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

Summary of meeting with Financial Instruments Advisory Panel
(Extract of minutes)

Date: 29 April 2020, Wednesday
Time: 9:30 a.m. – 12:00 noon
Venue: Boardroom, 37/F., Wu Chung House, 213 Queen's Road East, Wanchai, Hong Kong (and via videoconference)

Present:	Panel members	HKICPA staff
	Eros Lau, Deloitte	Michelle Fisher, Deputy Director
	Fran Hung, Deloitte	Carmen Ho, Associate Director
	Mateusz Lasik, Deloitte	Eky Liu, Associate Director
	Joe Ng, Ernst & Young	Joni Kan, Associate Director
	Isabel Lin, KPMG	Katherine Leung, Associate Director
	Martin Friedhoff, KPMG	
	Lisa Zhang, PwC	

ED/2020/1 Interest Rate Benchmark Reform – Phase 2 (Proposed Amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16)

Comments on the overall direction of the ED

- Most panel members supported the overall direction of providing a practical expedient and relief to help entities to address the financial reporting issues arising from the replacement of an interest rate benchmark.
- One panel member considered that the guidance about what is a modification in the context of the interest rate benchmark reform ('the reform') is helpful. This member also considered that without the relief for specific hedge accounting requirements, there would be difficulties for preparers to consider re-designating all of their hedging relationships.
- One panel member considered that the Phase 1 amendments only provided an interim measure to address the pre-replacement financial reporting issues arising from the reform and so there is a need to address the issues arising on replacement of the interest benchmark in Phase 2. This member also questioned whether the use of the term 'practical expedient' is appropriate as the proposed amendments for modification are mandatory 'exceptions' from the current requirements.

Modifications of financial assets and financial liabilities

- One panel member suggested deleting the words 'required as' in paragraph 6.9.3 of the ED as this member considered that there is no need to assess whether the modification is required by the contract or regulation/law.
- Most panel members supported the proposals of what constitutes a modification in the context of the reform (paragraphs 6.9.2 of the ED), examples of modifications (paragraph 6.9.4 of the ED) and the qualifying criteria for the practical expedient (paragraph 6.9.3 of the ED). Most panel members also considered that preparers generally would not have any major practical difficulties in applying these amendments (such as what is meant by economically equivalent, modification caused by the reform etc.)
- One panel member considered that with the addition of a fallback provision in paragraph 6.9.4 (d), preparers may take the opportunity to update other contract terms that are not allowed under paragraph 6.9.4 (a)-(c) and are not caused by the reform. This member also questioned whether the scope of what should be included in the

fallback provision is clear in the proposed amendments. Another member considered that paragraph 6.9.4. (a) – (c) adequately addresses what could be covered in the fallback provision and that entities would be required to apply paragraph 6.9.6 of the ED if there are changes other than those that qualify for the practical expedient.

- All panel members agreed with the following proposals:
  (i) The corresponding amendments to IFRS 4;
  (ii) The proposed amendments to IFRS 16; and
  (iii) No amendments to other IFRS Standards are necessary.

Amendments to hedging relationships

- One panel member questioned under paragraph 6.9.7 of the ED, whether entities would encounter any practical difficulties if they were required to amend the hedge designation exactly on the date of transition or whether there is any flexibility for entities to amend it before the end of their interim reporting period. Two panel members considered that amending the hedge designation and the documentation is not an issue, the difficult part is to identify when the transition happens. Also, these two panel members considered that other than amending the hedge documentation, entities also need to do a prospective assessment, and a retrospective assessment (for IAS 39 only), and determine the gain or loss as in paragraph 6.9.11 of the ED on the date of transition. These two members considered that the IASB could provide relief for the entities to amend the hedge designation between the date of transition and the end of the reporting period. Most panel members also recommended that the IASB makes clear in the standard that entities also need to do a prospective test (for both IFRS 9 and IAS 39) and retrospective test (for IASB 39 only) when amending the hedge designation.

Accounting for qualifying hedging relationship and groups of items

- One panel member did not agree with the proposed amendments in paragraph 6.9.11 of the ED. This member considered that the gain or loss arising from remeasurement should be amortised to profit or loss over time instead of charging it to profit or loss immediately at the time the hedge designation is amended, as when hedge accounting is discontinued. Other members considered that the proposed amendments allow entities to continue the existing hedging relationships, which is not comparable to the case when entities discontinue hedge relationships. They agreed with the IASB's explanation for the proposed accounting treatment in paragraph BC 61(a) of the ED.
- One panel member questioned whether entities require the history of the alternative benchmark rate to remeasure the carrying amount of the hedged item in paragraph 6.9.11(b). Another member considered that 6.9.11(b) requires entities to discount the old cash flow designated using the new benchmark rate to arrive at the end point of fair value adjusted by risk. It was noted that based on the current wording it would appear that under the proposed paragraph 6.9.7(b) while "description of the hedged item" is to be amended so that "it refers to the alternative benchmark rate", it appears that the wording may not allow, in the case of a fair value hedge, for an adjustment to the designated portion of the hedged item such that the portion is equal to the new alternative benchmark rate so as to minimize ineffectiveness. For instance in case where previous portion designated was equal to the LIBOR, say 4% portion of the full cash flows of 5%, not clear if the hedged item portion can/should be adjusted to different, lower portion that corresponds to new alternative benchmark rate of EONIA/SONIA etc. It was also noted that there was an equivalent issue for cash flow hedges (that again could lead to ineffectiveness going forward as well as one off issue on adoption) in the case of the wording of proposed paragraph 6.9.12(b). In particular

in that case the issue in practice is that while "the cumulative change in fair value of the hedged item calculated based on the alternative benchmark rate" means that the discounting is using the new rate the wording may not allow for a reset of the fixed leg of the hypothetical derivative that is in practice used to measure the hedged item.

- Two panel members recommended that the IASB provides clarification on how to mechanically apply paragraph 102S when the entity resets to zero the cumulative item and hedging instrument.

Designation of risk components and portions

- Two panel members considered that the IASB did not provide a clear rationale for the proposed 24-month period with regard to the separately identifiable risk components. One member considered that it is like a 2-year grace period when entities could be exempted from the current requirements. Another member considered that the market would be expected to develop in a short period of time, e.g. in 6 months. But panel members generally did not express concerns about this proposal.
- Most panel members recommended that the IASB clarifies the consequence of discontinuing hedge accounting in paragraph 6.9.17 of the ED, i.e. whether the cash flow hedge reserve should be immediately recycled to profit or loss when an entity expects that the alternative benchmark rate will not be separately identifiable within 24 month from the date it was designated as a risk component.

Effective date and transition

- Two panel members noted that the ED introduced a new concept of reinstating a discontinued hedging relationship on transition, which is inconsistent with the current requirements in IFRS 9 and IAS 39 in which hedge accounting is applied prospectively. These members considered that in practice, once a hedge is discontinued, the derivatives would have been re-designated in other hedging relationships. Therefore, panel members recommended that the IASB clarifies:
  (i) The rationale for requiring reinstatement of a discontinued hedging relationship; and
  (ii) Which hedging relationship would survive if an entity has already re-designated the derivative in another hedging relationship.

Disclosures

- Panel members do not have comments on the proposed disclosures. One Panel member observed that they would not be onerous for entities.

Conference call with Financial Instrument Advisory Panel

Date: 12 May 2020, Tuesday
Time: 3:00 p.m. – 3:45 p.m.

Present:	**Panel members**	**HKICPA staff**
	Mateusz Lasik, Deloitte	Michelle Fisher, Deputy Director
	Joe Ng, Ernst & Young	Carmen Ho, Associate Director
	Martin Friedhoff, KPMG	Eky Liu, Associate Director
	Ian Farrar, PwC	

- The purpose of the call was to discuss the concern raised by a panel member regarding the proposed amendments in relation to fair value hedges and cash flow hedges.
- All panel members expressed concerns about how paragraphs 6.9.11 and 6.9.12 of the ED should be interpreted and applied.

Fair value hedges

- Panel members considered that paragraph 6.9.11, together with the explanation in paragraph BC63 of the ED, may be read as requiring entities to remeasure both the hedging instrument and the hedged item at the same time based on the new benchmark rate on an 'as if' basis, regardless of whether the hedged item has been changed. Most panel members questioned the conceptual rationale and the usefulness of recognising an immediate gain or loss from remeasuring the hedged item (e.g. a fixed-rate loan) if the hedged item has not changed, and when this does not reflect the actual risk being hedged prior to the modification. They considered that this accounting outcome does not reflect the economic effects of the transition to alternative benchmark rates and would result in less useful information than if the hedge was discontinued.
- In addition, all panel members are concerned that remeasuring the hedged item on an "as if" basis would pose application complexities for entities because the alternative benchmark rates might not have existed at the inception of the hedging relationships.
- For these reasons, panel members considered that discontinuing the existing hedging relationship and restarting hedge accounting for the new hedging relationship would be more understandable and useful to users of financial statements. Accordingly, they strongly recommended that the IASB deletes paragraph 6.9.11 of the ED and considers an alternative approach that would allow for discontinuation of the existing hedge relationship and designation of a new relationship

Cash flow hedges

- Similar to fair value hedges, panel members expressed significant concerns about the practical difficulties and the usefulness of remeasuring the hedged cash flows based on the alternative benchmark rate on an "as if" basis for cash flow hedges, which they interpret by reading paragraph 6.9.12(b) together with the explanation in paragraph BC63(b) of the ED.
- Similarly, panel members consider that discontinuing hedge accounting for the existing hedging relationship and restarting hedge accounting for cash flow hedges on transition to an alternative benchmark rate would provide more relevant and reliable information. However, they agree relief would still be required to prevent immediate recycling of the cash flow hedge reserve and suggested entities assume the hedged future cash flows are still expected to occur to avoid this.

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