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

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25 May 2020

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

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 IASB's initiative and timely response to the financial reporting issues that arise from the interest rate benchmark reform (the reform). Overall, the HKICPA welcomes and supports the proposals in the ED and generally agrees that they would provide useful information to users about the effect of the reform on an entity's financial statements while reducing the operational burden on preparers.

That said, some of our stakeholders have expressed concerns about the proposed amendments in relation to fair value and cash flow hedges. Specifically, they are concerned about the conceptual rationale for and the practical difficulties of remeasuring the hedged cash flows (in a cash flow hedge) and the hedged risk (in a fair value hedge) based on the alternative benchmark rate on an "as if" basis, which they interpret by reading paragraphs 6.9.11, 6.9.12 and BC63 of the ED. Our stakeholders also questioned the relevance of the resulting accounting outcome to users of financial statements. Accordingly, they strongly recommended that the IASB considers an alternative approach that allows for de-designation and re-designation of the hedging relationship. The HKICPA understands that the IASB's intention is to provide relief to entities so that they can continue their existing hedging relationships. However, the HKICPA recommends that the IASB clarifies how these paragraphs of the ED should be interpreted and applied, and reconsiders whether these particular proposals would lead to an outcome aligned with the objective of this project in paragraph BC6 of the ED.

Our stakeholders also raised concerns about the proposal to reinstate a discontinued hedging relationship on transition to an alternative benchmark rate. The HKICPA recommends that the IASB explains the rationale for this requirement and clarifies which hedging relationships would survive if an entity has already re-designated the derivative in another hedging relationship.

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

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

Yours sincerely,

Michelle Fisher
Deputy Director, Standard Setting Department

APPENDIX 1

Work undertaken by the HKICPA in forming its views:

The HKICPA:
(a) issued an Invitation to Comment on the ED on 14 April 2020 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 academics, preparer representatives from various industry sectors, investors, regulators, and technical and industry experts from small, medium and large accounting firms.

This submission outlines the HKICPA's views as well as the main comments from our stakeholders on the ED. In addition to the comments in this letter, our financial institution preparers provided a few suggestions to further clarify the proposals and address practical challenges and these are attached in Appendix 2.

Question 1—Modifications of financial assets and financial liabilities

The HKCPA supports the IASB's proposal to provide a practical expedient that requires an entity to apply paragraph B5.4.5 of IFRS 9 to account for modifications arising from the reform. We agree that this proposal would provide more useful information to users of financial statements while also reducing the operational burden on preparers.

The HKICPA also supports the IASB's proposal for what constitutes a modification in the context of the reform and the qualifying criteria for the practical expedient. We agree that the description of a modification in paragraph 6.9.2 should only be applicable to modifications included in the scope of the amendments (i.e. limited to changes made as a result of the reform). We consider that extending the scope of the amendments to other changes could have possible unintended consequences and would require a separate project for further discussion.

The HKICPA would also like to highlight the following areas where further clarification and/or improvement would be helpful in the final amendments:

- We recommend replacing the words "is required" with "arises" in paragraphs 6.9.3(a) and 6.9.5(b) of the ED. We consider that the wording "is required" may imply that entities can only apply the practical expedient when the modification is required by law or regulation, and a modification arising as a direct consequence of the reform may not always be required by law or regulation.
- We consider that the term "practical expedient" implies that an entity has an option to apply the proposed requirements in the ED, but the IASB is proposing a mandatory exception to the current requirements. For the avoidance of doubt, the HKICPA suggests that the term "practical expedient" be replaced by "mandatory exception".
- There appears to be an inconsistency between paragraphs 6.9.6 and BC35 of the ED regarding the order of accounting for changes made as a result of the reform and other additional changes. Paragraph BC35 indicates that if there are changes to the basis for determining the contractual cash flows in addition to those required by the reform, an entity would first assess whether those other changes to the financial instrument result in derecognition. However, paragraph 6.9.6 requires an entity to perform this derecognition assessment after the practical expedient is applied to changes made as a result of the reform. We recommend that the IASB clarifies or removes this inconsistency in the final amendments.

The HKICPA agrees with the proposed amendments to IFRS 4 and IFRS 16, and agrees that no amendments to other IFRS Standards are necessary.

Question 2—Amendments to hedging relationships

The HKICPA generally agrees with the IASB's proposals in paragraphs 6.9.7 to 6.9.10 of the ED regarding when entities should be entitled to amend their hedge relationships as a direct consequence of the reform.

However, some of our stakeholders expressed concerns over the sufficiency and completeness of the permitted changes to the hedge documentation in paragraph 6.9.7 of the ED. They noted that there are likely to be several other changes to hedge documentation arising from the transition to alternative benchmark rates, including some of the other items covered by paragraph 6.9.4 of the ED. Accordingly, the HKICPA recommends that those items in paragraph 6.9.7 of the ED be provided as examples of permitted changes rather than an exhaustive list.

In addition, some of our stakeholders also expressed concerns about the potential operational difficulties of complying with paragraph 6.9.7 of the ED as and when the uncertainty arising from the reform is no longer present. They noted that entities may need to amend the formal designation of different hedging relationships at different times or amend the formal designation of a particular hedging relationship more than once. These stakeholders suggested giving entities a period of time during which to comply with the proposed requirements. Therefore, the HKICPA suggests that the IASB permits entities to amend the hedge designation between the point in time when the uncertainty arising from the reform is no longer present and the end of the reporting period. The HKICPA also recommends that the IASB clarifies in the body of the final amendments whether, in addition to amending the formal designation, entities also need to perform a prospective effectiveness test under IFRS 9 and IAS 39 and a retrospective effectiveness test under IAS 39.

Question 3—Accounting for qualifying hedging relationships and groups of items

Fair value hedges

Some of our stakeholders expressed significant concerns about the proposed requirements for fair value hedges in paragraph 6.9.11 of the ED. Specifically, paragraph 6.9.11, together with the explanation in paragraph BC63 of the ED, may be interpreted 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. Some stakeholders 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, our stakeholders 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. Therefore, the remeasurement to reflect changes in value attributable to the alternative benchmark rate would necessitate 'made-up' amounts that would not be relevant for users of financial statements.

For these reasons, for fair value hedges on transition to an alternative benchmark rate, our stakeholders 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 suggested deleting paragraph 6.9.11 of the ED and applying an alternative approach that would allow for discontinuation of the existing hedge relationship and designation of a new relationship.

The HKCPA understands that the IASB's intention is to provide relief to entities so that they can continue their existing hedging relationships. However, we recommend that the IASB clarifies how paragraph 6.9.11 of the ED should be interpreted and applied, and reconsiders whether these particular proposals would lead to an outcome aligned with the objective of this project in paragraph BC6 of the ED.

Cash flow hedges

Similar to fair value hedges, our stakeholders 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, our stakeholders 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, as it would not require an entity, for example, to develop hypothetical derivatives with fixed legs based on 'made-up' rates that might not have existed at hedge inception. 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.

The HKICPA recommends that to help to respond to these concerns the IASB clarifies how paragraph 6.9.12(b) should be interpreted and applied and re-considers whether the resulting outcome would align with the objective of this project in paragraph BC6 of the ED.

Groups of items

The HKICPA agrees with the IASB's proposal in paragraph 6.9.15 of the ED in relation to groups of items designated as hedged items in a hedging relationship.

Retrospective effectiveness test under IAS 39

Our stakeholders questioned how the proposal in paragraph 102S of the ED would be applied to a hedge effectiveness test that is assessed on a cumulative basis. These stakeholders considered that if entities reset the cumulative change in fair value to zero, the hedged item and the hedging instrument will still have a non-zero fair value immediately after ceasing to apply paragraph 102G of IAS 39 and that may impact the effectiveness of the hedge going forward. Some stakeholders also foresee difficulties in using the regression model to perform the test on transition to an alternative benchmark rate. Therefore, the HKICPA recommends that the IASB provides clarification on how to perform the retrospective effectiveness test under IAS 39 based on the proposal in paragraph 102S of the ED.

Question 4—Designation of risk components and portions

The HKICPA agrees with the IASB's proposal to provide temporary relief from the requirement for risk components to be separately identifiable to qualify for hedge accounting to relieve the operational burden on entities when transitioning to the alternative benchmark rate. As noted in paragraph BC95 of the ED, there may be diversity in the approaches to the reform across different jurisdictions. In this context, the HKICPA agrees that 24 months is a reasonable timeframe to allow the relevant markets to develop during the early stages of the reform and for the entities to comply with the separately identifiable criterion while avoiding potential operational disruption.

Nevertheless, our stakeholders note it is unclear, applying 6.9.17, whether the cash flow hedge reserve should be immediately recycled to profit and loss if subsequently an entity reasonably expects that the alternative benchmark rate will not be separately identifiable within the 24 month timeframe. The HKICPA suggests that the IASB considers whether it would be helpful to clarify this in its 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 practical expedient and the relief.

The HKICPA also supports mandatory application of the proposals to avoid selective applications to achieve intended accounting outcomes, thereby enhancing comparability of financial statements across entities. Nevertheless, our stakeholders considered that if the IASB does not adopt their alternative approach (refer our response to question 3 that suggests discontinuing hedge accounting for the existing hedging relationship and designation of a new hedging relationship), they would suggest allowing the voluntary de-designation and re-designation of hedge relationships where entities believe this results in more relevant and reliable information.

Our stakeholders also expressed concerns about the proposed requirement of reinstating a discontinued hedging relationship on transition, which as noted in paragraph BC112 of the ED, is inconsistent with the current requirements in IFRS 9 and IAS 39 in which hedge accounting is applied prospectively. In practice, once a hedge is discontinued, the derivatives may have been re-designated in other hedging relationships. Therefore, the HKICPA recommends that the IASB clarifies:

- the rationale for requiring reinstatement of a discontinued hedging relationship; and
- which hedging relationship would survive if an entity has already re-designated the derivative in another hedging relationship.

Question 6—Disclosures

The HKICPA agrees with the IASB's proposed disclosures and considers that they would provide useful information to users of the financial statements about the effect of the reform on an entity's financial statements and its risk management, while achieving an appropriate cost-benefit balance.

~ End ~

APPENDIX 2

Comments from Hong Kong Association of Banks

HKAB's Comments on IASB Exposure Draft ED/2020/1 Interest Rate Benchmark Reform - Phase 2 Proposed Amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16

No	IASB Question	HKAB Comments / Feedback
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. (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.	We agree with the proposal since it provides useful information to financial statement users, avoids unnecessary modification of financial instruments or introduction of new definition under IFRS 9, and reduce the operational burden on financial statement preparers.

No	IASB Question	HKAB Comments / Feedback
	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.	
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.	We agree with the proposal as it enables entities to continue hedge relationships with modifying hedged items and hedging instruments as a direct consequence of the IBOR reform. This is in line with the economic substance of the transactions. Regarding paragraph 6.9.7 of IFRS 9 and paragraph 102O of IAS 39, in cases where there is a structural market change as a result of the IBOR reform (i.e. overnight floating rate IBOR cash products are replaced with overnight fixed rate cash products), we seek clarification whether such structural market change is permitted. If so, we suggest the IASB to specify such permitted change in the respective paragraphs of IFRS 9 and IAS 39. In respect of the amendments to IAS 39, one of the tentative decision made by the IASB during the meeting held on 11-12 December 2019 previously was not included in the ED, which being the requirement on an entity changing the

No	IASB Question	HKAB Comments / Feedback
	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.	hedged risk in the hedge documentation for a portfolio hedge of interest rate risk to assume all items included in the portfolio of financial assets or financial liabilities share the risk being hedged. Accordingly, we suggest this requirement to be added in the final amendments to IAS 39.
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-	We agree with the proposal as this reflects the underlying economic substance of the transaction properly. We suggest the IASB to provide illustrative examples to elaborate the application for each type of hedging relationship upon the transition to alternative benchmark rate. Also, in cases where the hedge has been regarded as highly effective (i.e. actual results of the hedge are within the range of 80-125 per cent) during Phase 1 of the Interest Rate Benchmark Reform, resetting cumulative effectiveness when assessing retrospective effectiveness in Phase 2 is considered not necessary. Therefore, we suggest the IASB to consider permitting instead of requiring entities to reset cumulative effectiveness when assessing retrospective effectiveness as required by IAS 39.

No	IASB Question	HKAB Comments / Feedback
	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.	
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	We agree with the proposal as it is a practical expedient for hedge accounting application in the context of early stage of the IBOR reform where the market for alternative benchmark rate might not be sufficiently developed. Nonetheless, we suggest the IASB to consider below suggestions: (i) Provide further guidance on the factors or situations which the entities could consider when justifying that they "reasonably expect" the alternative benchmark rate will or will not be separately identifiable; and (ii) Provide clarification on BC87 and BC88 whether an available term structure of zero coupon interest rates is required for a benchmark to be considered separately identifiable. With reference to Paragraph B6.3.14 of IFRS 9, the ability to build a term structure of zero-coupon real interest rates is only relevant to inflation-linked bonds in determining whether inflation risk component is separately identifiable and reliably measurable.

No	IASB Question	HKAB Comments / Feedback
	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.	The proposed wording in BC 87 and BC 88 may impact the existing application of the standard.
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.	We agree with the proposal as it is reasonable in view of the urgency of the IBOR reform implementation and in line with the LIBOR transition's effective date. Nonetheless, we suggest the IASB to consider below suggestions: (i) Entities should be "permitted" but not "required" to reinstate the discontinued hedging relationships that have failed solely due to the impact of IBOR reform. An entity may designate the hedging instrument in the discontinued hedging relationship in a new hedging relationship and re-instating the original hedging relationship may cause the new hedging relationship to fail; and (ii) Provide further guidance on how the entities could demonstrate "without the use of hindsight" in order to avoid confusion on the application of reinstatement. We also seek clarification whether the "without use of hindsight" requirement is also applicable when restating the opening position on the first application date.

No	IASB Question	HKAB Comments / Feedback
	(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.	
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 agree with the proposal as the required disclosures provide a better understanding for the reader of the financial statement on the related risk, the entity's action and the transition progress. Nonetheless, we suggest the IASB to consider below suggestions: (i) Provide illustrative examples of the proposed disclosures, especially on the changes to an entity's risk management strategy as required under paragraph 24J(d) where the current requirement is not specific to a point that enables entities to provide adequate information to comply with it; and (ii) Provide clarification that in the first year of adoption, entities are not required to disclose comparative information for the requirements under paragraph 24J(b).