ASC
ACCOUNTING STANDARDS COUNCIL
SINGAPORE

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(By online submission)

Dear Hans

RESPONSE TO EXPOSURE DRAFT ON INTEREST RATE BENCHMARK REFORM—PHASE 2 (PROPOSED AMENDMENTS TO IFRS 9, IAS 39, IFRS 7, IFRS 4 AND IFRS 16)

The Singapore Accounting Standards Council appreciates the opportunity to comment on the Exposure Draft on *Interest Rate Benchmark Reform—Phase 2* (Proposed amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16) (the ED) issued by the International Accounting Standards Board (the IASB or the Board) in April 2020.

We appreciate the IASB's efforts in addressing, as a priority, the accounting issues that arise from the reform of interest rate benchmarks. Subject to our specific comments, we are generally supportive of the proposed amendments. The proposed amendments would enable entities to provide useful information about the effects of the interest rate benchmark reform (as defined in the ED and hereinafter referred to as the reform) on their financial statements.

Our specific comments on the ED are as follows:

Question 1—Modifications of financial assets and financial liabilities (paragraphs 6.9.1–6.9.6 of the [Draft] amendments to IFRS 9, paragraphs 20R–20S and 50–51 of the [Draft] amendments to IFRS 4 and paragraphs 104–106 and C1A–C1B of the [Draft] amendments to IFRS 16)
Paragraphs 6.9.2–6.9.6 of the draft amendments to IFRS 9 propose that: (a) a financial asset or financial liability would be modified if the basis for determining the contractual cash flows is changed after the initial recognition of the financial instrument. In this context, a modification can arise even if the contractual terms of the financial instrument are not amended.

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(b) an entity would apply paragraph B5.4.5 of IFRS 9 as a practical expedient to account for a modification of a financial asset or financial liability that is required by interest rate benchmark reform.

(c) a modification is required by interest rate benchmark reform if and only if (i) it is required as a direct consequence of interest rate benchmark reform; and (ii) the new basis for determining the contractual cash flows is economically equivalent to the previous basis (ie the basis immediately preceding the modification).

(d) an entity would also apply the practical expedient proposed in paragraph 6.9.3 if an existing contractual term is activated that results in a change in the basis for determining the contractual cash flows of a financial asset or a financial liability, and particular other conditions are met.

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

(e) The Exposure Draft proposes to make corresponding amendments to IFRS 4 that would require insurers applying the temporary exemption from IFRS 9 to apply the same practical expedient as described above.

(f) The Exposure Draft proposes amendments to IFRS 16 that would require entities to apply paragraph 42 of IFRS 16 to account for a lease modification that is required by interest rate benchmark reform.

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

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

We are generally supportive of the principles underlying the proposed amendments on the basis of the IASB's rationale.

However, we have the following comments on the proposed amendments:

Description of 'modification' solely for the purpose of the proposed amendments

We are concerned that introducing a description of 'modification' solely for the purpose of applying the proposed amendments, including the proposed paragraph 6.9.6 of IFRS 9, could have unintended consequences, for example, by giving rise to additional complexity and interaction issues.

A modification can arise even if the contractual terms of the financial instrument are not amended, but not from an activation of existing contractual terms. In both cases, the contractual terms are not amended, and therefore, an attempted distinction between these two cases could create confusion and add unnecessary complexity. The distinguishing factor

appears to be whether or not the changes to the basis for determining the contractual cash flows required by the reform would have been contemplated in the existing contract, but that factor is not articulated in the proposed amendments.

Furthermore, the term ‘additional modifications’ is used in the proposed paragraph 6.9.6 to describe changes to the basis for determining the contractual cash flows in addition to the changes required by the reform. It is possible that the term is read in a way to include changes that did not arise from an amendment to the contractual terms. Therefore, there is a risk that the proposed accounting for ‘additional modifications’ may be applied to changes not required by the reform that did not arise from an amendment to the contractual terms. It would be inconsistent with the notion of ‘modification’ in IFRS 9 being applied in practice.

Besides, our stakeholders have raised a potential risk of the description of ‘modification’ being applied more broadly than intended by analogy, in the absence of guidance in IFRS 9 on what constitutes a ‘modification’ of a financial asset or financial liability.

Therefore, we recommend that the IASB considers refining the current drafting as follows:

(a) The proposed practical expedient applies to a change to the basis for determining the contractual cash flows after the initial recognition of the financial instrument, and that change meets the following conditions:

    (i) the change is required as a direct consequence of the reform; and

    (ii) the new basis for determining the contractual cash flows is economically equivalent to the previous basis (i.e. the basis immediately preceding the change).

(b) The change could be made by:

    (i) amending the contractual terms of the financial instrument;

    (ii) changing the basis for determining the contractual cash flows of the financial instrument, without amending its contractual terms (e.g. the reform is effected by changing the method for calculating the interest rate benchmark); or

    (iii) activating existing contractual terms, which change the basis for determining the contractual cash flows of the financial instrument.

In our view, this approach has the potential to achieve the intended accounting outcomes, without the concerns of the current drafting.

In addition, we encourage the IASB to develop narrow-scope amendments to provide a description of ‘modification’ that would apply to all modifications of financial instruments within the scope of IFRS 9, and to eliminate existing differences in the wording used in IFRS 9 to describe a modification of financial assets and a modification of financial liabilities.

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The 'economically equivalent' condition

While we are supportive of the principles underlying the 'economically equivalent' condition, this term is not ordinarily used in existing IFRS Standards. The Basis for Conclusions provides an example to explain this term, but it is not part of IFRS Standards.

Therefore, we believe that additional guidance on the 'economically equivalent' condition would help to reduce potential diversity in the assessment of an important condition that ensures discipline around the application of the practical expedient, particularly when entities are implementing the reform under time pressure.

For example, the IASB could consider clarifying the following matters:

(a) Whether and when a quantitative assessment is required, and how the quantitative assessment is performed, for example, by determining whether the discounted present value of the cash flows is substantially similar before and after the transition.

(b) Whether the spread adjustment used in the derivative markets could be a reference point for cash market products.

(c) Whether the following spread adjustments could cause the condition to fail:

    (i) differences in contractual cash flows as a result of applying fallback mechanisms of internationally recognised bodies such as ISDA; and

    (ii) additional spread to compensate for administrative costs incurred to effect the transition.

Question 2—Amendments to hedging relationships (paragraphs 6.9.7–6.9.10 of the [Draft] amendments to IFRS 9 and paragraphs 102O–102R of the [Draft] amendments to IAS 39)
Paragraphs 6.9.7–6.9.10 of the draft amendments to IFRS 9 and paragraphs 102O–102R of the draft amendment to IAS 39 propose that an entity would amend the formal designation of the hedging relationship only to make one or more of the changes specified in paragraph 6.9.7 and paragraph 102O as and when uncertainty arising from interest rate benchmark reform is no longer present with respect to the hedged risk and/or the timing and the amount of interest rate benchmark-based cash flows of the hedged item or of the hedging instrument. Paragraphs BC42–BC50 of the Basis for Conclusions describe the Board's reasons for these proposals. Do you agree with these proposals? Why or why not? If you agree with only parts of the proposals, please specify what you agree and disagree with. If you disagree with the proposals, please explain what you propose and why.

We are generally supportive of the proposed amendments on the basis of the IASB's rationale.

Nevertheless, a literal reading of the permitted changes to hedge designation, as described in the proposed paragraph 6.9.7 of IFRS 9 and the proposed paragraph 102O of IAS 39, seems to rule out any other necessary changes to hedge documentation. Therefore, we recommend that the IASB considers clarifying that the permitted changes to hedge designation include any changes that are necessary to effect those permitted changes, such as the changes as described in the proposed paragraph 6.9.4(c) of IFRS 9.

Question 3—Accounting for qualifying hedging relationships and groups of items (paragraphs 6.9.11–6.9.15 of the [Draft] amendments to IFRS 9 and paragraphs 102S–102X of the [Draft] amendments to IAS 39)
Paragraphs 6.9.11–6.9.15 of the draft amendments to IFRS 9 and paragraphs 102S–102X of the draft amendments to IAS 39 propose that: (a) the requirements in IFRS 9 and IAS 39 would be applied when the designation of a hedging relationship is amended to remeasure the hedging instrument and the hedged item based on the alternative benchmark rate and recognise any resulting ineffectiveness in profit or loss. (b) the amount accumulated in the cash flow hedge reserve at the date the entity amends the description of the hedged item would be deemed to be based on the alternative benchmark rate on which the hedged future cash flows are determined. (c) when there is a change in the basis for determining the contractual cash flows of a financial asset or a financial liability previously designated as a hedged item in a hedging relationship that has been discontinued, the amount accumulated in the cash flow hedge reserve for the discontinued hedging relationship would be deemed to be based on the alternative benchmark rate on which the hedged future cash flows will be based. (d) when applying paragraph 6.9.7 or paragraph 102O to groups of items designated as hedged items, the hedged items would be allocated to sub-groups within the same hedging relationship based on the benchmark rate to which they are referenced and that the proportionality test would be applied to each sub-group separately. (e) for the purpose of assessing retrospective effectiveness as required by IAS 39, the cumulative fair value changes of the hedged item and hedging instrument would be reset to zero when paragraph 102G of IAS 39 ceases to apply. Paragraphs BC51–BC79 of the Basis for Conclusions describe the Board's reasons for these proposals. Do you agree with these proposals? Why or why not? If you agree with only parts of the proposals, please specify what you agree and disagree with. If you disagree with the proposals, please explain what you propose and why.

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We are supportive of the proposed amendments on the basis of the IASB's rationale.

Portfolio hedges of interest rate risk

During an entity's transition to an alternative benchmark rate, a portfolio of financial assets and/or financial liabilities could consist of items still referenced to the interest rate benchmark as well as items that are already referenced to the alternative benchmark rate. For interest rate risk management purposes, the entity may continue to manage those items together on a portfolio basis. However, hedge accounting is discontinued, if the items in the portfolio do not share the risk being hedged during the transition period.

During the development of the proposed amendments, the IASB tentatively decided to amend IAS 39 to require an entity changing the hedged risk in the hedge documentation for a portfolio hedge of interest rate risk to assume that all items included in the portfolio of financial assets or financial liabilities share the risk being hedged. That tentative decision is not reflected as a proposed amendment in the ED.

Therefore, we encourage the IASB to provide the relief as described in its tentative decision. If the IASB were to conclude that a relief from the requirement would not be necessary, the IASB should explain its rationale in the Basis for Conclusions on the final amendments.

Question 4—Designation of risk components and portions (paragraphs 6.9.16–6.9.18 of the [Draft] amendments to IFRS 9 and paragraphs 102Y–102Z1 of the [Draft] amendments to IAS 39)
Paragraphs 6.9.16–6.9.18 of the draft amendments to IFRS 9 and paragraphs 102Y–102Z1 of the draft amendments to IAS 39 propose that: (a) an alternative benchmark rate designated as a non-contractually specified risk component that is not separately identifiable at the date it is designated, would be deemed to have met that requirement at that date, if and only if, the entity reasonably expects the alternative benchmark rate will be separately identifiable within a period of 24 months from the date the alternative benchmark rate is designated as a risk component. (b) if subsequently, an entity reasonably expects that the alternative benchmark rate will not be separately identifiable within 24 months from the date it was designated as a risk component, an entity would cease applying the requirement in paragraph 6.9.16 and paragraph 102Y and discontinue hedge accounting prospectively from the date of that reassessment. Paragraphs BC87–BC97 of the Basis for Conclusions describe the Board's reasons for these proposals. Do you agree with these proposals? Why or why not? If you agree with only parts of the proposals, please specify what you agree and disagree with. If you disagree with the proposals, please explain what you propose and why.

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We are generally supportive of the proposed amendments on the basis of the IASB's rationale.

Nevertheless, paragraph BC92 of the Basis for Conclusions could be read as requiring discontinuation of hedge accounting, if an alternative benchmark rate fails to meet the 'separately identifiable' requirement during the 24-month period – instead of failing to be separately identifiable within the 24-months period. That reading contradicts the IASB's objective of providing an exception to the 'separately identifiable' requirement in the first place.

Therefore, we recommend that the IASB considers refining the drafting of paragraph BC92 to eliminate the apparent inconsistency with the proposed paragraph 6.9.17 of IFRS 9 and the proposed paragraph 102Z of IAS 39.

Question 5—Effective date and transition (paragraphs 7.1.9 and 7.2.36–7.2.38 of the [Draft] amendments to IFRS 9 and paragraphs 108H–108J of the [Draft] amendments to IAS 39)
(a) The Exposure Draft proposes that the amendments would have an effective date of annual periods beginning on or after 1 January 2021. Earlier application would be permitted. (b) The Exposure Draft proposes that the amendments would be applied retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, except as specified in (ii) below. An entity would: (i) reinstate a discontinued hedging relationship if and only if the entity discontinued that hedging relationship solely due to changes required by interest rate benchmark reform and, therefore, the entity would not have been required to discontinue that hedging relationship if the amendments had been applied at that time. (ii) not be required to restate prior periods to reflect the application of these amendments. However, the entity may restate prior periods if, and only if, it is possible without the use of hindsight. Paragraphs BC110–BC115 of the Basis for Conclusions describe the Board's reasons for these proposals. Do you agree with these proposals? Why or why not? If you agree with only parts of the proposals, please specify what you agree and disagree with. If you disagree with the proposals, please explain what you propose and why.

We are generally supportive of the proposed effective date and transition requirements on the basis of the IASB's rationale.

However, we recommend that the IASB considers providing a relief so that an entity does not reinstate discontinued hedging relationships that had been terminated, in accordance with the entity's documented risk management objective, subsequent to the discontinuation of hedge accounting solely due to changes required by the reform but before:

(a) the date of initial application of the proposed amendments, if the entity does not restate prior periods; or

(b) the beginning of the earliest period presented, if the entity restates prior periods.

In our view, the benefits of reinstating such hedging relationships, only to subsequently discontinue those hedging relationships before the date of initial application or the beginning of the earliest period presented, would not outweigh the associated costs. Besides, reinstating such hedging relationship is not always practicable due to system constraints.

Question 6—Disclosures (paragraphs 24I–24J and paragraphs 44HH–44II of [Draft] amendments to IFRS 7)
The Exposure Draft proposes that entities provide specific disclosures in order to provide information about: (a) the nature and extent of risks arising from interest rate benchmark reform to which the entity is exposed, and how it manages those risks; and (b) the entity's progress in completing the transition from interest rate benchmarks to alternative benchmark rates, and how the entity is managing that transition. Paragraphs BC105–BC109 of the Basis for Conclusions describe the Board's reasons for this proposal. Do you agree with this proposal? Why or why not? If you disagree with the proposal, please explain what you propose and why.

We are generally supportive of the proposed disclosure requirements on the basis of the IASB's rationale.

Nevertheless, we recommend that the IASB considers the following changes to the proposed disclosure requirements:

(a) Additional disclosure of hedge ineffectiveness recognised on the remeasurement of hedged items and hedging instruments at the time that the hedge designation is amended. IFRS 7 already requires the disclosure of hedge ineffectiveness separately by risk category for the various types of hedges. Therefore, the separate disclosure has the potential to provide useful information about the effect of changes required by the reform, without undue operational burden.

(b) Relief from presentation of comparative information for the quantitative disclosures as described in the proposed paragraph 24J(b) of IFRS 7. The current-period disclosures

will provide information about the entity's exposure to risks arising from the reform and progress in completing the transition, without a need for comparative information. Besides, comparative information may not be useful, particularly if the entity does not restate prior periods. Therefore, the benefits of presenting comparative information are unlikely to outweigh the costs of such disclosures.

We hope that our comments will contribute to the IASB's deliberation on the ED. Should you require any further clarification, please contact our project manager Yat Hwa Guan at Guan_Yat_Hwa@asc.gov.sg.

Yours faithfully

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