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

Meeting with Financial Instruments Advisory Panel
(Extract of minutes)

Date: 30 May 2019, Thursday
Time: 2:30 p.m. – 4:30 p.m.
Venue: Room 5, 27/F., Wu Chung House, 213 Queen's Road East, Wanchai, Hong Kong

Present: Joe Ng, Ernst & Young
Isabel Lin, KPMG
Martin Friedhoff, KPMG
Lisa Zhang, PwC
Christina Ng, Standard Setting, HKICPA (attended item 1 only)
Michelle Fisher, Standard Setting, HKICPA
Carmen Ho, Standard Setting, HKICPA
Eky Liu, Standard Setting, HKICPA

1. IASB project on Interest Rate Benchmark Reform

(a) Phase 1: IASB Exposure Draft *Interest Rate Benchmark Reform (Proposed amendments to IFRS 9 and IAS 39)*

General comments:

- Two panel members generally welcomed the proposals to provide relief to entities when they apply specific hedge accounting requirements in IFRS 9 and IAS 39 during the current period of uncertainty arising from the interest rate benchmark reform (reform). Both of them considered that although the ED does not provide comprehensive solutions to the financial reporting issues arising from the reform (it is only an interim solution), the proposal would still be useful to entities. One of these two members considered that it would be challenging for entities to assess the uncertainty arising from the reform and hedge effectiveness if the IASB does not provide any relief to entities.
- Another member did not support the proposals in the ED. This member considered that the IASB has not provided a clear rationale as to why discontinuing hedge accounting solely due to the uncertainty arising from the reform would not provide useful information to users of financial statements (BC 12 of the ED). This member noted that the ED was driven by the Financial Stability Board's recommendations to reform existing interest rate benchmarks. This member observed that this may create expectations that similar relief might be considered in other circumstances, for example if other reforms occur (e.g. changes in the commodity market), even within a single jurisdiction.
- The same panel member considered that if the IASB considers that discontinuing hedge accounting would not provide useful information to users, then the IASB should propose amendments to the hedge accounting requirements (for example, recognise the hedge ineffectiveness directly in reserves or amortise it to profit or loss) instead of ignoring the impact arising from the reform. This member would also support limiting the relief to hedges where both hedging instruments and hedged items are expected to be affected in the same way by the alternative interest rate.
- All panel members agreed that the IASB should commence the work of Phase 2 as soon as possible in order to fully address the financial reporting implications of the reform. Two members noted it was difficult to comment on the ED without understanding the IASB's comprehensive proposals under Phase 2.

Highly probable and prospective assessment

- One panel member expressed some concerns about the proposal in relation to the prospective assessment. This member considered that entities should not just ignore what would happen in the future when performing the prospective assessment. Instead, entities should estimate the impact of the reform on both hedging instruments and hedged items when there is a high degree of certainty of the effect on the hedging relationship. This member noted that there could be cases where the uncertainty in the derivative market is resolved earlier than the cash market, hence resulting in certainty about the future cash flows of hedging instruments but not about the hedged items. In such case, entities should not just ignore the impact on the hedging instrument because of the ongoing uncertainty regarding the hedged item. This member noted that entities would have to apply judgement when determining whether there is a high degree of certainty.
- One panel member also questioned whether continuing hedge accounting would still make sense when the replacement of existing interest rate benchmark gets closer.

Designating a component of an item as the hedged item

- One panel member considered that it is not clear whether the proposal is intended to provide relief to only non-contractually specified risk components or to both contractually and non-contractually specified risk components. This member noted that BC 25 and BC 31 of the ED state that the relief is provided to non-contractually specified risk components only. However, the proposed amendments to paragraph 6.8.7 of IFRS 9 and paragraph 102G of IAS 39 do not specify which risk components. This member questioned whether the relief should be provided to both contractual and non-contractually risk components.
- Another panel member considered that the proposal is intended to provide relief to only non-contractually specified risk components. This member considered that there is no need to provide relief to those risk components that are contractually specified (as noted in the IASB's reasoning in BC25).
- One panel member noted that the IASB does not propose any exception from the requirement for a risk component to be reliably measureable (BC 27 of the ED). This member considered that there would be questions arising from the reliably measureable requirement when the existing interest rate benchmark is no longer available (eg if a 3 month LIBOR rate is no longer available), for example, in a fair value hedge.

Mandatory application

- Two panel members supported mandatory application of the proposals because it would avoid entities selectively discontinuing hedge accounting and hence enhance comparability of financial statements across entities.
- Another panel member disagreed with mandatory application because it would be unreasonable to require mandatory application of proposals that would not fairly reflect the impact of the reform to entities.

End of application

- One panel member considered that there is no need to propose requirements for when entities should cease applying the exceptions if the prospective assessment incorporates a requirement to assess the impact of the reform when there is a high degree of certainty.
- Another panel member considered that it is not clear in BC 43 of the ED as to why the IASB does not propose an end of application in relation to the separate identification requirement.

Disclosures

- One panel member supported the proposed disclosure. This member considered that the IASB should also provide an exception to IAS 8 that requires entities to disclose the impact of the proposals on the current year's financial statements.
- Two panel members noted that many entities provide 'boilerplate' disclosures in relation to the current disclosure requirements about an entity's risk management strategy on hedge accounting under IFRS 7. These members considered that entities should provide disclosures that are specific to the entities, in particular, specifying how entities manage their long term interest rates/the impact arising from the reform.

Effective date and transition

- Two panel members noted that the IASB proposes that the amendments would be applied retrospectively. However, these members considered that it is not a full retrospective approach as it does not allow reinstatement of hedge accounting that has already been discontinued, or allow designation in hindsight (BC 46 of the ED).
- One panel member believed that prospective application from the date of initial application would be more appropriate.
- Another panel member noted that the retrospective application proposed in the ED would provide relief from the need to look back to reporting periods before the final proposals are published and consider whether hedges should have already been discontinued as a result of the uncertainty arising from the reform.

Other comments

. One panel member considered that it is not clear whether the proposed exceptions apply to interest rate risk only. This member considered that there could also be implications on foreign exchange risk as a result of the uncertainty arising from the reform for those contracts that combine interest rate with foreign exchange risk hedges, e.g. in certain cross currency interest rate swap arrangements.

. The same panel member also suggested providing relief on the retrospective test in IAS 39, in particular the 80-125% threshold because entities may fail this test because of the reform. For example, a relief might require that entities instead apply the economic relationship requirement in IFRS 9.

. Another panel member noted that there will also be questions about measurement issues leading up to the reform, for example how to measure hedge ineffectiveness.

(b) Phase 2: Issues that might affect financial reporting when an existing interest rate benchmark is replaced with an alternative interest rate

- Panel members shared that local entities are currently keeping track of which of their contracts would be affected; however panel members were not aware of any additional activities that have been undertaken by entities to address the implications arising from the reform.
- Panel members considered that the key financial reporting issues arising from the replacement of an existing interest rate benchmark would be:
  (i) modification vs derecogniton
  (ii) hedge accounting
- Panel members noted that the HKMA is proposing to retain HIBOR while introducing an alternative interest rate. They expected that there would not be great impact to those contracts that are based on HIBOR. However, there would be definitely an impact to those contracts that are based on LIBOR as LIBOR may discontinue after 2021.