# IBOR reform – Phase 2 discussions on hedge accounting

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## Tentative agreement on how reform of interbank offered rates (IBOR) may affect hedging

### Highlights

– Certain changes in hedge documentation to reflect IBOR reform would not result in discontinuation of the hedge

– Potential amendments to IFRS®9 and IAS®39 to avoid discontinuing a hedge of a group of items

– No changes proposed for valuation adjustments arising from IBOR reform in a continuing hedge relationship

– Next steps – Phase 2 discussions ongoing; an exposure draft is expected in H1 2020

**After IBOR reform, users of financial statements will require clear information on how hedge relationships are affected.**

After the discussion on **modification of financial instruments** in October 2019, the International Accounting Standards Board (the Board) continues to discuss potential hedge accounting issues that could arise as a result of IBOR reform.

At its December meeting, it tentatively agreed that amending hedge documentation to refer to a new benchmark rate would not result in a discontinuation of the hedge in certain instances. The Board also discussed the accounting for a hedge of a group of items and valuation adjustments that might arise following IBOR reform.

**"Preparers and users of financial statements will need to understand the impact on hedge relationships arising from IBOR reform. These discussions provide an early indication of the standard setter's approach."**

Chris Spall,
KPMG's global IFRS financial instruments leader

### Changes in hedge documentation

Changes in hedge documentation would normally cause a discontinuation of the hedge under the current requirements in IFRS 9 *Financial Instruments* and IAS 39 *Financial Instruments: Recognition and Measurement*.

When the changes are directly required by IBOR reform, the Board considered that discontinuing the hedge would not provide useful information for the users of financial statements.

Therefore, the Board tentatively decided to provide an amendment clarifying that the following changes, and only those changes, in hedge documentation would not result in discontinuation of hedge accounting.

– Redefining the hedged risk from current IBOR to an alternative benchmark rate.

– Redefining the description of the hedging instrument and/or hedged items to reflect the alternative benchmark rate.

– Changing the method used for assessing hedge effectiveness following a modification (for IAS 39 only).

## Hedge of a group of items

When a group of items is designated as hedged, the Board noted that different aspects or timing of IBOR-related modifications may cause a discontinuation of the hedge under the current requirements in IFRS 9 and IAS 39, and that this would not provide useful information for the users of financial statements. Therefore, the Board tentatively decided to amend IFRS 9 and IAS 39 to require a company to:

– amend the hedge documentation to create two subgroups of hedged items – one referencing the original interest rate benchmark and the other the alternative benchmark rate;

– perform the proportionality test* separately for each subgroup of items designated in the hedging relationship;

– treat those subgroups as a single hedging relationship, so the hedge effectiveness requirements would be applied in their entirety; and

– treat IBOR and its alternative benchmark rate as if they share similar risk characteristics.

(*) The proportionality test assesses whether the change in cash flows (IFRS 9) or fair value (IAS 39) attributable to the hedged risk for each individual item in the group is expected to be approximately proportional to the overall change of the group.

## Valuation adjustments

IBOR reform may cause valuation adjustments to a continuing hedging relationship, which would often be recognised in profit or loss. The Board tentatively decided that no change to the accounting for those valuation adjustments would be required and they would continue to be accounted for in accordance with the requirements of IFRS 9/IAS 39.

## Next steps

The Board expects to discuss the issues regarding the end of application for **Phase 1 exceptions in hedge accounting**, along with other IFRS Standards and disclosure issues, at its next meeting in January. It is expected that an exposure draft for IBOR Phase 2 will be issued in H1 2020.

Look out for **further updates** and speak to your usual KPMG contact to find out more about the Board's tentative decisions.

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