2 amendments)*. The Phase 2 amendments, which confirmed with modifications the proposals in the 2020 Exposure Draft, added paragraphs 5.4.5–5.4.9, 6.8.13, Section 6.9 and paragraphs 7.1.9 and 7.2.43–7.2.46 to IFRS 9.

Changes in the basis for determining the contractual cash flows of financial assets and financial liabilities arising from the reform

- BC5.294 The IASB was informed that changes to financial assets or financial liabilities arising from the reform could be made in different ways. Specifically, entities may change the basis for determining the contractual cash flows of a financial instrument by:
- (a) amending the contractual terms of a financial asset or a financial liability to replace the referenced interest rate benchmark with an alternative benchmark rate;
 - (b) altering the method for calculating the interest rate benchmark without amending the contractual terms of the financial instrument; and/or
 - (c) triggering the activation of an existing contractual term such as a fallback clause.
- BC5.295 To meet the objective described in paragraph BC5.290, the IASB concluded that the scope of the Phase 2 amendments in paragraphs 5.4.5–5.4.9 of IFRS 9 should include all changes to a financial asset or financial liability as a result of the reform, regardless of the legal form triggering those changes. In each situation outlined in paragraph BC5.294 the basis for determining the

contractual cash flows of a financial instrument changes as a result of the reform. Therefore, for the purpose of the Phase 2 amendments, the IASB collectively refers to these changes as ‘changes in the basis for determining the contractual cash flows of a financial asset or a financial liability’.

What constitutes ‘a change in the basis for determining the contractual cash flows of a financial asset or a financial liability’

- BC5.296 In the IASB’s view, determining whether a change in the basis for determining the contractual cash flows 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, when, to effect the reform, the method for calculating the interest rate benchmark is altered. Although the contractual terms of the financial instrument may not be amended, such a change in the method for calculating the interest rate benchmark may change the basis for determining the contractual cash flows of that financial instrument compared to the prior basis (ie the basis immediately preceding the change).
- BC5.297 The IASB noted that 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 IASB noted that although these paragraphs use 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 considered in the contract at initial recognition.
- BC5.298 The IASB considered that if the amendments in paragraphs 5.4.6–5.4.9 of IFRS 9 applied only to cases in which the contractual terms are amended as a result of the reform, 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 arising as a result of the reform to be 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.
- BC5.299 Consequently, the IASB highlighted that the basis for determining the contractual cash flows of a financial asset or a financial liability can change even if the contractual terms of the financial instrument are not amended. In the IASB’s view, accounting consistently for a change in the basis for determining the contractual cash flows arising as a result of the reform, 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.

BC5.300 In addition, as noted in paragraph BC5.294(c), the IASB also learned that some entities may implement the reform through the activation of existing contractual terms, such as fallback provisions. For example, 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 IASB decided these situations—ie 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—should also be within the scope of the Phase 2 amendments. Doing so, avoids differences in accounting outcomes simply because the changes in the basis for determining the contractual cash flows were triggered by an existing contractual term instead of by a change in the contractual cash flows or contractual terms after the initial recognition of the financial instrument. Such diversity in accounting outcomes would reduce the usefulness of information provided to users of financial statements and would be burdensome to preparers.

Changes required by the reform

BC5.301 As set out in paragraph 5.4.7 of IFRS 9, the Phase 2 amendments provide a practical expedient that requires entities to apply paragraph B5.4.5 of IFRS 9 to account for changes in the basis for determining the contractual cash flows of a financial asset or a financial liability that are required by the reform. In reaching that decision, the IASB considered the usefulness of the information that would result from applying the requirements in IFRS 9 that would otherwise apply to these changes.

BC5.302 In the absence of the practical expedient in paragraph 5.4.7 of IFRS 9, 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.

BC5.303 The IASB 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 to avoid a transfer of economic value between the parties to a financial instrument. If these are the only changes made, the IASB considers that it would be unlikely that the transition to an alternative benchmark rate alone would result in the derecognition of that financial instrument.

BC5.304 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 other revisions in estimated future contractual cash flows, including

modifications of 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.¹

- BC5.305 Thus, in the absence of the practical expedient in paragraph 5.4.7 of IFRS 9, an entity would generally apply the requirements in paragraphs 5.4.3 or B5.4.6 of IFRS 9 to a change required by the reform, by recalculating the carrying amount of a financial instrument with any difference 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.
- BC5.306 In the IASB'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 IASB considered a situation in which a financial instrument was amended only to 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 over the remaining life in this situation would not reflect the economic effects of the modified financial instrument. Maintaining the original effective interest rate could also be difficult, and perhaps impossible, if that rate is no longer available.
- BC5.307 The IASB therefore decided that applying the practical expedient, which requires an entity to apply paragraph B5.4.5 of IFRS 9 to account for changes in the basis for determining the contractual cash flows of financial assets and financial liabilities as a result of the reform, would provide more useful information to users of financial statements in circumstances when the changes are limited to changes required by the reform and would be less burdensome for preparers for the reasons noted in paragraph BC5.306.
- BC5.308 Applying the practical expedient in paragraph 5.4.7 of IFRS 9, an entity would account for a change in the basis for determining the contractual cash flows of a financial asset or a financial liability 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, an entity applying the practical expedient to account for a change in the basis for determining the contractual cash flows of a financial asset or a financial liability that is required by the reform would not apply the derecognition requirements to that financial instrument, and would not apply paragraphs 5.4.3 or B5.4.6 of IFRS 9 to account for the change in contractual cash flows. In other words, changes in the basis for determining the contractual cash flows of a financial asset or a financial liability that are required by the reform would not result in an adjustment to the carrying amount of the financial instrument or immediate recognition of a gain or loss. The IASB concluded that the application of the practical expedient would provide useful information about the effect of the reform on an entity's financial instruments in the circumstances in which it applies.

¹ Paragraph B5.4.6 does not apply to changes in estimates of expected credit losses.

- BC5.309 The IASB considered the risk that the practical expedient could be applied too broadly, which could result in unintended consequences. The IASB decided to limit the scope of the practical expedient so that it applies only to changes in the basis for determining the contractual cash flows of a financial asset or a financial liability that are required by the reform. For this purpose, applying paragraph 5.4.7 of IFRS 9, a change is required by the reform if, and only if, the change is necessary 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 change). This is consistent with the conditions proposed in the 2020 Exposure Draft.
- BC5.310 In the 2020 Exposure Draft, the IASB considered only changes in the basis for determining the contractual cash flows of a financial asset or a financial liability that are required as a direct consequence of the reform. This condition was designed to capture changes in the basis for determining the contractual cash flows that are necessary—or in other words, changes that are required—to implement the reform.
- BC5.311 Furthermore, because the objective of the reform is limited to the transition to alternative benchmark rates—ie it does not encompass other changes that would lead to value transfer between the parties to a financial instrument—in the 2020 Exposure Draft, the IASB proposed economic equivalence as the second condition for applying the practical expedient. That is, to be within the scope of the practical expedient, at the date the basis is changed, the new basis for determining the contractual cash flows would be required to be economically equivalent to the previous basis.
- BC5.312 In discussing the concept of economic equivalence, the IASB considered circumstances in which an entity makes changes necessary as a direct consequence of the reform in a way so that the overall contractual cash flows (including amounts relating to interest) of the financial instrument are substantially similar before and after the changes. For example, a change would be economically equivalent if it involved only 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 and the alternative benchmark rate. The IASB observed that, in this situation, applying paragraph B5.4.5 of IFRS 9 (that is, revising the effective interest rate when cash flows are re-estimated) would have an accounting outcome similar to applying paragraph 5.4.3 or B5.4.6 of IFRS 9 (that is, recognising a modification gain or loss) because it is unlikely that the resulting modification gain or loss would be significant.
- BC5.313 With respect to the proposed condition described in paragraph BC5.310, some respondents to the 2020 Exposure Draft asked whether the practical expedient would apply even if the transition to alternative benchmark rates is not required by law or regulation, or if the existing interest rate benchmark is not being discontinued. For example, these respondents said that some existing interest rate benchmarks prevalent in their jurisdictions are not—at least in the near future—being discontinued. Nonetheless, entities are expected to transition to alternative benchmark rates because, for example, they anticipate reduced liquidity for the existing benchmark or want to align with

global market developments. In response, the IASB noted that the practical expedient is not limited to only particular ways of effecting the reform, provided the reform is consistent with the description in paragraph 6.8.2 of IFRS 9. The IASB also noted that the Phase 2 amendments encompass changes that are required to implement the reform—or, in other words, changes that are necessary as a direct consequence of the reform—even if the reform itself is not mandatory.

- BC5.314 With respect to the proposed condition described in paragraph BC5.311, some respondents to the 2020 Exposure Draft asked the IASB to specify whether an entity would need to perform detailed quantitative analysis of the cash flows of a financial instrument to demonstrate that a particular change meets the economic equivalence condition. For example, some respondents asked whether an entity would need to determine that the discounted present value of the cash flows of the affected financial instrument or its fair value are substantially similar before and after the transition to alternative benchmark rates.
- BC5.315 The IASB intended ‘economic equivalence’ to be principle-based and therefore decided not to include detailed application guidance related to the assessment of that condition. Acknowledging that different entities in different jurisdictions would implement the reform differently, the IASB did not require a particular approach for assessing this condition. The IASB noted that because it set no ‘bright lines’, an entity is required to apply judgement to assess whether circumstances meet the economic equivalence condition. For example, assuming that the entity determines that replacing an interest rate benchmark with an alternative benchmark rate is necessary for the affected financial instrument as a direct consequence of the reform (ie the condition in paragraph 5.4.7(a) of IFRS 9 is met), the entity determines:
- (a) what alternative benchmark rate will replace the interest rate benchmark and whether a fixed spread adjustment is necessary to compensate for a basis difference between the alternative benchmark rate and the interest rate benchmark preceding replacement. The entity would assess the overall resulting cash flows, including amounts relating to interest (ie alternative benchmark rate plus any fixed spread adjustment), to determine whether the economic equivalence condition is met. In other words, in this example, the entity would assess whether the interest rate remained substantially similar before and after the replacement—specifically, whether the interest rate after replacement (eg the alternative benchmark rate plus the fixed spread) was substantially similar to the interest rate benchmark immediately preceding the replacement; and
 - (b) whether the alternative benchmark rate (plus the necessary fixed spread described in paragraph BC5.315(a)) was applied to the relevant affected financial instrument(s).

- BC5.316 The IASB noted that for a scenario such as the one described in the example in paragraph BC5.315, that assessment would be sufficient to determine that the economic equivalence condition had been met for those changes. As described in paragraph 5.4.8(a) of IFRS 9, an entity in such circumstances would not be required to do further analysis in order to determine that the economic equivalence condition has been satisfied (eg the entity would not be required to analyse whether the discounted present value of the cash flows of that financial instrument are substantially similar before and after the replacement).
- BC5.317 The IASB acknowledged that changes in the basis for determining the contractual cash flows of a financial asset or a financial liability are likely to vary significantly across jurisdictions, product types and contracts. Developing a comprehensive list of changes required by the reform—and, hence, that qualify for the practical expedient—would not be feasible. Nonetheless, the IASB decided to include in paragraph 5.4.8 of IFRS 9 some examples of changes that give rise to a new basis for determining the contractual cash flows that is economically equivalent to the previous basis. If an entity makes only the changes specified in paragraph 5.4.8 of IFRS 9, the entity would not be required to analyse these changes further to conclude that the changes meet the condition in paragraph 5.4.7(b) of IFRS 9—ie the changes in paragraph 5.4.8 of IFRS 9 are examples of changes that satisfy that condition. The IASB concluded that adding such examples would assist entities in understanding and applying the amendments. These examples are not exhaustive.

Changes that are not required by the reform

- BC5.318 The IASB noted that during negotiations with counterparties to agree on changes to the contractual cash flows required by the reform, entities could simultaneously agree to make changes to the contractual terms that are not necessary as a direct consequence of the reform or are not economically equivalent to the previous terms (eg to reflect a change in the counterparty's credit worthiness). If there are changes in addition to those required by the reform, an entity would first apply the practical expedient in paragraph 5.4.7 of IFRS 9 to account for the changes to the basis for determining the contractual cash flows of a financial asset or financial liability determined to be required by the reform (ie changes that meet the conditions in paragraph 5.4.7 of IFRS 9) by updating the effective interest rate based on the alternative benchmark rate. Then the entity would apply the relevant requirements in IFRS 9 to determine if the additional changes to that financial instrument (ie any changes to which the practical expedient does not apply) result in the derecognition of the financial instrument. If the entity determines that the additional changes do not result in derecognition of that financial asset or financial liability, the entity would account for the additional changes (ie changes not required by the reform) by applying paragraph 5.4.3 or paragraph B5.4.6 of IFRS 9. In the IASB's view, this approach would provide useful information to users of financial statements about the economic effects of any changes to financial instruments not

required by the reform while consistently accounting for changes required by the reform.

Other classification and measurement issues

BC5.319 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 IASB to consider additional matters related to applying the classification and measurement requirements in IFRS 9 to financial assets and financial liabilities. These matters included:

- (a) whether IFRS 9 provides an adequate basis to account for the derecognition of a financial instrument in the statement of financial position and the recognition of any resulting gain or loss in the statement of profit or loss when an entity determines that it is required to derecognise a financial asset or financial liability because of the reform.
- (b) determining whether derecognition of a financial asset following changes in the basis for determining the contractual cash flows resulting from the reform affects an 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. Specifically, assessing whether some alternative benchmark rates are consistent with the description of 'interest' in paragraph 4.1.3(b) of IFRS 9 including if the time value of money element of that rate is modified (ie imperfect).
- (d) assessing the effect on expected credit losses of derecognising an existing financial asset and recognising a new financial asset as a result of the reform.
- (e) determining potential effects on the accounting for embedded derivatives in the context of the reform. Specifically, following the transition to alternative benchmark rates, whether entities reassess whether an embedded derivative is required to be separated from the host contract.
- (f) determining whether the practical expedient in paragraph 5.4.7 of IFRS 9 applies to a hybrid financial liability that has been separated into a host contract (measured at amortised cost) and an embedded derivative (measured at fair value through profit or loss). Specifically, determining whether the practical expedient applies when the interest rate benchmark is not a contractual term of the host contract but instead is imputed at initial recognition.

BC5.320 The IASB discussed these matters and concluded that IFRS 9 provides an adequate basis to determine the required accounting for each of these matters. Therefore, considering the objective of Phase 2, the IASB made no amendments for these matters. Specific to paragraph BC5.319(f), the IASB

observed that the practical expedient in paragraph 5.4.7 of IFRS 9 would apply to such a host contract if the conditions set out in paragraph 5.4.7 of IFRS 9 are met.

Hedge accounting (Chapter 6)

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Amendments for *Interest Rate Benchmark Reform—Phase 2* (August 2020)

Amendments to hedging relationships

- BC6.604 The Phase 2 amendments relating to the hedge accounting requirements in IFRS 9 apply to hedging relationships directly affected by the reform as and when the requirements in paragraphs 6.8.4–6.8.8 of IFRS 9 cease to apply to a hedging relationship (see paragraphs 6.8.9–6.8.13 of IFRS 9). Therefore, an entity is required to amend the hedging relationship to reflect the changes required by the reform as and when the uncertainty arising from the reform is no longer present with respect to the hedged risk or the timing and the amount of interest rate benchmark-based cash flows of the hedged item or of the hedging instrument. The scope of the hedging relationships to which the Phase 2 amendments apply is therefore the same as the scope to which the Phase 1 amendments apply, except for the amendment to the separately identifiable requirement, which also applies to the designation of new hedging relationships (see paragraph 6.9.13 of IFRS 9).
- BC6.605 As part of the Phase 1 amendments, the IASB acknowledged that, in most cases, for uncertainty regarding the timing and the amount of interest rate benchmark-based cash flows arising from the reform to be resolved, the underlying financial instruments designated in the hedging relationship would have to be changed to specify the timing and the amount of alternative benchmark rate-based cash flows.
- BC6.606 The IASB noted that, applying the hedge accounting requirements in IFRS 9, changes to the basis for determining the contractual cash flows of a financial asset or a financial liability (see paragraphs 5.4.6–5.4.9 of IFRS 9) that are designated in a hedging relationship would affect the designation of such a hedging relationship in which an interest rate benchmark was designated as a hedged risk.
- BC6.607 The IASB observed that amending the formal designation of a hedging relationship to reflect the changes required by the reform would result in the discontinuation of the hedging relationship. This is because, as part of the qualifying criteria for hedge accounting to be applied, IFRS 9 requires the formal designation of a hedging relationship to be documented at inception. 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. IFRS 9 permits the hedge designation and documentation to be amended without causing the discontinuation of hedge accounting only in limited circumstances. In all other circumstances,

amendments to the hedge designation as documented at inception of the hedging relationship, result in the discontinuation of hedge accounting.

- BC6.608 The IASB therefore concluded that, in general, the hedge accounting requirements in IFRS 9 are sufficiently clear about how to account for hedging relationships directly affected by the reform after the Phase 1 exceptions set out in paragraphs 6.8.4–6.8.8 of IFRS 9 cease to apply. However, consistent with the IASB’s objective for Phase 2 (see paragraph BC5.290) and its objective for Phase 1 (see paragraph BC6.550), the IASB considered that discontinuing hedge accounting solely due to the effects of the reform would not always reflect the economic effects of the changes required by the reform on a hedging relationship and therefore would not always provide useful information to users of financial statements.
- BC6.609 Accordingly, the IASB decided that if the reform requires a change to a financial asset or a financial liability designated in a hedging relationship (see paragraphs 5.4.6–5.4.8 of IFRS 9), it would be consistent with the IASB’s objective for Phase 2 to require the hedging relationship to be amended to reflect such a change without requiring discontinuation of that hedging relationship. For these reasons, in the 2020 Exposure Draft, the IASB proposed that an entity would be required to amend the formal designation of the hedging relationship as previously documented to make one or more of these 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; or
 - (c) amending the description of the hedging instrument so it refers to the alternative benchmark rate.
- BC6.610 Respondents to the 2020 Exposure Draft agreed with the proposed amendments because those proposals would generally result in an entity continuing to apply hedge accounting to hedging relationships directly affected by the reform. Respondents also said that changes to the hedge designation necessary to reflect changes required by the reform are not expected to represent a change in an entity’s risk management strategy or risk management objective for hedging their exposure to interest rate risk. Therefore, the IASB concluded that continuing to apply hedge accounting to the affected hedging relationships when making changes required by the reform would correspond with the IASB’s objective for issuing the Phase 1 amendments in September 2019.
- BC6.611 However, notwithstanding their general agreement with the proposed amendments, some respondents asked the IASB to clarify the scope and timing of the required changes to the affected hedging relationships.
- BC6.612 Regarding the scope of the required changes to the affected hedging relationships, the IASB acknowledged it may be necessary to amend the designated hedged portion of the cash flows or fair value being hedged when the hedging relationship is amended to reflect the changes required by the

reform. The IASB also noted that the changes required by the reform described in paragraphs 5.4.6–5.4.8 of IFRS 9 were implicit in the required amendments to the hedging relationships as proposed in the 2020 Exposure Draft. In considering the timing of when entities are required to amend an affected hedging relationship, the IASB sought to balance the operational effort needed to amend the hedging relationships with maintaining the required discipline in the amendments to hedging relationships. Specifically, it sought to address the challenges associated with specifying the timing of when entities have to amend hedging relationships as required in paragraph 6.9.1 of IFRS 9—particularly in the context of the large volume of changes that entities may need to make in a relatively short time—while also ensuring that the amendments to hedging relationships are accounted for in the applicable reporting period.

- BC6.613 In response to respondents' requests, the IASB revised the proposed wording in paragraph 6.9.1 of IFRS 9 so that:
- (a) amending the description of the hedged item includes amending the description of the designated portion of the cash flows or fair value being hedged;
 - (b) the changes required by the reform described in paragraphs 5.4.6–5.4.8 of IFRS 9 are relevant when amending the formal designation of a hedging relationship; and
 - (c) amendments to hedging relationships are required to be made by the end of the reporting period during which the respective changes to the hedged item, hedged risk or hedging instrument are made.
- BC6.614 The IASB noted that the Phase 1 amendments may cease to apply at different times to directly affected hedging relationships and to the different elements within a hedging relationship. Therefore, an entity may be required to apply the applicable Phase 2 exceptions in paragraphs 6.9.1–6.9.12 of IFRS 9 at different times, which may result in the designation of a particular hedging relationship being amended more than once. The Phase 2 amendments to the hedge accounting requirements in IFRS 9 apply only to the requirements specified in these paragraphs. All other hedge accounting requirements in IFRS 9, including the qualifying criteria in paragraph 6.4.1 of IFRS 9, apply to hedging relationships directly affected by the reform. In addition, consistent with the IASB's decision for the Phase 1 amendments (see paragraph BC6.568), the Phase 2 amendments also do not provide an exception from the measurement requirements for a hedging relationship. Therefore, entities apply the requirements in paragraphs 6.5.8 or 6.5.11 of IFRS 9 to account for any changes in the fair value of the hedged items or hedging instruments (also see paragraphs BC6.623–BC6.627).
- BC6.615 As set out in paragraph BC5.318, the IASB considered that changes might be made to a financial asset or a financial liability, or to the formal designation of a hedging relationship, in addition to those changes required by the reform. The effect of such additional changes to the formal hedge designation on the application of the hedge accounting requirements would depend on whether

those changes result in the derecognition of the underlying financial instrument (see paragraph 5.4.9 of IFRS 9).

- BC6.616 The IASB therefore required an entity first to apply the applicable requirements in IFRS 9 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 no longer meets the qualifying criteria to be an eligible hedged item as a result of changes in addition to those required by the reform. Similarly, if an entity amends the hedge designation to make a change other than the changes described in paragraph 6.9.1 of IFRS 9 (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 the discontinuation of hedge accounting, the designation of the hedging relationship would be amended as required by paragraph 6.9.1 of IFRS 9.
- BC6.617 Some respondents to the 2020 Exposure Draft said that entities may change a hedging relationship as a result of the reform, but such a change is not necessary as a direct consequence of the reform. This could include, for example, designating a basis swap as a new hedging instrument to mitigate ineffectiveness arising from the difference between the compounding of the alternative benchmark rates used for cash products and derivatives. These respondents asked the IASB to permit such changes to be in the scope of the required changes to the hedging relationship set out in paragraph 6.9.1 of IFRS 9. The IASB however decided not to extend the scope of paragraph 6.9.1 of IFRS 9 to other changes an entity makes as a result of the reform. The IASB considered that its objective for the Phase 2 amendments is not only to support entities in applying the IFRS requirements during the transition to alternative benchmark rates, but also to provide users of financial statements with useful information about the effect of the reform on an entity's financial statements. To balance achieving this objective with maintaining the discipline that exists in the hedge accounting requirements in IFRS 9, the IASB limited the scope of the changes required to the designation of hedging relationships to only those changes that are necessary to reflect the changes required by the reform (as described in paragraphs 5.4.6–5.4.8 of IFRS 9).

Replacement of hedging instruments in hedging relationships

- BC6.618 Respondents to the 2020 Exposure Draft said that, instead of changing the contractual terms of a derivative designated as a hedging instrument, counterparties may facilitate the transition to alternative benchmark rates using approaches that result in outcomes equivalent to changing the contractual terms of the derivative. These respondents asked whether using such an approach would be within the scope of the Phase 2 amendments—ie whether paragraph 6.9.1(c) of IFRS 9 would apply—if the approach results in an economic outcome that is similar to changing the basis for determining the contractual cash flows of the derivative.

BC6.619 The IASB confirmed that, consistent with the rationale in paragraph BC5.298, it is the substance of an arrangement, rather than its form, that determines the appropriate accounting treatment. The IASB considered that the conditions in paragraph 5.4.7 of IFRS 9—ie the change is necessary as a direct consequence of the reform and is done on economically equivalent basis—are helpful in analysing the amendments to the contractual terms of derivatives described in paragraph BC6.618. In this context, the IASB noted that if these other approaches result in derivatives with substantially different terms from those of the original derivative, the change may not have been made on an economically equivalent basis. The IASB also noted that if a hedging instrument is derecognised, hedge accounting is required to be discontinued. Therefore, the IASB decided that for hedge accounting to continue it is also necessary that the original hedging instrument would not be derecognised.

BC6.620 The IASB considered these approaches described by respondents:

- (a) *close-out and replace on the same terms (ie off-market terms)*—An entity applying this approach would enter into two new derivatives with the same counterparty. These two would be, a new derivative that is equal and offsetting to the original derivative (so both contracts are based on the interest rate benchmark to be replaced), and a new alternative benchmark-based derivative with the same terms as the original derivative so its fair value at initial recognition is equivalent to the fair value—on that date—of the original derivative (ie the new derivative is off-market). Under this approach, the counterparty to the new derivatives is the same as to the original derivative, the original derivative has not been derecognised and the terms of the alternative benchmark rate derivative are not substantially different from that of the original derivative. The IASB therefore concluded that such an approach could be regarded as consistent with the changes required by the reform as required in paragraph 6.9.1 of IFRS 9.
- (b) *close-out and replace on substantially different terms (eg on-market terms)*—An entity applying this approach would terminate (close-out) the existing interest rate benchmark-based derivative with a cash settlement. The entity then enters into a new on-market alternative benchmark rate derivative with substantially different terms, so that the new derivative has a fair value of zero at initial recognition. Some respondents to the 2020 Exposure Draft were of the view that since this approach does not result in any gain or loss recognised in profit or loss, it suggests the exchange was done on an economically equivalent basis. The IASB disagreed with this view because the original derivative is extinguished and replaced with an alternative benchmark rate derivative with substantially different contractual terms. Therefore, this approach is not considered consistent with the changes required by the reform as required in paragraph 6.9.1 of IFRS 9.
- (c) *add a new basis swap*—An entity applying this approach would retain the original interest rate benchmark-based derivative but enter into a basis swap that swaps the existing interest rate benchmark for the alternative benchmark rate. The combination of the two derivatives is

equivalent to modifying the contractual terms of the original derivative to replace the interest rate benchmark with an alternative benchmark rate. The IASB noted that, in principle, the combination of an interest rate benchmark-based derivative and an interest rate benchmark-alternative benchmark rate swap could achieve an outcome economically equivalent to amending the original interest rate benchmark-based derivative. However, the IASB observed that, in practice, basis swaps are generally entered into on an aggregated basis to economically hedge an entity's net exposure to basis risk, rather than on an individual derivative basis. The IASB, therefore, noted that for this approach to be consistent with the changes required by the reform as described in paragraph 6.9.1 of IFRS 9, the basis swap must be coupled or linked with the original derivative, ie done on an individual derivative basis. This is because a change to the basis for determining the contractual cash flows of a hedging instrument is made to an individual instrument and, to achieve the same outcome, the basis swap would need to be coupled with an individual derivative.

- (d) *novating to a new counterparty*—An entity applying this approach would novate the original interest rate benchmark-based derivative to a new counterparty and subsequently change the contractual cash flows on the novated derivative to replace the interest rate benchmark with an alternative benchmark rate. The IASB noted that novation of a derivative would result in the derecognition of the original derivative and thus would require hedge accounting to be discontinued in accordance with paragraph 6.5.6 of IFRS 9 (see further paragraphs BC6.636–BC6.638). Therefore, this approach is not consistent with the changes required by the reform as set out in paragraph 6.9.1 of IFRS 9.

BC6.621 The IASB therefore added paragraph 6.9.2 of IFRS 9 so that, an entity also applies paragraph 6.9.1(c) of IFRS 9 if these three conditions are met:

- (a) the entity makes a change required by the reform using an approach other than changing the basis for determining the contractual cash flows of the hedging instrument (as described in paragraph 5.4.6 of IFRS 9);
- (b) the original hedging instrument is not derecognised; and
- (c) the chosen approach is economically equivalent to changing the basis for determining the contractual cash flows of the original hedging instrument (as described in paragraphs 5.4.7 and 5.4.8 of IFRS 9).

BC6.622 The IASB decided not to add further amendments or provide application guidance because IFRS 9 as amended provides an adequate basis for analysing the accounting requirements in context of the approaches described in paragraph BC6.620.

Remeasurement of the hedged item and hedging instrument

- BC6.623 In paragraph BC6.568, the IASB explained that no exceptions were made in Phase 1 to the measurement requirements for hedged items or hedging instruments. The IASB 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 paragraph BC6.567). 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.
- BC6.624 Applying the hedge accounting requirements in IFRS 9, a gain or loss arising from the remeasurement of the hedged item attributable to the hedged risk or from remeasuring the hedging instrument is reflected in profit or loss when measuring and recognising hedge ineffectiveness.
- BC6.625 When deliberating the Phase 2 amendments, the IASB considered that changes in the fair value of the hedged item or hedging instrument could arise when the formal designation of a hedging relationship is amended. The IASB considered whether to provide an exception from the requirement to include in hedge ineffectiveness such fair value changes when they arise. The IASB considered, but rejected, these approaches:
- (a) *recognising the measurement adjustment in profit or loss over time*—An entity applying this approach would recognise the measurement adjustment in profit or loss over time (ie amortised) as the hedged item affects profit or loss. The IASB 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 in the *Conceptual Framework*. Adjusting the carrying amount of the hedged item or hedging instrument would result in the recognition of a net measurement adjustment of zero and would be inconsistent with the IASB’s decision that no exceptions would be made to the measurement of hedged items or hedging instruments. The IASB also noted that such an approach would likely result in increased operational complexity because an entity would need to track adjustments that occur at different times for the purpose of amortising the adjustments in the period(s) in which the hedged item affects profit or loss.
 - (b) *recognising the measurement adjustment as an adjustment to retained earnings*—An entity applying this approach would recognise the measurement adjustment as an adjustment to retained earnings during the period in which the measurement difference arises. However, the IASB 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 time would be inconsistent with the IASB’s previous decisions (throughout IFRS Standards) that an adjustment to retained

earnings only applies on transition to new requirements in IFRS Standards. Furthermore, the IASB 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 IASB 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.

- BC6.626 Some respondents to the 2020 Exposure Draft said they would not expect any significant changes in fair value to arise from the remeasurement of a hedged item or hedging instrument based on the alternative benchmark rate. That is because these amendments would apply only when the conditions in paragraph 5.4.7 of IFRS 9 are met, which require that changes are made on an economically equivalent basis. The IASB acknowledged these comments noting that, applying paragraph 6.9.1 of IFRS 9, a significant change in fair value arising from the remeasurement of the hedged item or the hedging instrument indicates that the changes were not made on an economically equivalent basis. Furthermore, the IASB observed that the requirement in paragraph 6.9.1(b) of IFRS 9, which requires the description of the designated portion for the cash flows or fair value being hedged enables entities to amend a hedging relationship to minimise fair value changes on the remeasurement of the hedged item or the hedging instrument.
- BC6.627 The IASB therefore confirmed its previous decision not to provide an exception from the requirements in IFRS 9 regarding the measurement and recognition of hedge ineffectiveness. Therefore, an entity would apply the requirements in paragraphs 6.5.8 (for a fair value hedge) and 6.5.11 (for a cash flow hedge) of IFRS 9 for the measurement and recognition of hedge ineffectiveness. The IASB considered that accounting for such fair value changes in any other way would be inconsistent with the decision to continue applying hedge accounting for such amended hedging relationships (see paragraph 6.9.1 of IFRS 9). In the IASB's view, applying the requirements in IFRS 9 for the recognition and measurement of ineffectiveness 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.

Accounting for qualifying hedging relationships

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

- BC6.628 The Phase 1 exception in paragraph 6.8.6 of IFRS 9 requires an entity to assume that, for the purpose of assessing the economic relationship between the hedged item and the hedging instrument as required by paragraphs 6.4.1(c)(i) and B6.4.4–B6.4.6 of IFRS 9, 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, this exception ceases 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.

- BC6.629 Consistent with the IASB’s considerations on the highly probable requirement (see paragraphs BC6.630–BC6.631), the IASB considered that, when the formal designation of a hedging relationship has been amended (see paragraph 6.9.1 of IFRS 9), the assessment of the economic relationship between the hedged item and the hedging instrument should be performed based on the alternative benchmark rate on which the hedged cash flows and/or the hedged risk will be based. The IASB therefore provided no exceptions from the assessment of the economic relationship between the hedged item and the hedging instrument for the period after the Phase 1 exception in paragraph 6.8.6 of IFRS 9 ceases to apply.

Amounts accumulated in the cash flow hedge reserve

- BC6.630 During the period in which a hedging relationship is affected by uncertainty arising from the reform, paragraph 6.8.4 of IFRS 9 requires 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 exception 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 a part of is discontinued.
- BC6.631 The IASB considered 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 an entity amends the description of the hedged item, including the description of the designated portion of the cash flows or fair value being hedged, applying paragraph 6.9.1(b) of IFRS 9. Thereafter, applying the requirement in paragraph 6.3.3 of IFRS 9, 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.
- BC6.632 The IASB noted that the amendment in paragraph 6.9.1(b) of IFRS 9 for amending the formal designation of a hedging relationship could lead to changes in the hedged item. Therefore, if an entity uses a hypothetical derivative—that is, a derivative that would have terms matching the critical terms of the designated cash flows and the hedged risk, commonly used in cash flow hedges to represent the forecast transaction—the entity may need to change the hypothetical derivative to calculate the change in the value of the hedged item to measure hedge ineffectiveness.

- BC6.633 Consequently, as hedge accounting would not be discontinued when a hedging relationship is amended for changes required by the reform (see paragraph 6.9.1 of IFRS 9), the IASB decided that an entity would deem the amount accumulated in the cash flow hedge reserve at that point to be based on the alternative benchmark rate on which the hedged future cash flows are determined. Therefore, in applying paragraph 6.5.11(d) of IFRS 9, the amount accumulated in the cash flow hedge reserve would be reclassified to profit or loss in the same period(s) during which the hedged cash flows based on the alternative benchmark rate affect profit or loss.
- BC6.634 The approach described in paragraph BC6.633 is consistent with the IASB’s view that, when a hedging relationship is amended for changes required by the reform, more useful information is 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.
- BC6.635 Consistent with the requirements in paragraphs 6.8.5 and 6.8.10 of IFRS 9, the IASB considered whether to provide similar relief for any discontinued hedging relationships in which the previously designated hedged item is subject to the reform. The IASB 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 IASB noted that if the hedged future cash flows are still expected to occur, the previously designated hedged item will be subject to a change required by the reform, even if the hedging relationship has been discontinued.
- BC6.636 The IASB therefore decided that, for the purpose of applying paragraph 6.5.12 of IFRS 9, an entity deems the amount accumulated in the cash flow hedge reserve for a discontinued hedging relationship to be based on the alternative benchmark rate on which the contractual cash flows will be based, which is similar to the amendment in paragraph 6.9.7 of IFRS 9. 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.
- BC6.637 Some respondents to the 2020 Exposure Draft asked the IASB to clarify whether the requirements in paragraphs 6.9.7–6.9.8 of IFRS 9 require the retrospective measurement of the hedged item based on the alternative benchmark rate-based cash flows—in other words, whether an entity would be required to recalculate what the amount accumulated in the cash flow hedge reserve would have been if the hedged item was based on the alternative benchmark rate since inception.
- BC6.638 The IASB considered that the cash flow hedge reserve is adjusted as required by paragraph 6.5.11(a) of IFRS 9 (ie the cash flow hedge reserve is not subject to separate measurement requirements, but instead is derived from the cumulative changes in the fair value of the hedged item (present value) and hedging instrument). The Phase 2 amendments do not include an exception from the measurement requirements in IFRS 9. Accordingly, the fair value of

the hedging instrument or of the hedged item (ie the present value of the cumulative changes in the hedged expected future cash flows) is determined at the measurement date based on the expected future cash flows and assumptions that market participants would use. In other words, the fair values are not determined retrospectively. The IASB therefore considered that the cash flow hedge reserve is not remeasured as if it had been based on the alternative benchmark rate since inception of the hedging relationship.

- BC6.639 The IASB confirmed that the amendments in paragraphs 6.9.7 and 6.9.8 of IFRS 9 extend to cash flow hedges, regardless of whether the cash flow hedge is for an open or closed hedged portfolio. The general reference to cash flow hedges in these paragraphs reflects such scope, therefore the IASB considered that explicitly addressing open or closed hedged portfolios was unnecessary.

Groups of items

- BC6.640 The IASB considered that for groups of items designated as hedged items in a fair value or cash flow hedge, the hedged items could consist of items still referenced to the interest rate benchmark as well as items already referenced to the alternative benchmark rate. Therefore, an entity could not amend the description of the hedged risk or the hedged item, including the designated portion of the cash flows or fair value being hedged, with reference only to an alternative benchmark rate for the whole group. The IASB also considered that it would be inconsistent with the objectives of the Phase 2 amendments to require the discontinuation of such a hedging relationship solely because of the effects of the reform. In the IASB's view, the same requirements and relief that apply to other hedging relationships should apply to groups of items designated as hedged items, including dynamic hedging relationships.
- BC6.641 Paragraphs 6.9.9–6.9.10 of IFRS 9 therefore require an entity to allocate the individual hedged items to subgroups based on the benchmark rate designated as the hedged risk for each subgroup and to apply the requirements in paragraph 6.6.1 of IFRS 9 to each subgroup separately. The IASB acknowledged this approach is an exception to the hedge accounting requirements in IFRS 9 because other hedge accounting requirements, including the requirements in paragraphs 6.5.8 and 6.5.11 of IFRS 9, are applied to the hedging relationship in its entirety. However, in the IASB's view, the robustness of the hedge accounting requirements is maintained because if any subgroup fails to meet the requirements in paragraph 6.6.1 of IFRS 9, the entity is required to discontinue hedge accounting for that entire hedging relationship. The IASB concluded this accounting outcome is appropriate because 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.
- BC6.642 The IASB acknowledged that preparers may incur additional costs to assess each subgroup in a hedging relationship separately, and to track items moving from one subgroup to another. However, the IASB concluded that an entity is likely to have such information available because IFRS 9 already requires it to identify and document hedged items designated within a hedging relationship with sufficient specificity. Therefore, the IASB concluded that the benefits of

avoiding the discontinuation of hedge accounting and the resulting accounting impacts outweigh the associated costs of this exception.

- BC6.643 Respondents to the 2020 Exposure Draft asked the IASB whether the requirement for groups of items applies to dynamic hedges of interest rate benchmark-based items when the items mature and are replaced with alternative benchmark-based items. The IASB considered that although the objective of the Phase 2 amendments is to provide relief when individual items transition to an alternative benchmark rate, the replacement of items that have expired with items that reference the alternative benchmark rate is a natural consequence of a dynamic hedging relationship. Therefore, the IASB observed that new items designated as part of the group to replace interest rate benchmark-based items that have matured would be allocated to the relevant subgroup based on the benchmark rate being hedged.
- BC6.644 Respondents also asked the IASB to clarify how the requirements in paragraphs 6.9.9–6.9.10 of IFRS 9 apply to the hypothetical derivative in a cash flow hedge, specifically, whether the hypothetical derivative could be amended (and therefore measured) based on the alternative benchmark rate if the actual hedged item (such as a floating rate loan) has not yet transitioned to the alternative benchmark rate. The IASB considered that IFRS 9 does not include specific requirements for the hypothetical derivative but mentions it as one possible way of calculating the change in the value of the hedged item to measure ineffectiveness (see paragraph B6.5.5 of IFRS 9). Therefore, the terms on which the hypothetical derivative is constructed replicate the hedged risk and the hedged cash flows of the hedged item an entity is hedging. The hypothetical derivative cannot include features in the value of the hedged item that exist only in the hedging instrument (but not in the hedged item). The IASB therefore decided that the identification of an appropriate hypothetical derivative is based on the requirements to measure hedge ineffectiveness and it would not be appropriate to include specific amendments for applying the requirements in paragraphs 6.9.9–6.9.10 to the hypothetical derivative.

Designation of risk components

End of application of the Phase 1 exception

- BC6.645 An entity may designate an item in its entirety or a component of an item as the hedged item in a hedging relationship. Paragraphs 6.3.7(a) and B6.3.8 of IFRS 9 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).
- BC6.646 When developing the Phase 1 amendments, the IASB decided not to set an end date for applying the exception for the separately identifiable requirement (see paragraphs 6.8.7–6.8.8 of IFRS 9). The IASB considered that 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). As noted in paragraph BC6.597, in

the IASB's view, such an immediate discontinuation of hedge accounting would be inconsistent with the objective of this exception in Phase 1. Therefore, when issuing the Phase 1 amendments, the IASB decided that an entity should cease applying the Phase 1 exception from the separately identifiable requirement to a hedging relationship only when that hedging relationship is discontinued applying the requirements in IFRS 9.

BC6.647 Having considered the interaction between the Phase 1 exception from the separately identifiable requirement and the Phase 2 amendments to the hedge accounting requirements in IFRS 9, the IASB decided it is necessary to specify that an entity is required to cease applying the Phase 1 exception from the separately identifiable requirement when the uncertainty arising from the reform, which led to that exception, is no longer present.

BC6.648 The IASB considered that continuing to apply the Phase 1 amendments 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 IASB therefore added paragraph 6.8.13 to IFRS 9 so 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 non-contractually specified risk component as set out in paragraph 6.9.1 of IFRS 9; or
- (b) when the hedging relationship in which the non-contractually specified risk component was designated is discontinued.

Application of the 'separately identifiable' requirement to an alternative benchmark rate

BC6.649 In developing the Phase 2 amendments, the IASB was aware that considerations similar to those discussed in paragraphs BC6.645–BC6.648 apply to designating 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 that a risk component must be separately identifiable and reliably measurable could be affected in the early stages of the reform.

BC6.650 Specific application guidance and examples on the separately identifiable requirement are already set out in paragraphs B6.3.9–B6.3.10 of IFRS 9. However, the IASB considered that an entity might expect an alternative benchmark rate to meet the separately identifiable requirement in IFRS 9 within a reasonable period of time even though the alternative benchmark rate does not meet the requirement when designated as a risk component.

BC6.651 The amendment in paragraph 6.9.11 of IFRS 9 applies to a different set of instruments from the Phase 1 exception. For items within the scope of paragraph 6.9.11 of IFRS 9, the separately identifiable requirement has never been satisfied. In contrast, 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 IASB therefore considered that any relief from the separately identifiable requirement in Phase 2 should be temporary.

- BC6.652 Consequently, in the 2020 Exposure Draft, the IASB proposed that an alternative benchmark rate that does not meet the requirement to be separately identifiable at the date it is designated as a non-contractually specified risk component 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 24 months from the date it is designated as a risk component.
- BC6.653 Respondents to the 2020 Exposure Draft agreed with this proposed amendment but asked the IASB to clarify the date from which the 24-month period applies. The IASB acknowledged respondents' concerns, and considered whether the 24-month period applies:
- (a) on a hedge-by-hedge basis—that is, to each hedging relationship individually, beginning from the date an alternative benchmark rate is designated as a risk component in that relationship; or
 - (b) on a rate-by-rate basis—that is, to each alternative benchmark rate separately, beginning from the date when an entity first designates an alternative benchmark rate as a hedged risk for the first time.
- BC6.654 The IASB acknowledged that applying the 24-month period to each hedging relationship individually (as proposed in the 2020 Exposure Draft)—that is, on a hedge-by-hedge basis—is consistent with the basis on which hedging relationships are designated. For each new hedge designation, an entity is required to assess whether the qualifying criteria to apply hedge accounting, including the separately identifiable requirement, have been met. However, the IASB also considered that applying the 24-month period to different hedging relationships (with the same alternative benchmark rate designated as a risk component) at different times could add an unnecessary operational burden as the period would end at different times and thus would need to be monitored over different periods, for different hedging relationships. For example, if an entity designates the alternative benchmark rate as the risk component in two hedging relationships—the first designated on 31 March 20X1 and the second on 30 June 20X1—the 24-month period for each hedge would begin and end at different dates, although the designated risk is the same in both hedging relationships.
- BC6.655 Therefore, the IASB decided that the requirement in paragraph 6.9.11 would apply on a rate-by-rate basis so the 24-month period applies to each alternative benchmark rate separately and hence, starts from the date that an entity designates an alternative benchmark rate as a non-contractually specified risk component for the first time (but see also paragraph 7.2.45 of IFRS 9). The IASB considered that if an entity concludes for one hedging relationship that it no longer has a reasonable expectation that the alternative benchmark rate would meet the requirements within the 24-month period, it is likely that the entity would reach the same conclusion for all other hedging relationships in which that particular alternative benchmark rate has been designated. Applying this requirement to the example in paragraph BC6.654, the 24-

month period will begin on 31 March 20X1 for that alternative benchmark rate.

- BC6.656 Despite the requirement to apply the 24-month period to each alternative benchmark rate separately, the requirement to assess whether an alternative benchmark rate is separately identifiable continues to separately apply to each hedging relationship. In other words, an entity is required to assess, for each hedge designation, whether the qualifying criteria to apply hedge accounting, including the separately identifiable requirement, are met for the remainder of the 24-month period (ie until 31 March 20X3 following from the example in paragraph BC6.654).
- BC6.657 Consistent with the requirement in IFRS 9 to continuously assess the separately identifiable requirement, an entity's ability to conclude that an alternative benchmark rate is a separately identifiable component requires assessment over the life of the hedging relationship including during the 24-month period discussed in paragraph BC6.655. However, the IASB decided that to avoid the complexity of detailed judgements during the 24-month period, an entity is required to cease applying 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 that period. If an entity reasonably expects that an alternative benchmark rate will not be separately identifiable within 24 months from the date the entity designates it as a non-contractually specified risk component for the first time, the entity is required to cease applying the requirement in paragraph 6.9.11 of IFRS 9 to that alternative benchmark rate and discontinue applying hedge accounting prospectively from the date of that reassessment to all hedging relationships in which the alternative benchmark rate was designated as a non-contractually specified risk component.
- BC6.658 The IASB acknowledged that 24 months is an arbitrary period. However, in the IASB's view, a clearly defined end point is necessary because of the temporary nature of the amendment. The exception described in paragraphs 6.9.11–6.9.13 is a significant relief from one of the requirements that is a basis for the robustness of the hedge accounting requirements, therefore the relief is intentionally short-lived. The IASB considered that a period of 24 months will assist entities in applying the hedge accounting requirements in IFRS 9 particularly during the early stages of the transition to alternative benchmark rates. Therefore, the IASB decided that a period of 24 months from the date an entity first designates an alternative benchmark rate as a non-contractually specified risk component is a reasonable period and would enable entities to implement the reform and comply with any regulatory requirements, while avoiding potential short-term disruption as the market for an alternative benchmark rate develops.
- BC6.659 While developing the proposals in the 2020 Exposure Draft, the IASB considered proposing alternative periods for the requirement in paragraph 6.9.11 of IFRS 9, including a period of 12 months or a period longer than 24 months. However, the IASB acknowledged the diversity in the approaches to the reform or replacement of interest rate benchmarks and the timing of the expected completion across various jurisdictions. The IASB was

concerned that 12 months would not provide sufficient time across all jurisdictions. At the same time, the IASB considered that entities may not be able to have a reasonable expectation that an alternative benchmark rate would satisfy the separately identifiable requirement over a period longer than 24 months.

- BC6.660 The IASB emphasised that the amendments apply only for the separately identifiable requirement and not the reliably measurable requirement. Therefore, if the risk component is not reliably measurable, either when it is designated or thereafter, the alternative benchmark rate would 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 qualifying criteria set out in IFRS 9 to apply hedge accounting, either at the date the alternative benchmark rate is designated or during the 24-month period, the entity is required to discontinue hedge accounting prospectively from that date. The IASB decided that providing relief only for the separately identifiable requirement would achieve the objective described in paragraph BC5.290.

Effective date and transition (Chapter 7)

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Amendments for *Interest Rate Benchmark Reform—Phase 2 (August 2020)*

Mandatory application

- BC7.86 The IASB decided to require application of the Phase 2 amendments. The IASB considered that allowing voluntary application of these amendments could lead to selective application to achieve specific accounting results. The IASB also noted that the 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. The IASB also does not expect that mandatory application of these amendments would result in significant additional costs for preparers and other affected parties because these 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

- BC7.87 The IASB did not add specific end of application requirements for the Phase 2 amendments because the application of these amendments 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 amendments has a natural end.

- BC7.88 The IASB noted that, in a simple scenario, the Phase 2 amendments will be applied only once to each financial instrument or element of a hedging relationship. However, the IASB acknowledged that because of differences in the approach to the reform applied in different jurisdictions, and differences in timing, implementing the reform could require more than one change to the basis for determining the contractual cash flows of a financial asset or a financial liability. This could be the case, for example, when a central authority, 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 Phase 2 amendments to account for that change.
- BC7.89 As noted in paragraph 6.9.3 of IFRS 9, the IASB considered that an entity may be required to amend the formal designation of its hedging relationships at different times, or to 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 designated as a hedging instrument, while only making changes required by the reform to the financial instrument designated as the hedged item later. In applying the amendments, the entity would be required to amend the hedge documentation to amend the description of the hedging instrument. The hedge documentation of the hedging relationship would then have to be amended again to change the description of the hedged item and/or hedged risk as required in paragraph 6.9.1 of IFRS 9.
- BC7.90 The amendment for hedges of risk components in paragraph 6.9.11 of IFRS 9 applies only at the date an entity first designates a particular alternative benchmark rate as a non-contractually specified risk component for the first time 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 this amendment in other circumstances in which the entity is not able to conclude that an alternative benchmark rate is a separately identifiable risk component.

Effective date and transition

- BC7.91 Acknowledging the urgency of the amendments, the IASB decided that entities must apply the Phase 2 amendments for annual periods beginning on or after 1 January 2021, with earlier application permitted.
- BC7.92 The IASB decided that the amendments apply retrospectively in accordance with IAS 8 (except as discussed in paragraphs BC7.94–BC7.98) because prospective application would have resulted in entities applying the amendments only if the transition to alternative benchmark rates occurred after the effective date of the amendments.
- BC7.93 The IASB acknowledged that there could be situations in which an entity amended a hedging relationship as specified in paragraph 6.9.1 of IFRS 9 in a period before the entity first applied the Phase 2 amendments; and in the absence of the Phase 2 amendments, IFRS 9 would require the entity to

discontinue hedge accounting. The IASB noted that the reasons for the amendment in paragraph 6.9.1 of IFRS 9 (see paragraphs BC6.608–BC6.609), apply equally in such situations. The IASB therefore considered that discontinuation of hedge accounting solely because of amendments an entity made in hedge documentation to reflect appropriately the changes required by the reform, regardless of when those changes occurred, would not provide useful information to users of financial statements.

- BC7.94 The IASB acknowledged that the reinstatement of discontinued hedging relationships is inconsistent with the IASB’s previous decisions about hedge accounting in IFRS 9. This is because hedge accounting is applied prospectively and applying it retrospectively to discontinued hedging relationships usually requires the use of hindsight. However, the IASB 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 IASB noted that this reinstatement of discontinued hedging relationships would apply to a very targeted population for a short period—that is, for hedging relationships which would not have been discontinued if the Phase 2 amendments relating to hedge accounting had been applied at the point of discontinuation. The IASB therefore proposed in the 2020 Exposure Draft that an entity would be required to reinstate hedging relationships that were discontinued solely due to changes required by the reform before an entity first applies the proposed amendments.
- BC7.95 Respondents to the 2020 Exposure Draft generally supported and welcomed the transition proposals but asked the IASB to reconsider a specific aspect of the proposal that would require entities to reinstate particular discontinued hedging relationships. Specifically, these respondents highlighted circumstances in which reinstating discontinued hedging relationships would be challenging or have limited benefit—for example, when:
- (a) the hedging instruments or the hedged items in the discontinued hedging relationships have been subsequently designated into new hedging relationships;
 - (b) the hedging instruments in the discontinued hedging relationships no longer exist at the date of initial application of the amendments—eg they have been terminated or sold; or
 - (c) the hedging instruments in the discontinued hedging relationships are now being managed within a trading mandate with other trading positions and reported as trading instruments.
- BC7.96 The IASB noted that the transition requirements as proposed in the 2020 Exposure Draft to apply the amendments retrospectively in accordance with IAS 8—including the requirement to reinstate particular discontinued hedging relationships—would be subject to impracticability applying IAS 8. However, the IASB agreed with respondents’ concerns that there could be other circumstances in which it would not be impracticable to reinstate the hedging relationship, but such reinstatement would be challenging or would have limited benefit. For example, if the hedging instrument or hedged item has been designated in a new hedging relationship, it appears inappropriate to

require entities to reinstate the 'old' (original) hedging relationship and discontinue or unwind the 'new' (valid) hedging relationship. Consequently, the IASB added paragraph 7.2.44(b) to IFRS 9 to address these concerns.

- BC7.97 In addition, the IASB concluded that if an entity reinstates a discontinued hedging relationship applying paragraph 7.2.44 of IFRS 9, for the purpose of applying paragraphs 6.9.11–6.9.12 of IFRS 9, the 24-month period for the alternative benchmark rate designated as a non-contractually specified risk component begins from the date of initial application of the Phase 2 amendments (ie it does not begin from the date the entity designated the alternative benchmark rate as a non-contractually specified risk component for the first time in the original hedging relationship).
- BC7.98 Consistent with the transition requirements for Phase 1, the IASB decided that an entity is not 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.
- BC7.99 The IASB decided that it did not need to amend IFRS 1. Entities adopting IFRS Standards for the first time as required by IFRS 1 would apply IFRS Standards, including the Phase 2 amendments, and the transition requirements in IFRS 1 as applicable.

Amendments to the Basis for Conclusions on IAS 39 *Financial Instruments: Recognition and Measurement*

This Basis for Conclusions accompanies, but is not part of, IAS 39.

Paragraphs BC289–BC371 are added. A heading is added before paragraph BC289. For ease of reading new text is not underlined.

Hedging

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Amendments for *Interest Rate Benchmark Reform—Phase 2 (August 2020)*

Background

- BC289 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, nearly risk-free interest rates that are based, to a greater extent, on transaction data (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. 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 (the reform).
- BC290 In September 2019, the Board amended IFRS 9, IAS 39 and IFRS 7, to address as a priority 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 (Phase 1 amendments). The Phase 1 amendments provide temporary exceptions to specific hedge accounting requirements due to the uncertainty arising from the reform. Paragraphs BC223–BC288 discuss the background to the Phase 1 amendments.
- BC291 After the issuance of the Phase 1 amendments, the Board commenced its Phase 2 deliberations. In Phase 2 of its project on the reform, the Board addressed issues that might affect financial reporting during the reform of an interest rate benchmark, including changes to contractual cash flows or hedging relationships arising from the replacement of an interest rate benchmark with an alternative benchmark rate (replacement issues).
- BC292 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 because of the transition to alternative benchmark rates. The Board observed that for information about the effects of the transition to

alternative benchmark rates to be useful, the information has to 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 amend IFRS Standards or whether the requirements in IFRS Standards already provided an adequate basis to account for such effects.

- BC293 In April 2020 the Board published the Exposure Draft *Interest Rate Benchmark Reform—Phase 2 (2020 Exposure Draft)*, which proposed amendments to specific requirements in IFRS 9, IAS 39, IFRS 7, IFRS 4 *Insurance Contracts* and IFRS 16 *Leases* to address replacement issues.
- BC294 Almost all respondents to the 2020 Exposure Draft welcomed the Board’s decision to address replacement issues and agreed that the proposed amendments would achieve the objective of Phase 2. Many respondents highlighted the urgency of these amendments, especially in some jurisdictions that have progressed towards the reform or the replacement of interest rate benchmarks with alternative benchmark rates.
- BC295 In August 2020 the Board amended IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16 by issuing *Interest Rate Benchmark Reform—Phase 2 (Phase 2 amendments)*. The Phase 2 amendments, which confirmed with modifications the proposals in the 2020 Exposure Draft added paragraphs 102O–102Z3 and 108H–108K of IAS 39. Paragraph 102M was amended.

Amendments to hedging relationships

- BC296 The Phase 2 amendments relating to the hedge accounting requirements in IAS 39 apply to hedging relationships directly affected by the reform as and when the requirements in paragraphs 102D–102I of IAS 39 cease to apply to a hedging relationship (see paragraphs 102J–102O of IAS 39). Therefore, an entity is required to amend the hedging relationship to reflect the changes required by the reform as and when the uncertainty arising from the reform is no longer present with respect to the hedged risk or the timing and the amount of interest rate benchmark-based cash flows of the hedged item or of the hedging instrument. The scope of the hedging relationships to which the Phase 2 amendments apply is therefore the same as the scope to which the Phase 1 amendments apply, except for the amendment to the separately identifiable requirement, which also applies to the designation of new hedging relationships (see paragraph 102Z3 of IAS 39).
- BC297 As part of the Phase 1 amendments, the Board acknowledged that, in most cases, for uncertainty regarding the timing and the amount of interest rate benchmark-based cash flows arising from the reform to be resolved, the underlying financial instruments designated in the hedging relationship would have to be changed to specify the timing and the amount of alternative benchmark rate-based cash flows.
- BC298 The Board noted that, applying the hedge accounting requirements in IAS 39, changes to the basis for determining the contractual cash flows of a financial asset or a financial liability (see paragraphs 5.4.6–5.4.9 of IFRS 9) that are designated in a hedging relationship would affect the designation of such a

hedging relationship in which an interest rate benchmark was designated as a hedged risk.

- BC299 The Board observed that amending the formal designation of a hedging relationship to reflect the changes required by the reform would result in the discontinuation of the hedging relationship. This is because, as part of the qualifying criteria for hedge accounting to be applied, IAS 39 requires the formal designation of a hedging relationship to be documented at inception. 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.
- BC300 The Board therefore concluded that, in general, the hedge accounting requirements in IAS 39 are sufficiently clear about how to account for hedging relationships directly affected by the reform after the Phase 1 exceptions set out in paragraphs 102D–102I of IAS 39 cease to apply. However, consistent with the Board’s objective for Phase 2 (see paragraph BC292) and its objective for Phase 1 (see paragraph BC227), the Board considered that discontinuing hedge accounting solely due to the effects of the reform would not always reflect the economic effects of the changes required by the reform on a hedging relationship and therefore would not always provide useful information to users of financial statements.
- BC301 Accordingly, the Board decided that if the reform requires a change to a financial asset or a financial liability designated in a hedging relationship (see paragraphs 5.4.6–5.4.8 of IFRS 9), it would be consistent with the Board’s objective for Phase 2 to require the hedging relationship to be amended to reflect such a change without requiring discontinuation of that hedging relationship. For these reasons, in the 2020 Exposure Draft, the Board proposed that an entity would be required to amend the formal designation of the hedging relationship as previously documented to make one or more of these 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.
- BC302 Respondents to the 2020 Exposure Draft agreed with the proposed amendments because those proposals would generally result in an entity continuing to apply hedge accounting to hedging relationships directly affected by the reform. Respondents also said that changes to the hedge designation necessary to reflect changes required by the reform are not expected to represent a change in an entity’s risk management strategy or risk management objective for hedging their exposure to interest rate risk. Therefore, the Board concluded that continuing to apply hedge accounting to

the affected hedging relationships when making changes required by the reform would correspond with the Board's objective for issuing the Phase 1 amendments in September 2019.

- BC303 However, notwithstanding their general agreement with the proposed amendments, some respondents asked the Board to clarify the scope and timing of the required changes to the affected hedging relationships.
- BC304 Regarding the scope of the required changes to the affected hedging relationships, the Board acknowledged it may be necessary to amend the designated hedged portion of the cash flows or fair value being hedged when the hedging relationship is amended to reflect the changes required by the reform. The Board also noted that the changes required by the reform described in paragraphs 5.4.6–5.4.8 of IFRS 9 were implicit in the required amendments to the hedging relationships as proposed in the 2020 Exposure Draft. In considering the timing of when entities are required to amend an affected hedging relationship, the Board sought to balance the operational effort needed to amend the hedging relationships with maintaining the required discipline in the amendments to hedging relationships. Specifically, it sought to address the challenges associated with specifying the timing of when entities have to amend hedging relationships as required in paragraph 102P of IAS 39—particularly in the context of the large volume of changes that entities may need to make in a relatively short time—while also ensuring that the amendments to hedging relationships are accounted for in the applicable reporting period.
- BC305 In response to respondents' requests, the Board revised the proposed wording in paragraph 102P of IAS 39 so that:
- (a) amending the description of the hedged item includes amending the description of the designated portion of the cash flows or fair value being hedged;
 - (b) the changes required by the reform described in paragraphs 5.4.6–5.4.8 of IFRS 9 are relevant when amending the formal designation of a hedging relationship; and
 - (c) amendments to hedging relationships are required to be made by the end of the reporting period during which the respective changes to the hedged item, hedged risk or hedging instrument are made.
- BC306 The Board noted that the Phase 1 amendments may cease to apply at different times to directly affected hedging relationships and to the different elements within a hedging relationship. Therefore, an entity may be required to apply the applicable Phase 2 exceptions in paragraphs 102P–102Z2 of IAS 39 at different times, which may result in the designation of a particular hedging relationship being amended more than once. The Phase 2 amendments to the hedge accounting requirements in IAS 39 apply only to the requirements specified in these paragraphs. All other hedge accounting requirements in IAS 39, including the qualifying criteria in paragraph 88 of IAS 39, apply to hedging relationships directly affected by the reform. In addition, consistent with the Board's decision for the Phase 1 amendments (see paragraph BC254),

the Phase 2 amendments also do not provide an exception from the measurement requirements for a hedging relationship. Therefore, entities apply the requirements in paragraphs 89 or 96 of IAS 39 to account for any changes in the fair value of the hedged items or hedging instruments (also see paragraphs BC315–BC320).

- BC307 As set out in paragraph BC5.318 of the Basis for Conclusions on IFRS 9, the Board considered that changes might be made to a financial asset or a financial liability, or to the formal designation of a hedging relationship, in addition to those changes required by the reform. The effect of such additional changes to the formal hedge designation on the application of the hedge accounting requirements would depend on whether those changes result in the derecognition of the underlying financial instrument (see paragraph 5.4.9 of IFRS 9).
- BC308 The Board therefore required an entity first to apply the applicable requirements in 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 no longer meets the qualifying criteria to be an eligible hedged item as a result of changes in addition to those required by the reform. Similarly, if an entity amends the hedge designation to make a change other than the changes described in paragraph 102P of IAS 39 (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 the discontinuation of hedge accounting, the designation of the hedging relationship would be amended as required by paragraph 102P of IAS 39.
- BC309 Some respondents to the 2020 Exposure Draft said that entities may change a hedging relationship as a result of the reform, but such a change is not necessary as a direct consequence of the reform. This could include, for example, designating a basis swap as a new hedging instrument to mitigate ineffectiveness arising from the difference between the compounding of the alternative benchmark rates used for cash products and derivatives. These respondents asked the Board to permit such changes to be in the scope of the required changes to the hedging relationship set out in paragraph 102P of IAS 39. The Board however decided not to extend the scope of paragraph 102P of IAS 39 to other changes an entity makes as a result of the reform. The Board considered that its objective for the Phase 2 amendments is not only to support entities in applying the IFRS requirements during the transition to alternative benchmark rates, but also to provide users of financial statements with useful information about the effect of the reform on an entity's financial statements. To balance achieving this objective with maintaining the discipline that exists in the hedge accounting requirements in IAS 39, the Board limited the scope of the changes required to the designation of hedging relationships to only those changes that are necessary to reflect the changes required by the reform (as described in paragraphs 5.4.6–5.4.8 of IFRS 9).

Replacement of hedging instruments in hedging relationships

- BC310 Respondents to the 2020 Exposure Draft said that, instead of changing the contractual terms of a derivative designated as a hedging instrument, counterparties may facilitate the transition to alternative benchmark rates using approaches that result in outcomes that are equivalent to changing the contractual terms of the derivative. These respondents asked whether using such an approach would be within the scope of the Phase 2 amendments—ie whether paragraph 102P(c) of IAS 39 would apply—if the approach results in an economic outcome that is similar to changing the basis for determining the contractual cash flows of the derivative.
- BC311 The Board confirmed that, consistent with the rationale in paragraph BC5.298 of the Basis for Conclusions on IFRS 9, it is the substance of an arrangement, rather than its form, that determines the appropriate accounting treatment. The Board considered that the conditions in paragraph 5.4.7 of IFRS 9—ie the change is necessary as a direct consequence of the reform and is done on economically equivalent basis—are helpful in analysing the amendments to the contractual terms of derivatives described in paragraph BC310. In this context, the Board noted that if these other approaches result in derivatives with substantially different terms from those of the original derivative, the change may not have been made on an economically equivalent basis. The Board also noted that if a hedging instrument is derecognised, hedge accounting is required to be discontinued. Therefore, the Board decided that for hedge accounting to continue it is also necessary that the original hedging instrument would not be derecognised.
- BC312 The Board considered these approaches described by respondents:
- (a) *close-out and replace on the same terms (ie off-market terms)*—An entity applying this approach would enter into two new derivatives with the same counterparty. These two would be, a new derivative that is equal and offsetting to the original derivative (so both contracts are based on the interest rate benchmark to be replaced), and a new alternative benchmark-based derivative with the same terms as the original derivative so its fair value at initial recognition is equivalent to the fair value—on that date—of the original derivative (ie the new derivative is off-market). Under this approach the counterparty to the new derivatives is the same as to the original derivative, the original derivative has not been derecognised and the terms of the alternative benchmark rate derivative are not substantially different from that of the original derivative. The Board therefore concluded that such an approach could be regarded as consistent with the changes required by the reform as required in paragraph 102P of IAS 39.
 - (b) *close-out and replace on substantially different terms (eg on-market terms)*—An entity applying this approach would terminate (close-out) the existing interest rate benchmark-based derivative with a cash settlement. The entity then enters into a new on-market alternative benchmark rate derivative with substantially different terms, so that the new derivative has a fair value of zero at initial recognition. Some respondents to the

2020 Exposure Draft were of the view that since this approach does not result in any gain or loss recognised in profit or loss, it suggests the exchange was done on an economically equivalent basis. The Board disagreed with this view because the original derivative is extinguished and replaced with an alternative benchmark rate derivative with substantially different contractual terms. Therefore, this approach is not considered consistent with the changes required by the reform as required in paragraph 102P of IAS 39.

- (c) *add a new basis swap*—An entity applying this approach would retain the original interest rate benchmark-based derivative but enter into a basis swap that swaps the existing interest rate benchmark for the alternative benchmark rate. The combination of the two derivatives is equivalent to modifying the contractual terms of the original derivative to replace the interest rate benchmark with an alternative benchmark rate. The Board noted that, in principle, the combination of an interest rate benchmark-based derivative and an interest rate benchmark-alternative benchmark rate swap could achieve an outcome economically equivalent to amending the original interest rate benchmark-based derivative. However, the Board observed that, in practice, basis swaps are generally entered into on an aggregated basis to economically hedge an entity's net exposure to basis risk, rather than on an individual derivative basis. The Board therefore noted that for this approach to be consistent with the changes required by the reform as described in paragraph 102P of IAS 39, the basis swap must be coupled or linked with the original derivative, ie done on an individual derivative basis. This is because a change to the basis for determining the contractual cash flows of a hedging instrument is made to an individual instrument and, to achieve the same outcome, the basis swap would need to be coupled with an individual derivative.
- (d) *novating to a new counterparty*—An entity applying this approach would novate the original interest rate benchmark-based derivative to a new counterparty and subsequently change the contractual cash flows on the novated derivative to replace the interest rate benchmark with an alternative benchmark rate. The Board noted that novation of a derivative would result in the derecognition of the original derivative and thus would require hedge accounting to be discontinued in accordance with paragraph 101 of IAS 39 (see further paragraphs BC333–BC335). Therefore, this approach is not consistent with the changes required by the reform as set out in paragraph 102P of IAS 39.

BC313 The Board therefore added paragraph 102Q of IAS 39 so that, an entity also applies paragraph 102P(c) of IAS 39 if these three conditions are met:

- (a) the entity makes a change required by the reform using an approach other than changing the basis for determining the contractual cash flows of the hedging instrument (as described in paragraph 5.4.6 of IFRS 9);
- (b) the original hedging instrument is not derecognised; and

- (c) the chosen approach is economically equivalent to changing the basis for determining the contractual cash flows of the original hedging instrument (as described in paragraphs 5.4.7 and 5.4.8 of IFRS 9).

BC314 The Board decided not to add further amendments or provide application guidance because IAS 39 as amended provides an adequate basis for analysing the accounting requirements in context of the approaches described in paragraph BC312.

Remeasurement of the hedged item and hedging instrument

BC315 In paragraph BC254, the Board explained that no exceptions were made in Phase 1 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 paragraph BC253). 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.

BC316 Applying the hedge accounting requirements in IAS 39, a gain or loss arising from the remeasurement of the hedged item attributable to the hedged risk or from remeasuring the hedging instrument is reflected in profit or loss when measuring and recognising hedge ineffectiveness.

BC317 When deliberating the Phase 2 amendments, the Board considered that changes in the fair value of the hedged item or hedging instrument could arise when the formal designation of a hedging relationship is amended.

BC318 The Board considered whether to provide an exception from the requirement to include in hedge ineffectiveness such fair value changes when they arise. The Board considered, but rejected, these approaches:

- (a) *recognising the measurement adjustment in profit or loss over time* – An entity applying this approach would recognise the measurement adjustment in profit or loss over time (ie amortised) 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 in the *Conceptual Framework*. Adjusting the carrying amount of the hedged item or hedging instrument would result in the recognition of a net measurement adjustment of zero and would be inconsistent with the Board’s decision that no exceptions would be made to the measurement of hedged items or hedging instruments. The Board also noted that such an approach would likely result in increased operational complexity because an entity would need to track adjustments that occur at different times for the purpose of amortising the adjustments in the period(s) in which the hedged item affects profit or loss.

- (b) *recognising the measurement adjustment as an adjustment to retained earnings*
 – An entity applying this approach would recognise the measurement adjustment 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 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.

BC319 Some respondents to the 2020 Exposure Draft said they would not expect any significant changes in fair value to arise from the remeasurement of a hedged item or hedging instrument based on the alternative benchmark rate. That is because these amendments would apply only when the conditions in paragraph 5.4.7 of IFRS 9 are met, which require that changes are made on an economically equivalent basis. The Board acknowledged these comments noting that, applying paragraph 102P of IAS 39, a significant change in fair value arising from the remeasurement of the hedged item or the hedging instrument indicates that the changes were not made on an economically equivalent basis. Furthermore, the Board observed that the requirement in paragraph 102P(b) of IAS 39 which requires the description of the designated portion for the cash flows or fair value being hedged enables entities to amend a hedging relationship to minimise fair value changes on the remeasurement of the hedged item or the hedging instrument.

BC320 The Board therefore confirmed its previous decision not to provide an exception from the requirements in IAS 39 regarding the measurement and recognition of hedge ineffectiveness. Therefore, an entity would apply the requirements in paragraphs 89 (for a fair value hedge) and 96 (for a cash flow hedge) of IAS 39 for the measurement and recognition of hedge ineffectiveness. The Board considered that accounting for such fair value changes in any other way would be inconsistent with the decision to continue applying hedge accounting for such amended hedging relationships (see paragraph 102P of IAS 39). In the Board’s view, applying the requirements in IAS 39 for the recognition and measurement of ineffectiveness 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.

Accounting for qualifying hedging relationships*Retrospective effectiveness assessment*

- BC321 Applying the Phase 1 exception in paragraph 102G of IAS 39, an entity is not required to discontinue a hedge accounting relationship because the actual results of the hedge do not meet the requirements in paragraph AG105(b) of IAS 39. Applying paragraph 102M of IAS 39, an entity is required to 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 amendments, at the date the exception in paragraph 102G of IAS 39 ceases to apply, an entity must apply the requirements in IAS 39 (as amended by the Phase 2 amendments). Therefore, at that time, an entity would apply paragraph AG105(b) of IAS 39 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.
- BC322 The Board considered that when paragraph 102G of IAS 39 ceases to apply and an entity first applies the requirement in paragraph AG105(b) of IAS 39 to assess the retrospective effectiveness of a hedging relationship, the hedging relationship could fail the retrospective assessment if the entity assesses hedge effectiveness on a cumulative basis. In the Board's view, this outcome would be inconsistent with the Board's objective for Phase 1. Specifically, it would be inconsistent with the objective of the exception 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.
- BC323 To address the issue described in paragraph BC322, the 2020 Exposure Draft proposed an amendment to IAS 39 that would require an entity, only for the purpose of applying the retrospective assessment, to reset to zero the cumulative fair value changes of the hedged item and the hedging instrument when the exception from the retrospective assessment ceases to apply. This proposed amendment would apply only when an entity assesses retrospective effectiveness on a cumulative basis (ie using the dollar offset method on a cumulative basis). As required by IAS 39, the entity would continue to measure and recognise hedge ineffectiveness by comparing the actual gains or losses on the hedged item to those on the hedging instrument.
- BC324 Respondents to the 2020 Exposure Draft agreed with the objective of this proposed amendment but identified particular circumstances in which it could unintentionally cause some hedging relationships to fail the retrospective effectiveness assessment. For example, this could be the case when there is market volatility during the initial period following the transition to an alternative benchmark rate. Such volatility could cause the retrospective effectiveness assessment to breach the 80-125 per cent threshold because an entity would be precluded from assessing effectiveness based on data prior to the reset date even if that data would show that the hedging relationship actually is effective over a longer time horizon. The Board agreed

with these comments and therefore, amended paragraph 102V of IAS 39 so that it permits, rather than requires, entities (ie entities may elect) to reset to zero the cumulative fair value changes for the purpose of assessing the retrospective effectiveness of a hedging relationship on a cumulative basis. Considering the nature of this amendment, the Board decided this election is made on an individual hedging relationship basis.

Prospective assessments

BC325 The Phase 1 exception in paragraph 102F of IAS 39 requires an entity to assume that, for the purpose of the prospective effectiveness assessment as required by paragraphs 88(b) and AG105(a) of IAS 39, 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 102L of IAS 39, this exception ceases 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.

BC326 Consistent with the Board's considerations on the highly probable requirement (see paragraphs BC327–BC328), the Board considered that, when the formal designation of a hedging relationship has been amended (see paragraph 102P of IAS 39), the prospective assessment 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 therefore provided no exceptions from the prospective assessment for the period after the Phase 1 exception in paragraph 102F of IAS 39 ceases to apply.

Amounts accumulated in the cash flow hedge reserve

BC327 During the period in which a hedging relationship is affected by uncertainty arising from the reform, paragraph 102D of IAS 39 requires 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 exception 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 a part of is discontinued.

BC328 The Board considered 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 an entity amends the description of the hedged item, including the description of the designated portion of the cash flows or fair value being hedged, applying paragraph 102P(b) of IAS 39. Thereafter, applying the requirement in 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.

- BC329 The Board noted that the amendment in paragraph 102P(b) of IAS 39 for amending the formal designation of a hedging relationship could lead to changes in the hedged item. Therefore, if an entity uses a hypothetical derivative—that is, a derivative that would have terms matching the critical terms of the designated cash flows and the hedged risk, commonly used in cash flow hedges to represent the forecast transaction—the entity may need to change the hypothetical derivative to calculate the change in the value of the hedged item to measure hedge ineffectiveness.
- BC330 Consequently, as hedge accounting would not be discontinued when a hedging relationship is amended for changes required by the reform (see paragraph 102P of IAS 39), the Board decided that an entity would deem the amount accumulated in the cash flow hedge reserve at that point to be based on the alternative benchmark rate on which the hedged future cash flows are determined. Therefore, in applying 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(s) during which the hedged cash flows based on the alternative benchmark rate affect profit or loss.
- BC331 The approach described in paragraph BC330 is consistent with the Board's view that, when a hedging relationship is amended for changes required by the reform, more useful information is 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.
- BC332 Consistent with the requirements in paragraphs 102E and 102K of IAS 39, the Board considered whether to provide similar relief for any discontinued hedging relationships in which the previously designated hedged item is subject to the reform. 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 required by the reform, even if the hedging relationship has been discontinued.
- BC333 The Board therefore decided that, for the purpose of applying paragraph 101(c) of IAS 39, an entity deems the cumulative gain or loss recognised in the other comprehensive income for a discontinued hedging relationship, to be based on the alternative benchmark rate on which the contractual cash flows will be based, which is similar to the amendment in paragraph 102W of IAS 39. 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.

- BC334 Some respondents to the 2020 Exposure Draft asked the Board to clarify whether the requirements in paragraphs 102W–102X of IAS 39 require the retrospective measurement of the hedged item based on the alternative benchmark rate-based cash flows—in other words, whether an entity would be required to recalculate what the cumulative gain or loss recognised in other comprehensive income would have been if the hedged item was based on the alternative benchmark rate since inception.
- BC335 The Board considered that the cumulative gain or loss recognised in other comprehensive income is adjusted as required by paragraph 96 of IAS 39 (ie the cumulative gain or loss recognised in other comprehensive income is not subject to separate measurement requirements, but instead is derived from the cumulative changes in the fair value of the hedged item (present value) and hedging instrument). The Phase 2 amendments do not include an exception from the measurement requirements in IFRS 9. Accordingly, the fair value of the hedging instrument or of the hedged item (ie the present value of the cumulative changes in the hedged expected future cash flows) is determined at the measurement date based on the expected future cash flows and assumptions that market participants would use. In other words, the fair values are not determined retrospectively. The Board therefore considered that the cumulative gain or loss recognised in other comprehensive income is not remeasured as if it had been based on the alternative benchmark rate since inception of the hedging relationship.
- BC336 The Board confirmed that the amendments in paragraphs 102W–102X of IAS 39 extend to cash flow hedges, regardless of whether the cash flow hedge is for an open or closed hedged portfolio. The general reference to cash flow hedges in these paragraphs reflects such scope, therefore, the Board considered that explicitly addressing open or closed hedged portfolios was unnecessary.

Groups of items

- BC337 The Board considered that for groups of items designated as hedged items in a fair value or cash flow hedge, the hedged items could consist of items still referenced to the interest rate benchmark as well as items already referenced to the alternative benchmark rate. Therefore, an entity could not amend the description of the hedged risk or the hedged item, including the designated portion of the cash flows or fair value being hedged with reference only to an alternative benchmark rate for the whole group. The Board also considered that it would be inconsistent with the objectives of the Phase 2 amendments to require the discontinuation of such a hedging relationship solely because of the effects of the reform. In the Board's view, the same requirements and relief that apply to other hedging relationships should apply to groups of items designated as hedged items, including dynamic hedging relationships.
- BC338 Paragraphs 102Y–102Z of IAS 39 therefore require an entity to allocate the individual hedged items to subgroups based on the benchmark rate designated as the hedged risk for each subgroup and to apply the requirements in paragraphs 78 and 83 of IAS 39 to each subgroup separately. The Board acknowledged that this approach is an exception to the hedge accounting

requirements in IAS 39 because other hedge accounting requirements, including the requirements in paragraphs 89 and 96 of IAS 39, are applied to the hedging relationship in its entirety. However, in the Board's view, the robustness of the hedge accounting requirements is maintained because if any subgroup fails to meet the requirements in paragraphs 78 and 83 of IAS 39, the entity is required to discontinue hedge accounting for that entire hedging relationship. The Board concluded this accounting outcome is appropriate because 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.

- BC339 The Board acknowledged that preparers may incur additional costs to assess each subgroup in a hedging relationship separately, and to track items moving from one subgroup to another. However, the Board concluded that an entity is likely to have such information available because IAS 39 already requires it 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 of this exception.
- BC340 Respondents to the 2020 Exposure Draft asked the Board whether the requirement for groups of items applies to dynamic hedges of interest rate benchmark-based items when the items mature and are replaced with alternative benchmark rate-based items. The Board considered that although the objective of the Phase 2 amendments is to provide relief when individual items transition to an alternative benchmark rate, the replacement of items that have expired with items that reference the alternative benchmark rate is a natural consequence of a dynamic hedging relationship. Therefore, the Board observed that new items designated as part of the group to replace interest rate benchmark-based items that have matured would be allocated to the relevant subgroup based on the benchmark rate being hedged.
- BC341 Respondents also asked the Board to clarify how the requirements in paragraphs 102Y–102Z of IAS 39 apply to the hypothetical derivative in a cash flow hedge, specifically, whether the hypothetical derivative could be amended (and therefore measured) based on the alternative benchmark rate if the actual hedged item (such as a floating rate loan) has not yet transitioned to the alternative benchmark rate. The Board considered that IAS 39 does not include specific requirements for the hypothetical derivative because it is one possible way of calculating the change in the value of the hedged item to measure ineffectiveness. Therefore, the terms on which the hypothetical derivative is constructed replicate the hedged risk and the hedged cash flows of the hedged item an entity is hedging. The hypothetical derivative cannot include features in the value of the hedged item that exist only in the hedging instrument (but not in the hedged item). The Board therefore decided that the identification of an appropriate hypothetical derivative is based on the requirements to measure hedge ineffectiveness and it would not be appropriate to include specific amendments for applying the requirements in paragraphs 102Y–102Z to the hypothetical derivative.

Designating financial items as hedged items

End of application of the Phase 1 exception

- BC342 An entity may designate an item in its entirety or a portion of an item as the hedged item in a hedging relationship. 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 portion).
- BC343 When developing the Phase 1 amendments, the Board decided not to set an end date for applying the exception for the separately identifiable requirement (see paragraphs 102H–102I of IAS 39). The Board considered that 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 portion based on the interest rate benchmark may no longer be separately identifiable (for example, as the market for the alternative benchmark rate is established). As noted in paragraph BC283, in the Board’s view, such an immediate discontinuation of hedge accounting would be inconsistent with the objective of this exception in Phase 1. Therefore, when issuing the Phase 1 amendments, the Board decided that an entity should cease applying the Phase 1 exception from the separately identifiable requirement to a hedging relationship only when that hedging relationship is discontinued applying the requirements in IAS 39.
- BC344 Having considered the interaction between the Phase 1 exception from the separately identifiable requirement and the Phase 2 amendments to the hedge accounting requirements in IAS 39, the Board decided it is necessary to specify that an entity is required to cease applying the Phase 1 exception from the separately identifiable requirement when the uncertainty arising from the reform, which led to that exception, is no longer present.
- BC345 The Board considered that continuing to apply the Phase 1 amendments 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 added paragraph 102O to IAS 39 so 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 non-contractually specified risk portion as set out in paragraph 102P of IAS 39; or
 - (b) when the hedging relationship in which the non-contractually specified risk portion was designated is discontinued.

Application of the ‘separately identifiable’ requirement to an alternative benchmark rate

- BC346 In developing the Phase 2 amendments, the Board was aware that considerations similar to those discussed in paragraphs BC342–BC345 apply to designating an alternative benchmark rate as a non-contractually specified risk portion 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 81 and AG99F of IAS 39 that a risk portion must be separately identifiable and reliably measurable could be affected in the early stages of the reform.

- BC347 Specific requirements on the separately identifiable requirement are already set out in paragraph 81 of IAS 39. However, the Board considered that an entity might expect an alternative benchmark rate to meet the separately identifiable requirement in IAS 39 within a reasonable period of time even though the alternative benchmark rate does not meet the requirement when it is designated as a risk portion.
- BC348 The amendment in paragraph 102Z1 of IAS 39 applies to different set of instruments from the Phase 1 exception. For items within the scope of paragraph 102Z1 of IAS 39, the separately identifiable requirement has never been satisfied. In contrast, 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 Board therefore considered that any relief from the separately identifiable requirement in Phase 2 should be temporary.
- BC349 Consequently, in the 2020 Exposure Draft, the Board proposed that an alternative benchmark rate that does not meet the requirement to be separately identifiable at the date it is designated as a non-contractually specified risk portion 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 24 months from the date it is designated as a risk portion.
- BC350 Respondents to the 2020 Exposure Draft agreed with this proposed amendment but asked the Board to clarify the date from which the 24-month period applies. The Board acknowledged respondents' concerns, and considered whether the 24-month period applies:
- (a) on a hedge-by-hedge basis—that is, to each hedging relationship individually, beginning from the date an alternative benchmark rate is designated as a risk portion in that relationship; or
 - (b) on a rate-by-rate basis—that is to, each alternative benchmark rate separately, beginning from the date when an entity first designates an alternative benchmark rate as a hedged risk for the first time.
- BC351 The Board acknowledged that applying the 24-month period to each hedging relationship individually (as proposed in the 2020 Exposure Draft)—that is, on a hedge-by-hedge basis—is consistent with the basis on which hedging relationships are designated. For each new hedge designation, an entity is required to assess whether the qualifying criteria to apply hedge accounting, including the separately identifiable requirement, have been met. However, the Board also considered that applying the 24-month period to different hedging relationships (with the same alternative benchmark rate designated as a risk portion) at different times, could add an unnecessary operational burden as the period would end at different times and thus would need to be monitored over different periods, for different hedging relationships. For

example, if an entity designates the alternative benchmark rate as the risk portion in two hedging relationships—the first designated on 31 March 20X1 and the second on 30 June 20X1—the 24-month period for each hedge would begin and end at different dates, although the designated risk is the same in both hedging relationships.

- BC352 Therefore, the Board decided that the requirement in paragraph 102Z1 would apply on a rate-by-rate basis so the 24-month period applies to each alternative benchmark rate separately and hence, starts from the date that an entity designates an alternative benchmark rate as a non-contractually specified risk portion for the first time (but see also paragraph 108J of IAS 39). The Board considered that if an entity concludes for one hedging relationship that it no longer has a reasonable expectation that the alternative benchmark rate would meet the requirements within the 24-month period, it is likely that the entity would reach the same conclusion for all other hedging relationships in which that particular alternative benchmark rate has been designated. Applying this requirement to the example in paragraph BC351, the 24-month period will begin on 31 March 20X1 for that alternative benchmark rate.
- BC353 Despite the requirement to apply the 24-month period to each alternative benchmark rate separately, the requirement to assess whether an alternative benchmark rate is separately identifiable continues to separately apply to each hedging relationship. In other words, an entity is required to assess, for each hedge designation, whether the qualifying criteria to apply hedge accounting, including the separately identifiable requirement, are met for the remainder of the 24-month period (ie until 31 March 20X3 following from the example in paragraph BC351).
- BC354 Consistent with the requirement in 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 assessment over the life of the hedging relationship including during the 24-month period discussed in paragraph BC352. However, the Board decided that to avoid the complexity of detailed judgements during the 24-month period, an entity is required to cease applying 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 that period. If an entity reasonably expects that an alternative benchmark rate will not be separately identifiable within 24 months from the date the entity designates it as a non-contractually specified risk portion for the first time, the entity is required to cease applying the requirement in paragraph 102Z1 of IAS 39 to that alternative benchmark rate and discontinue applying hedge accounting prospectively from the date of that reassessment to all hedging relationships in which the alternative benchmark rate was designated as a non-contractually specified risk portion.
- BC355 The Board acknowledged that 24 months is an arbitrary period. However, in the Board's view, a clearly defined end point is necessary because of the temporary nature of the amendment. The exception described in paragraphs 102Z1–102Z3 of IAS 39 is a significant relief from one of the requirements that is a basis for the robustness of the hedge accounting requirements,

therefore the relief is intentionally short-lived. The Board considered that a period of 24 months will assist entities in applying the hedge accounting requirements in IAS 39 particularly during the early stages of the transition to alternative benchmark rates. Therefore, the Board decided that a period of 24 months from the date an entity first designates an alternative benchmark rate as a non-contractually specified risk portion, is a reasonable period and would enable entities to implement the reform and comply with any regulatory requirements, while avoiding potential short-term disruption as the market for an alternative benchmark rate develops.

BC356 While developing the proposals in the 2020 Exposure Draft, the Board considered proposing alternative periods for the requirement in paragraph 102Z1 of IAS 39, including a period of 12 months or a period longer than 24 months. However, the Board acknowledged the 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 12 months would not provide sufficient time across all jurisdictions. At the same time, the Board considered that entities may not be able to have a reasonable expectation that an alternative benchmark rate would satisfy the separately identifiable requirement over a period longer than 24 months.

BC357 The Board emphasised that the amendments apply only for the separately identifiable requirement and not the reliably measurable requirement. Therefore, if the risk portion is not reliably measurable, either when it is designated or thereafter, the alternative benchmark rate would not meet the qualifying criteria to be designated as a risk portion in a hedging relationship. Similarly, if the hedging relationship fails to meet any other qualifying criteria set out in IAS 39 to apply hedge accounting, either at the date the alternative benchmark rate is designated or during the 24-month period, the entity is required to discontinue hedge accounting prospectively from that date. The Board decided that providing relief only for the separately identifiable requirement would achieve the objective described in paragraph BC292.

Mandatory application

BC358 The Board decided to require application of the Phase 2 amendments. The Board considered that allowing voluntary application of these amendments (ie except for the amendment in paragraph 102V of IAS 39 which is permitted, but not required) could lead to selective application to achieve specific accounting results. The Board also noted that the 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. The Board also does not expect that mandatory application of these amendments would result in significant additional costs for preparers and other affected parties because these 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

- BC359 The Board did not add specific end of application requirements for the Phase 2 amendments because the application of these amendments 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 amendments has a natural end.
- BC360 The Board noted that, in a simple scenario, the Phase 2 amendments will be applied only 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, implementing the reform could require more than one change to the basis for determining the contractual cash flows of a financial asset or a financial liability.
- BC361 As noted in paragraph 102R of IAS 39, the Board considered that an entity may be required to amend the formal designation of its hedging relationships at different times, or to 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 designated as a hedging instrument, while only making changes required by the reform to the financial instrument designated as the hedged item later. In applying the amendments, the entity would be required to amend the hedge documentation to amend the description of the hedging instrument. The hedge documentation of the hedging relationship would then have to be amended again to change the description of the hedged item and/or hedged risk as required in paragraph 102P of IAS 39.
- BC362 The amendment for hedges of risk portions in paragraph 102Z1 of IAS 39 applies only at the date an entity first designates a particular alternative benchmark rate as a non-contractually specified risk portion for the first time 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 this amendment in other circumstances in which the entity is not able to conclude that an alternative benchmark rate is a separately identifiable risk portion.
- BC363 The Board developed the amendment in paragraph 102V of IAS 39 to address the potential effect in hedge accounting at the date the Phase 1 exception from the retrospective assessment in paragraph 102G of IAS 39 ceases to apply. Therefore, the amendment in paragraph 102V of IAS 39 only applies at that date ie the date that the exception from the retrospective assessment in paragraph 102G of IAS 39 ceases to apply.

Effective date and transition

- BC364 Acknowledging the urgency of the amendments, the Board decided that entities must apply the Phase 2 amendments for annual periods beginning on or after 1 January 2021, with earlier application permitted.
- BC365 The Board decided that the amendments apply retrospectively in accordance with IAS 8 (except as discussed in paragraphs BC367–BC370) because prospective application would have resulted in entities applying the amendments only if the transition to alternative benchmark rates occurred after the effective date of the amendments.
- BC366 The Board acknowledged that there could be situations in which an entity amended a hedging relationship as specified in paragraph 102P of IAS 39 in the period before the entity first applied the Phase 2 amendments; and in the absence of the Phase 2 amendments, IAS 39 would require the entity to discontinue hedge accounting. The Board noted that the reasons for the amendment in paragraph 102P of IAS 39 (see paragraphs BC300–BC301), 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 reflect appropriately the changes required by the reform, regardless of when those changes occurred, would not provide useful information to users of financial statements.
- BC367 The Board acknowledged that the reinstatement of discontinued hedging relationships is inconsistent with the Board’s previous decisions about hedge accounting in IAS 39. This is because hedge accounting is applied prospectively and applying it retrospectively to discontinued hedging relationships 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 that this reinstatement of discontinued hedging relationships would apply to a very targeted population for a short period—that is, for hedging relationships which would not have been discontinued if the Phase 2 amendments relating to hedge accounting had been applied at the point of discontinuation. The Board therefore proposed in the 2020 Exposure Draft that an entity would be required to reinstate hedging relationships that were discontinued solely due to changes required by the reform before an entity first applies the proposed amendments.
- BC368 Respondents to the 2020 Exposure Draft generally supported and welcomed the transition proposals but asked the Board to reconsider a specific aspect of the proposal that would require entities to reinstate particular discontinued hedging relationships. Specifically, these respondents highlighted circumstances in which reinstating discontinued hedging relationships would be challenging or have limited benefit—for example, when:
- (a) the hedging instruments or the hedged items in the discontinued hedging relationships have been subsequently designated into new hedging relationships;

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- (b) the hedging instruments in the discontinued hedging relationships no longer exist at the date of initial application of the amendments—eg they have been terminated or sold; or
- (c) the hedging instruments in the discontinued hedging relationships are now being managed within a trading mandate with other trading positions and reported as trading instruments.

BC369 The Board noted that the transition requirements as proposed in the 2020 Exposure Draft to apply the amendments retrospectively in accordance with IAS 8—including the requirement to reinstate particular discontinued hedging relationships—would be subject to impracticability applying IAS 8. However, the Board agreed with respondents' concerns that there could be other circumstances in which it would not be impracticable to reinstate the hedging relationship, but such reinstatement would be challenging or would have limited benefit. For example, if the hedging instrument or hedged item has been designated in a new hedging relationship, it appears inappropriate to require entities to reinstate the 'old' (original) hedging relationship and discontinue or unwind the 'new' (valid) hedging relationship. Consequently, the Board added paragraph 108I(b) to IAS 39 to address these concerns.

BC370 In addition, the Board concluded that if an entity reinstates a discontinued hedging relationship applying paragraph 108I(b) of IAS 39, for the purpose of applying paragraphs 102Z1–102Z2 of IAS 39, the 24-month period for the alternative benchmark rate designated as a non-contractually specified risk portion begins from the date of initial application of the Phase 2 amendments (ie it does not begin from the date the entity designated the alternative benchmark rate as a non-contractually specified risk portion for the first time in the original hedging relationship).

BC371 Consistent with the transition requirements for Phase 1, the Board decided that an entity is not 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.

Amendments to the Basis for Conclusions on IFRS 7 *Financial Instruments: Disclosures*

This Basis for Conclusions accompanies, but is not part of, IFRS 7.

Paragraphs BC35DDD–BC35OOO are added. A heading is added before paragraph BC35DDD. For ease of reading new text is not underlined.

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Other Disclosures—Additional disclosures related to interest rate benchmark reform

BC35DDD In April 2020 the Board published the Exposure Draft *Interest Rate Benchmark Reform—Phase 2* (2020 Exposure Draft), which proposed amendments to specific requirements in IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16 to address 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. 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 (the reform). The Board issued the final amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16 in August 2020 (Phase 2 amendments). Paragraphs BC5.287–BC5.320, BC6.604–BC6.660 and BC7.86–BC7.99 of the Basis for Conclusions on IFRS 9 and paragraphs BC289–BC371 of the Basis for Conclusions on IAS 39 discuss the background to these amendments.

BC35EEE In deciding whether disclosures should accompany the Phase 2 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 requirements 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 strategy without requiring disclosures for which the cost of providing that information would outweigh the benefits of the amendments. Consequently, the Board decided not to require quantitative disclosures of what the effects of the reform would have been in the absence of the Phase 2 amendments because the cost of providing such information could outweigh the benefits provided by the amendments. For the same reason, the Board decided not to require entities to provide the disclosure that would otherwise be required by paragraph 28(f) of IAS 8.

BC35FFF In the 2020 Exposure Draft the Board proposed limited additional disclosure requirements by setting out the proposed disclosure objectives and the disclosure requirements to meet those objectives. Most respondents to the 2020 Exposure Draft supported the proposed disclosure objectives and broadly agreed with the proposed disclosures. However, respondents suggested that the Board should simplify aspects of the disclosure required by paragraph 24J(b) of IFRS 7. Furthermore, respondents asked the Board to reconsider whether disclosure of information about how an entity applied the

requirements in paragraphs 5.4.6–5.4.8 of IFRS 9 would provide useful information to users of financial statements.

- BC35GGG Paragraph 24J(b) of IFRS 7 in the 2020 Exposure Draft proposed requiring that entities disclose the carrying amount of non-derivative financial assets, non-derivative financial liabilities and the nominal amount of derivatives, that continue to reference interest rate benchmarks subject to the reform. Respondents to the 2020 Exposure Draft agreed that providing quantitative information about the magnitude of remaining financial instruments that still need to transition to alternative benchmark rates would be useful for understanding the entity’s progress towards completing the implementation of the reform. However, respondents said that the requirement to provide this quantitative information based on the carrying amounts of the relevant non-derivative financial instruments may require an entity to make costly enhancements to its reporting systems and implement additional controls and reconciliations. In the light of a limited time frame, this would be challenging for preparers, in particular those preparers that plan to early apply the Phase 2 amendments. These respondents asked the Board to permit entities to disclose quantitative information on alternative bases—for example, if information about the carrying amounts of relevant non-derivative financial instruments is not available without undue cost or effort, an entity would be able to disclose the quantitative information on the basis that is reported internally to management as part of implementing the reform.
- BC35HHH During outreach on the proposed disclosure requirements, users of financial statements told the Board that, while the quantitative information proposed in the 2020 Exposure Draft is a useful measure of an entity’s progress in implementing the reform, they acknowledge the quantitative information for non-derivative financial assets and non-derivative financial liabilities is only a subset of the amounts already presented in the relevant line items of the entity’s financial statements and therefore such quantitative information does not reconcile. These users of financial statements said that quantitative information would still be useful even if an entity selected another representative basis on which to disclose it.
- BC35III The Board considered that the underlying objective of the disclosure required by paragraph 24J(b) of IFRS 7 is to enable users of financial statements to understand the entity’s progress towards completing the transition to alternative benchmark rates. Quantitative information about financial assets and financial liabilities that—as at the end of the reporting period—reference interest rate benchmarks that are subject to the reform would therefore assist users of financial statements to assess an entity’s progress towards implementing the reform. The Board also considered that for this disclosure to be useful, the quantitative information about non-derivative financial assets, non-derivative financial liabilities and derivatives that continue to reference interest rate benchmarks subject to the reform should be provided in the context of the total non-derivative financial assets, total non-derivative financial liabilities and total derivatives as at the end of the reporting period.

- BC35JJJ The Board agreed that an entity could still meet the underlying objective of this disclosure requirement by providing the relevant quantitative information in different ways. Furthermore, the Board considered that permitting entities to select a basis on which to provide relevant quantitative information to achieve the disclosure objective would allow entities to leverage information that is already available and therefore would reduce the costs of providing the information.
- BC35KKK Accordingly, the Board amended paragraph 24J(b) of IFRS7 to require an entity to disclose quantitative information that enables users of financial statements to understand the extent of financial assets and financial liabilities that, as at the end of the reporting period, have yet to transition to alternative benchmark rates. This information would be disaggregated by significant interest rate benchmark. An entity would select the basis for disclosing the quantitative information and explain which basis was applied. For example, the quantitative information may be based on:
- (a) the carrying amounts of non-derivative financial assets, the carrying amount of non-derivative financial liabilities and the nominal amount of derivatives;
 - (b) the amounts related to recognised financial instruments (for example, the contractual par amount of non-derivative financial assets and non-derivative financial liabilities, and nominal amounts of derivatives); or
 - (c) the amounts provided internally to key management personnel (as defined in IAS 24) of the entity about these financial instruments, for example, the entity’s board of directors or chief executive officer.
- BC35LLL Furthermore, the Board clarified that the disclosure in paragraph 24J(b) of IFRS 7 does not require disclosure of financial instruments that are referenced to an interest rate benchmark subject to the reform at the reporting date, but which will expire prior to transitioning to an alternative benchmark rate. This is because, to meet the objective of this disclosure requirement (see paragraph BC35III), an entity is required to provide information about financial instruments that would be required to transition to alternative benchmark rates (ie before their maturity).
- BC35MMM The 2020 Exposure Draft proposed requiring a description of how an entity determined the base rate and relevant adjustments to that rate, including any significant judgements the entity made to assess whether the conditions for applying the practical expedient in paragraph 5.4.7 of IFRS 9 were met. Respondents to the 2020 Exposure Draft said that in the light of the regulatory nature of the reform, entities might be unable to provide this information in a way that would be sufficiently detailed and entity-specific for it to be useful to users of financial statements. Respondents often described the potential challenges in disclosing this information in a meaningful way by reference to multinational entities that are exposed to different alternative benchmark rates. These respondents said that if the proposed disclosure was intended to confirm that the changes were economically equivalent, then the disclosure was unnecessary. The fact that an entity has applied the practical expedient would automatically inform users of financial statements that the entity has

assessed that the conditions for applying the practical expedient were met. These respondents also said that, if applying those conditions required significant judgement, paragraph 122 of IAS 1 would require an entity to disclose those judgements.

BC35NNN During outreach on the proposed disclosure requirements in the 2020 Exposure Draft, users of financial statements expressed mixed views on this proposed disclosure requirement. While some users of financial statements said the proposed disclosure could be useful for understanding the extent of changes to financial instruments to which the practical expedient is being applied, others were sceptical about whether entities would be able to disclose information in sufficient detail for it to be meaningful. In particular, they highlighted the risk that the disclosures would be summarised at such an aggregated level that the information would not be useful. They also said that they would regard a requirement for an entity to explain how it has determined that it met the conditions to apply the practical expedient in paragraph 5.4.7 of IFRS 9 to be an audit or regulatory enforcement matter, rather than a matter for disclosure in the financial statements. The Board therefore decided to omit this proposed disclosure requirement from the final amendments to IFRS 7.

BC35000 Some respondents to the 2020 Exposure Draft asked the Board to clarify whether paragraphs 24I and 24J of IFRS 7 are required for comparative periods, ie periods before the date of initial application of these amendments, even if the entity does not restate prior periods. The Board noted that the transition requirements for the Phase 2 amendments to IFRS 9, IAS 39, IFRS 4 and IFRS 16 specify that an entity is not required (but is permitted if, and only if, it is possible without the use of hindsight) to restate prior periods to reflect the application of these amendments. Therefore, if the entity does not restate prior periods, paragraphs 24I and 24J of IFRS 7 need not be applied to prior reporting periods.

Amendments to the Basis for Conclusions on IFRS 4 *Insurance Contracts*

This Basis for Conclusions accompanies, but is not part of, IFRS 4.

Paragraphs BC277D–BC277G are added. A subheading is added before paragraph BC277D. For ease of reading new text is not underlined.

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Amendments for Interest Rate Benchmark Reform—Phase 2 (August 2020)

- BC277D In April 2020 the Board published the Exposure Draft *Interest Rate Benchmark Reform—Phase 2 (2020 Exposure Draft)*, which proposed amendments to specific requirements in IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16 to address 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. 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 (the reform). The Board issued the final amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16 in August 2020 (Phase 2 amendments). Paragraphs BC5.287–BC5.320 of the Basis for Conclusions on IFRS 9 discuss the background to these amendments.
- BC277E The Board noted that paragraph 20A of IFRS 4 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).
- BC277F When the Board decided to provide a temporary exemption from applying IFRS 9 (see paragraph 20A of IFRS 4), the Board noted that, because of the temporary nature of the exemption and its relatively narrow application, 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 to account for changes in the basis for determining contractual cash flows as a result of the reform; ie such an insurer would not be able to apply the amendments set out in paragraphs 5.4.5–5.4.9 of IFRS 9.
- BC277G The Board noted that the financial assets and financial liabilities of such an insurer could be affected by the reform in the same way as those for other entities. The Board therefore decided the Phase 2 amendments in paragraphs 5.4.5–5.4.9 of IFRS 9 should apply to insurers that apply the IAS 39 requirements. The Board noted that amending the superseded paragraphs in IAS 39 would be inconsistent with its previous decisions that IAS 39 (except for its hedge accounting requirements) would not be maintained. However, the Board decided to amend IFRS 4 to require insurers applying the temporary exemption from IFRS 9 to apply requirements that are comparable to paragraphs 5.4.5–5.4.9 of the Phase 2 amendments to financial assets and financial liabilities for which the basis for determining the contractual cash

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flows of those financial assets or financial liabilities change 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.

Amendments to the Basis for Conclusions on IFRS 16 *Leases*

This Basis for Conclusions accompanies, but is not part of, IFRS 16.

Paragraphs BC267A–BC267J are added. A heading is added before paragraph BC267A. For ease of reading new text is not underlined.

Temporary exception arising from interest rate benchmark reform

- BC267A In April 2020 the Board published the Exposure Draft *Interest Rate Benchmark Reform—Phase 2* (2020 Exposure Draft), which proposed amendments to specific requirements in IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16 to address 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. 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 (the reform). The Board issued the final amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16 in August 2020 (Phase 2 amendments). Paragraphs BC5.287–BC5.293 of the Basis for Conclusions on IFRS 9 and paragraphs BC289–BC295 of the Basis for Conclusions on IAS 39 discuss the background to these amendments.
- BC267B In developing the Phase 2 amendments, the Board also considered the potential effects of the reform on the financial statements of an entity applying the requirements of IFRS Standards, other than IFRS 9 and IAS 39. The Board specifically considered the potential effects arising in the context of IFRS 16.
- BC267C 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.
- BC267D 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.
- BC267E 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.
- BC267F 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 (ie when the conditions in paragraph 105 of IFRS 16 are met) 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 such lease modification.

- BC267G For the reasons set out in paragraph BC5.306 of the Basis for Conclusions to IFRS 9, the Board provided a practical expedient to account for a lease modification required by the reform applying paragraph 42 of IFRS 16. This 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 that are required as a result of the reform (see paragraphs 5.4.6 and 5.4.8 of IFRS 9). For this purpose, consistent with the amendments to IFRS 9, a lease modification required by the reform is a lease modification that satisfies two conditions—the modification is necessary 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).
- BC267H The practical expedient provided for 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.
- BC267I In contrast to the amendments for financial assets and financial liabilities in IFRS 9 (see paragraph 5.4.9 of IFRS 9), the Board decided not to specify the order of accounting for lease modifications required by the reform and other lease modifications. This is because 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.
- BC267J 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 amend the requirements for accounting for modifications to lease contracts from the lessor’s perspective. The Board did not make such amendments because, for finance leases, a lessor is required to apply the requirements in IFRS 9 to a lease modification, so the amendments in paragraphs 5.4.5–5.4.9 of IFRS 9 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 provide useful information about the modification in terms and conditions required by the reform in the light of the mechanics of the operating lease accounting model.