Hong Kong Institute of
Certified Public Accountants
香港會計師公會

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Sent electronically through the IASB Website (www.ifrs.org)

20 June 2019

Mr Hans Hoogervorst
International Accounting Standards Board
Columbus Building
7 Westferry Circus
Canary Wharf
London E14 4HD
United Kingdom

Dear Hans,

IASB Exposure Draft ED/2019/1
Interest Rate Benchmark Reform – Proposed amendments to IFRS 9 and IAS 39

The Hong Kong Institute of Certified Public Accountants (HKICPA) is the only body authorised by law to set and promulgate standards relating to financial reporting, auditing and ethics for professional accountants, in Hong Kong. We are grateful for the opportunity to provide you with our views on this Exposure Draft (ED).

The HKICPA appreciates the need for the IASB's proposals to provide temporary relief to entities when they apply specific hedge accounting requirements in IFRS 9 *Financial Instruments* and IAS 39 *Financial Instruments: Recognition and Measurement* during the period of uncertainty arising from the interest rate benchmark reform. Although the proposals do not provide a comprehensive solution to fully address the financial implications as a result of the reform, the HKICPA agrees that the ED serves as a practical interim solution for financial reporting issues that arise in the period before the replacement of an existing interest rate benchmark. Nevertheless, the HKICPA has suggested some improvements that would help to clarify the proposals in the Appendix to this letter.

The HKICPA notes that the IASB will deal with financial reporting issues that arise on transition to an alternative interest rate in the second phase of the project. Given the current development of the reform and the potential reaction of the market (e.g. amending legacy contracts), entities are likely to face these issues very soon and so the HKICPA considers the second phase is as urgent as, if not more important than, the first phase of this project. Therefore, the HKICPA strongly urges the IASB to work on the second phase of the project in parallel as the first phase and complete both phases as soon as possible in order to fully address the financial reporting implications of the reform.

Our detailed responses to the questions raised in this ED are in the Appendix.

If you have any questions regarding the matters raised in this letter, please contact me or Eky Liu (eky@hkicpa.org.hk) Associate Director of the Standard Setting Department.

Sincerely,

Christina Ng
Director, Standard Setting Department

APPENDIX

Work undertaken by HKICPA in forming its views:

The HKICPA:
(a) issued an Invitation to Comment on the ED on 7 May 2019 to our stakeholders;
(b) sought input from its Financial Instruments Advisory Panel comprising technical and industry experts and auditors from accounting firms; and
(c) developed its views through its Financial Reporting Standards Committee, having reflected on its stakeholder feedback. The Committee comprises of academics, preparer representatives from various industry sectors, investors, regulators, and technical and industry experts from small, medium and large accounting firms.

Detailed comments on the ED

Overall approach

The HKICPA appreciates the need for the IASB's proposals to provide temporary relief to entities when they apply specific hedge accounting requirements in IFRS 9 and IAS 39 during the period of uncertainty arising from the reform. Without the proposed relief, it would be challenging for entities to assess the uncertainty arising from the reform and hedge effectiveness. In addition, some of our investors informed us that the one-off impact on profit or loss from discontinuing hedge accounting, solely due to the uncertainties before the reform's economic effects are known, would not provide useful information to them. They considered that disclosures about how an entity's future cash flows from hedging instruments and hedged items could be affected by the reform and how the entity manages its interest rate risk in the context of the reform would be more useful.

Nevertheless, the HKICPA is concerned that the proposals could have unintended future consequences. The ED was driven by the Financial Stability Board's recommendations to reform existing interest rate benchmarks. We are concerned that the proposals may create expectations that similar relief might be considered in other circumstances, for example, if other reforms (e.g. changes in the commodity markets) occur, even within a single jurisdiction. We think that the IASB should explain clearly in the final Basis for Conclusions why this reform warrants standard-setting activity, including the objective and special circumstances for providing the proposed relief, to help understanding and to manage future expectations.

Finally, the HKICPA considers that the proposals only serve as an interim solution to the issues arising from the uncertainty of the reform on the forward-looking hedge accounting requirements. The HKICPA notes that the IASB will deal with other issues, including those that arise on transition to an alternative interest rate, in the second phase of the project. Given the current development of the reform and the potential reaction of the market (e.g. amending legacy contracts), entities are likely to face these issues very soon and so the HKICPA considers the second phase is as urgent as, if not more important than, the first phase of this project. Therefore, the HKICPA strongly urges the IASB to work on the second phase of the project in parallel as the first phase and complete both phases as soon as possible in order to fully address the financial reporting implications of the reform.

Question 1: Highly probable requirement and prospective assessments

The HKICPA agrees with the proposed amendments regarding the highly probable requirement and prospective assessments for the reasons stated in the above 'overall approach' section of this Appendix.

Question 2: Designating a component of an item as the hedged item

The HKICPA agrees with the proposed amendments relating to separately identifiable risk components for the reasons stated in the above 'overall approach' section of this Appendix.

The HKICPA notes that paragraphs BC25 and BC31 of the ED state that the proposed relief is to be provided to non-contractually specified risk components only. However, the proposed amendments to the standards (paragraph 6.8.7 of IFRS 9 and paragraph 102G of IAS 39) do not specify to which risk components the relief would be applied. The HKICPA recommends that the IASB clarifies in the standards whether the relief should be provided to non-contractually risk components only.

Question 3: Mandatory application and end of application

The HKICPA supports mandatory application of the proposed exceptions to avoid selective discontinuation of hedge accounting and reclassification of the hedging reserve to profit or loss, thereby also enhancing comparability of financial statements across entities.

For the reasons stated in paragraphs BC32-BC42 of the ED, the HKICPA supports the proposals that the exceptions would be temporary in nature and entities would cease applying them when the conditions specified in paragraphs 6.8.8 to 6.8.10 and paragraphs 102H to 102J of the ED are met.

The HKICPA finds the various scenarios provided in paragraphs BC35-BC40 of the ED useful for entities to understand when they should cease applying the proposed exceptions, in particular, when the contract is amended in anticipation of the reform. The HKICPA recommends that the IASB makes these scenarios more accessible by including them as illustrative examples accompanying the standards instead of in the Basis for Conclusions.

Question 4: Disclosures

The HKICPA supports the proposed disclosures and considers that they would provide users of financial statements with useful information about the extent to which hedging relationships could be impacted by the reform. We do not expect that entities would need to incur undue cost or effort in preparing the proposed disclosures.

Given the potential implications of the reform, the HKICPA also expects that entities should provide additional information about the reform under the existing risk management disclosure requirements in paragraphs 22A to 22C of IFRS 7 *Financial Instruments: Disclosures*. For example, disclosures about how an entity's future cash flows from hedging instruments and hedged items could be affected by the reform and how the entity manages its interest rate risk in the context of the reform. The IASB should emphasise the importance of entities providing sufficient information about the impact of the reform in the final amendments.

Question 5: Effective Date and Transition

The HKICPA supports the proposed effective date and permitted earlier application in view of the urgency of the relief.

The HKICPA also supports the retrospective approach proposed in the ED because it would provide relief from the need to look back to prior reporting periods and consider whether hedges should have already been discontinued as a result of the uncertainty arising from the reform. Entities would be able to continue hedge accounting for hedging relationships that were previously qualified for hedge accounting under IAS 39 or IFRS 9.

Other comments

The HKICPA would also like to draw your attention to the following issues that are not currently dealt with in the ED.

- As explained in the above 'overall approach' section, the HKICPA is concerned that the proposals in the ED may create expectations that similar relief might be considered in other circumstances, for example, if other reforms occur even within a single jurisdiction. We think the IASB should explain clearly in the final Basis for Conclusions why this reform warrants standard-setting activity, including the objective and the special circumstances for providing the proposed relief, to help understanding and to manage future expectations.
- The proposed relief applies only to hedging relationships of interest rate risk that are affected by the reform (paragraph BC6 of the ED). The HKICPA considers that the reform could also impact certain hedges of foreign currency risk, for example, in cross currency interest rate swap arrangements. The HKICPA recommends that the IASB clarifies in the final amendments whether an entity should also apply the proposed relief to such arrangements, and if not, the basis for such conclusion.
- The ED does not propose any exception from the requirement for a risk component to be reliably measureable (paragraph BC27 of the ED). The HKICPA considers that questions about the reliably measurable requirement could arise when the existing interest rate benchmark (e.g. 3-month LIBOR) is no longer available, for example, in a fair value hedge. Further guidance in this area would be helpful.
- The ED is not clear how the cumulative amount in the cash flow hedge reserve is accounted for at the date the proposed relief ends. For example, when an entity amends the contractual terms of both its hedging instrument and hedged items from LIBOR to an alternative interest rate, the ED would require the entity to cease applying the relief because the uncertainty from the reform is no longer present. This means that the entity would discontinue hedge accounting and reclassify the full amount of the related cash flow hedge reserve to profit or loss. The HKICPA thinks this accounting outcome may not be consistent with the rationale behind the ED given that the designated risk, LIBOR, may still be expected to occur via the alternative interest rate. We recommend that the IASB clarifies the accounting treatment.
- The ED does not propose any exception for the effects of the reform on retrospective assessments under IAS 39 (paragraph BC 23 of the ED). The HKICPA considers that entities may fail this assessment solely because of the reform. For example, ineffectiveness could arise temporarily as a result of the differences in the changes in the cash flows of the hedged item and the hedging instrument due to the differences in the timing in updating the contracts. We recommend that the IASB considers, in such case, whether relief for retrospective assessments would be necessary.

~ End ~