Deloitte.

A Closer Look

Financial instruments disclosures when applying the amendments to IFRS 9 and IAS 39 on Interest Rate Benchmark Reform

Contents

Talking points

- The Interest Rate Benchmark Reform amendments to IFRS 9 *Financial Instruments* and IAS 39 *Financial Instruments: Recognition and Measurement* issued in September 2019 introduced new disclosures to IFRS 7 *Financial Instruments: Disclosures*. The amendments apply to annual reporting periods beginning on or after 1 January 2020, though it is expected many entities will choose to apply the amendments in advance of that date (subject to local endorsement requirements) in order to avoid any potential disruption to existing designated hedge accounting relationships.

- The new disclosures are required when an entity applies the amendments to IFRS 9 and IAS 39, however, even in the absence of early application of the amendments an entity may consider including such disclosures, particularly given the more general requirement in IFRS 7:22 for an entity to disclose its risk management policies.

- The disclosures are not particularly onerous, though care is needed in integrating them along with pre-existing IFRS 7 disclosures on hedge accounting and risk management.

- A Deloitte IFRS in Focus publication provides more detail on the Interest Rate Benchmark Reform amendments.

Introduction

The amendments to IFRS 7 introduce new disclosure requirements for an entity that applies the amendments to IFRS 9 and IAS 39, Interest Rate Benchmark Reform. Paragraph 24H was added to IFRS 7 and requires that for hedging relationships that are subject to the exceptions introduced by the amendments to IFRS 9 and IAS 39 an entity shall disclose:

(a) the significant interest rate benchmarks to which the entity's hedging relationships are exposed;

(b) the extent of the risk exposure the entity manages that is directly affected by the interest rate benchmark reform;

(c) how the entity is managing the process to transition to alternative benchmark rates;

(d) a description of significant assumptions or judgements the entity made in applying these paragraphs (for example, assumptions or judgements about when the uncertainty arising from interest rate benchmark reform is no longer present with respect to the timing and the amount of the interest rate benchmark-based cash flows); and

(e) the nominal amount of the hedging instruments in those hedging relationships.

Paragraph 44DF was also added to IFRS 7 to exempt entities from applying paragraph 28(f) of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. The absence of an exemption would have required entities to disclose in the first year of application the amount of the adjustment to each financial statement line item and earnings per share.

The following illustrative examples are designed to show how an entity could apply the new disclosure requirements contained in IFRS 7:24H. They do not include financial instruments disclosures required other than those introduced by the amendments to IFRS 7. The interest rate benchmark reform may impact other disclosures, for example, IFRS 7:22 requires an entity to disclose its risk management strategy and paragraph 122 of IAS 1 *Presentation of Financial Statements* requires disclosure of the judgements that management has made in the process of applying the entity's accounting policies that have the most significant effect on the amounts recognised in the financial statements.

The illustrative examples are not intended to be exhaustive or represent the only way in which the information may be presented, e.g. depending on the volume of instruments the quantitative disclosures may be presented on a more aggregated basis. Therefore, application of the disclosure requirements will differ depending on an entity's particular facts and circumstances.

Illustrative Examples

1. Non-financial Corporate Group

Accounting policy (note [X])

In September 2019, the IASB issued *Interest Rate Benchmark Reform – Amendments to IFRS 9, IAS 39 and IFRS 7*. These amendments modify specific hedge accounting requirements to allow hedge accounting to continue for affected hedges during the period of uncertainty before the hedged items or hedging instruments affected by the current interest rate benchmarks are amended as a result of the on-going interest rate benchmark reforms.

The amendments are relevant to the Group given that it applies hedge accounting to its benchmark interest rate exposures. The application of the amendments impacts the Group's accounting in the following ways:

- The Group has issued sterling-denominated and US dollar-denominated fixed rate debt which it fair value hedges using sterling fixed to GBP LIBOR and US dollar fixed to USD LIBOR interest rate swaps. The amendments permit continuation of hedge accounting even if in the future the hedged benchmark interest rate, GBP LIBOR and USD LIBOR, may no longer be separately identifiable. However, this relief does not extend to the requirement that the designated interest rate risk component must continue to be reliably measureable. If the risk component is no longer reliably measureable, the hedging relationship is discontinued.

- The Group has floating rate debt, linked to USD LIBOR (issued bond) and JPY LIBOR (bank loan), which it cash flow hedges using interest rate swaps. The amendments permit continuation of hedge accounting even though there is uncertainty about the timing and amount of the hedged cash flows due to the interest rate benchmark reforms.

- The Group uses cross-currency interest rate swaps to hedge the foreign currency risk in its net investment in Japanese foreign operations. The amendments permit continuation of hedge accounting even though there is uncertainty about the replacement of the floating interest rates included in its cross-currency interest rate swaps.

- The Group will not discontinue hedge accounting should the retrospective assessment of hedge effectiveness fall outside the 80-125 per cent range and the hedging relationship is subject to interest rate benchmark reforms. For those hedging relationships that are not subject to the interest rate benchmark reforms the entity continues to cease hedge accounting if retrospective effectiveness is outside the 80-125 per cent range.[1]

- The Group will retain the cumulative gain or loss in the cash flow hedge reserve for designated cash flow hedges that are subject to interest rate benchmark reforms even though there is uncertainty arising from the interest rate benchmark reform with respect to the timing and amount of the cash flows of the hedged items. Should the Group consider the hedged future cash flows are no longer expected to occur due to reasons other than interest rate benchmark reform, the cumulative gain or loss will be immediately reclassified to profit or loss.

The Group has chosen to early apply the amendments to IFRS 9/IAS 39 for the reporting period ending 31 December 2019, which are mandatory for annual reporting periods beginning on or after 1 January 2020. Adopting these amendments allows the Group to continue hedge accounting during the period of uncertainty arising from interest rate benchmark reforms.

1 For those entities that apply the hedge accounting requirements in IFRS 9 (not IAS 39) the 80-125 per cent test is not applicable as IFRS 9 does not include that requirement and therefore this paragraph would not be applicable.

Financial Risk (note [Y])

The Group is exposed to the following interest rate benchmarks within its hedge accounting relationships, which are subject to interest rate benchmark reform: GBP LIBOR, USD LIBOR and JPY LIBOR (collectively 'IBORs'). As listed in note [X], the hedged items include issued sterling and US dollar fixed rate debt, issued USD and JPY LIBOR floating rate debt, and foreign currency risk associated with the Group's net investment in its Japanese foreign operations.

The Group has closely monitored the market and the output from the various industry working groups managing the transition to new benchmark interest rates. This includes announcements made by LIBOR regulators (including the Financial Conduct Authority (FCA) and the US Commodity Futures Trading Commission) regarding the transition away from LIBOR (including GBP LIBOR, USD LIBOR and JPY LIBOR) to the Sterling Overnight Index Average Rate (SONIA), the Secured Overnight Financing Rate (SOFR), and the Tokyo Overnight Average Rate (TONA) respectively. The FCA has made clear that, at the end of 2021, it will no longer seek to persuade, or compel, banks to submit to LIBOR.

In response to the announcements, the Group has set up an IBOR transition programme comprised of the following work streams: risk management, tax, treasury, legal, accounting and systems. The programme is under the governance of the Chief Financial Officer who reports to the Board. The aim of the programme is to understand where IBOR exposures are within the business and prepare and deliver on an action plan to enable a smooth transition to alternative benchmark rates. The Group aims to have its transition and fall back plans in place by the end of 2020.

None of the Group's current GBP LIBOR, USD LIBOR and JPY LIBOR linked contracts include adequate and robust fall back provisions for a cessation of the referenced benchmark interest rate. Different working groups in the industry are working on fall back language for different instruments and different IBORs, which the Group is monitoring closely and will look to implement these when appropriate.

For the Group's derivatives, the International Swaps and Derivatives Association's (ISDA) fall back clauses were made available at the end of 2019 and the Group will begin discussion with its banks with the aim to implement this language into its ISDA agreements in early 2020.

For the Group's floating rate debt, the Group has started discussions with Bank X to amend the JPY LIBOR bank loan so that the reference benchmark interest rate will change to TONA. The Group aims to finalise this amendment in the second half of 2020. For the USD LIBOR issued bond, the Group will begin a dialogue with bondholders in 2020 to propose amendments to the fall back provisions to move from USD LIBOR to the Secured Overnight Financing Rate (SOFR).

Below are details of the hedging instruments and hedged items in scope of the IFRS 9/IAS 39 amendments due to interest rate benchmark reform, by hedge type. The terms of the hedged items listed match those of the corresponding hedging instruments.

Hedge type	Instrument type	Maturing in	Nominal	Hedged item
Fair value hedges	Pay 3-month GBP LIBOR, receive sterling fixed interest rate swaps	2020	£10 million	Sterling fixed rate issued debt of the same maturity and nominal of the swap
	Pay 3-month GBP LIBOR, receive sterling fixed interest rate swaps	2022	£20 million	
	Pay 6-month GBP LIBOR, receive sterling fixed interest rate swaps	2025	£40 million	
	Pay 3-month USD LIBOR, receive US dollar fixed interest rate swaps	2026	US$50 million	US dollar fixed rate issued debt of the same maturity and nominal of the swap
Cash flow hedges	Receive 3-month USD LIBOR, pay US dollar fixed interest rate swap	2020	US$10 million	USD LIBOR issued bond of the same maturity and nominal of the swap
	Receive 3-month USD LIBOR, pay US dollar fixed interest rate swap	2021	US$10 million	
	Receive 1-month JPY LIBOR, pay Japanese yen fixed interest rate swap	2023	¥40 million	Japanese yen-denominated JPY LIBOR bank loan of the same maturity and nominal of the swap
Net investment hedge	Pay 1-month JPY LIBOR, receive 1-month GBP LIBOR cross-currency interest rate swap	2025	¥7,000 million/ £50 million	¥7,000 million net investment in Japanese foreign operation

The Group will continue to apply the amendments to IFRS 9/IAS 39 until the uncertainty arising from the interest rate benchmark reforms with respect to the timing and the amount of the underlying cash flows that the Group is exposed ends. The Group has assumed that this uncertainty will not end until the Group's contracts that reference IBORs are amended to specify the date on which the interest rate benchmark will be replaced, the cash flows of the alternative benchmark rate and the relevant spread adjustment. This will, in part, be dependent on the introduction of fall back clauses which have yet to be added to the Group's contracts and the negotiation with lenders and bondholders.

2. Banking Group

Accounting policy (note [X])

In September 2019, the IASB issued *Interest Rate Benchmark Reform – Amendments to IFRS 9, IAS 39 and IFRS 7*. These amendments modify specific hedge accounting requirements to allow hedge accounting to continue for affected hedges during the period of uncertainty before the hedged items or hedging instruments affected by the current interest rate benchmarks are amended as a result of the on-going interest rate benchmark reforms.

The amendments are relevant to the Group given that it hedges and applies hedge accounting to its benchmark interest rate exposure. The application of the amendments impact the Group's accounting in the following ways:

- The Group has issued sterling-denominated and US dollar-denominated fixed rate debt which it fair value hedges using sterling fixed to GBP LIBOR and US dollar fixed to USD LIBOR to fixed interest rate swaps. The amendments permit continuation of hedge accounting even if in the future the hedged benchmark interest rate, GBP LIBOR and USD LIBOR, may no longer be separately identifiable. However, this relief does not extend to the requirement that the designated interest rate risk component must continue to be reliably measureable. If the risk component is no longer reliably measureable, the hedging relationship is discontinued.

- The Group holds investments in sterling-denominated fixed rate debt securities for liquidity management purposes under a 'held to collect and sell' business model and are measured at fair value through other comprehensive income. The interest rate risk of the securities are hedged using GBP LIBOR interest rate swaps and as noted above, the amendments permit continuation of hedge accounting even if in the future the hedged benchmark interest rate, GBP LIBOR, may no longer be separately identifiable.

- The Group has fixed rate advances in the form of retail mortgage lending to customers which it includes in a portfolio fair value hedge of the GBP LIBOR risk component of those advances. This benchmark interest rate component was separately identifiable at the time of the initial designation, and as noted above, the amendments permit continuation of hedge accounting even if in the future the hedged benchmark interest rate, GBP LIBOR, may no longer be separately identifiable.

- The Group has floating rate debt, linked to USD LIBOR (issued bond) and EONIA (bank loan), which it cash flow hedges using interest rate swaps. The amendments permit continuation of hedge accounting even though there is uncertainty about the timing and amount of the hedged cash flows due to the interest rate benchmark reforms.

- The Group has floating rate advances to and deposits from customers, linked to GBP LIBOR and EONIA, which it includes in a portfolio cash flow hedge using interest rate swaps. The amendments permit continuation of hedge accounting even though there is uncertainty about the timing and amount of the hedged cash flows due to the interest rate benchmark reforms.

- The Group uses cross-currency interest rate swaps to hedge the foreign currency risk in its net investment in Japanese foreign operations. The amendments permit continuation of hedge accounting even though there is uncertainty about the replacement of the floating interest rates included in its cross-currency interest rate swaps.

- The Group will not discontinue hedge accounting should the retrospective assessment of hedge effectiveness fall outside the 80-125 per cent range and the hedging relationship is subject to interest rate benchmark reforms. For those hedging relationships that are not subject to the interest rate benchmark reforms the entity continues to cease hedge accounting if retrospective effectiveness is outside the 80-125 per cent range.[2]

- The Group will retain the cumulative gain or loss in the cash flow hedge reserve for designated cash flow hedges that are subject to benchmark interest rate reforms even though there is uncertainty arising from the interest rate benchmark reform with respect to the timing and amount of the cash flows of the hedged items. Should the Group consider the hedged future cash flows are no longer expected to occur due to reasons other than interest rate benchmark reforms, the cumulative gain or loss will be immediately reclassified to profit or loss.

2 For those entities that apply the hedge accounting requirements in IFRS 9 (not IAS 39) the 80-125 per cent test is not applicable as IFRS 9 does not include that requirement and therefore this paragraph would not be applicable.

The Group has chosen to early apply the amendments to IFRS 9/IAS 39 for the reporting period ending 31 December 2019, which are mandatory for annual reporting periods beginning on or after 1 January 2020. Adopting these amendments allows the Group to continue hedge accounting during the period of uncertainty arising from interest rate benchmark reforms.

Financial Risk (note [Y])

The Group is exposed to the following interest rate benchmarks within its hedge accounting relationships, which are subject to interest rate benchmark reform: GBP LIBOR, USD LIBOR, JPY LIBOR and EONIA (collectively 'IBORs'). As listed in note [X], the hedged items include issued sterling and US dollar fixed rate debt, holdings of sterling fixed rate debt securities and fixed rate sterling mortgage lending, issued USD LIBOR and EONIA floating rate debt, advances to and deposits from customers linked to GBP LIBOR and EONIA, and foreign currency risk associated with the Group's net investment in its Japanese foreign operations.

As well as the benchmark interest rate exposures described in note [X], the Group has significant volumes of derivative and non-derivative financial instruments in its trading books that are not included in hedge accounting relationships. Given hedge accounting is not applied, there is no accounting relief. The fair value of these financial assets and liabilities reflects the uncertainties arising from the interest rate benchmark reforms.

The Group is closely monitoring the market and the output from the various industry working groups managing the transition to new benchmark interest rates. This includes announcements made by LIBOR regulators (including the Financial Conduct Authority (FCA) and the US Commodity Futures Trading Commission) regarding the transition away from LIBOR (including GBP LIBOR, USD LIBOR and JPY LIBOR) to Sterling Overnight Index Average Rate (SONIA), the Secured Overnight Financing Rate (SOFR), and the Tokyo Overnight Average Rate (TONA) respectively and announcements on the transition from EONIA to Euro Short Term Rate (€STR). The FCA has made clear that, at the end of 2021, it will no longer seek to persuade, or compel, banks to submit to LIBOR. Furthermore, EONIA will cease to be published from 3 January 2022.

In response to the announcements, the Group has set up an IBOR transition programme which comprises the following work streams: risk management, tax, treasury, legal, accounting and systems. The programme is under the governance of the Chief Financial Officer who reports to the Board. The aim of the programme is to understand where IBOR exposures are within the business and prepare and deliver on an action plan to enable a smooth transition to alternative benchmark rates. The Group aims to have its transition and fall back plans in place by the end of 2020.

None of the Group's current GBP LIBOR, USD LIBOR, JPY LIBOR and EONIA linked contracts include adequate and robust fall back provisions for a cessation of the referenced benchmark interest rate. Different working groups in the industry are working on fall back language for different instruments and different IBORs, which the Group is monitoring closely and will look to implement these when appropriate.

For the Group's derivatives, the International Swaps and Derivatives Association's (ISDA) fall back clauses were made available at the end of 2019 and the Group will begin discussion with its banks with the aim to implement this language into its ISDA agreements in early 2020 for derivatives in both the banking and trading book.

For the Group's floating rate debt, the Group has started discussions with respective counterparties to amend the EONIA bank loan so that the reference benchmark interest rate will change to €STR given EONIA will cease to exist in January 2022. The Group aims to finalise this amendment in the second half of 2020. For the USD LIBOR issued bond, the Group will begin a dialogue with bondholders in 2020 to propose amendments to the fall back provisions to move from USD LIBOR to the SOFR.

In respect of floating rate customer advances and deposits, the Group's response is focused on treating customers fairly and considers several aspects of transition including the reduction of clients' exposures to legacy IBOR contracts by amending or replacing existing contracts to include robust fall back provisions or replace IBOR with relevant alternative benchmark interest rates. A critical aspect of this response is also the development of new products linked to relevant alternative benchmark interest rates. The Group has developed a detailed communication plan with a focus on communicating with customers in a way that is clear, fair and not misleading. Implementation of this plan will commence in 2020, and will include explanation of what will happen to contracts that mature beyond the end of 2021 and the effect of IBOR replacement on the customer. Communications will be undertaken in good time to ensure that all customers have time to consider the options available before the end of 2021. Initial communications will focus on raising awareness and engagement will increase with detailed discussions with all clients taking place well in advance of the end of 2021. Our response also includes a rigorous training programme to ensure that relevant client-facing staff have adequate knowledge and competence to understand the implications of IBORs ending and can respond to customers appropriately.

Below are details of the hedging instruments and hedged items in scope of the IFRS 9/IAS 39 amendments due to benchmark interest rate reform, by hedge type. The terms of the hedged items listed match those of the corresponding hedging instruments.

Hedge type	Instrument type	Maturing in	Nominal	Hedged item
Fair value hedges	Pay 3-month GBP LIBOR, receive sterling fixed interest rate swaps	2020	£10 million	Sterling fixed rate issued debt of the same maturity and nominal of the swaps
	Pay 3-month GBP LIBOR, receive sterling fixed interest rate swaps	2022	£20 million	
	Pay 6-month GBP LIBOR, receive sterling fixed interest rate swaps	2025	£40 million	
	Pay 3-month USD LIBOR, receive US dollar fixed interest rate swaps	2026	US$50 million	US dollar fixed rate issued debt of the same maturity and nominal of the swaps
	Pay sterling fixed, receive 3-month GBP LIBOR	2021	£30 million	Fixed rate debt securities held in the liquidity portfolio of the same maturity and nominal of the swap
	Pay sterling fixed, receive 3-month GBP LIBOR	2022	£30 million	
	Pay sterling fixed, receive 3-month GBP LIBOR	2021	£30 million	Portfolio fair value hedge of the GBP LIBOR component of fixed rate retail mortgage lending
Cash flow hedges	Receive 3-month USD LIBOR, pay US dollar fixed interest rate swap	2020	US$10 million	USD LIBOR issued bond of the same maturity and nominal of the swap
	Receive 3-month USD LIBOR, pay US dollar fixed interest rate swap	2021	US$10 million	
	Receive 1-month EONIA, pay euro fixed interest rate swap	2023	€40 million	Euro-denominated EONIA bank loan of the same maturity and nominal of the swap
	Receive sterling fixed, pay 3-month GBP LIBOR interest rate swap	2021	£70 million	Portfolio cash flow hedges of GBP LIBOR and EONIA interest rate risk associated with GBP LIBOR and EONIA floating rate customer advances and pricing of future fixed rate customer advances
	Receive euro fixed, pay 3-month EONIA interest rate swap	2021	US€50 million	
Net investment hedge	Pay 1-month JPY LIBOR, receive 1-month GBP LIBOR cross-currency interest rate swap	2025	¥7,000 million/ £50 million	¥7,000 million net investment in Japanese foreign operation

The Group will continue to apply the amendments to IFRS 9/IAS 39 until the uncertainty arising from the interest rate benchmark reforms with respect to the timing and the amount of the underlying cash flows that the Group is exposed ends. The Group has assumed that this uncertainty will not end until the Group's contracts that reference IBORs are amended to specify the date the interest rate benchmark will be replaced and the cash flows of the alternative benchmark rate and the relevant spread adjustment. This will, in part, be dependent on the introduction of fall back clauses which have yet to be added to the Group's contracts and the negotiation with lenders and bondholders.

Key contacts

Global IFRS Leader
Veronica Poole
ifrsglobalofficeuk@deloitte.co.uk

Global Lead for IFRS Financial Instruments
Andrew Spooner
aspooner@deloitte.co.uk

IFRS centres of excellence

Americas		
Argentina	Fernando Lattuca	arifrscoe@deloitte.com
Canada	Karen Higgins	ifrs@deloitte.ca
Mexico	Miguel Millan	mx-ifrs-coe@deloittemx.com
United States	Robert Uhl	iasplus-us@deloitte.com
Asia-Pacific		
Australia	Anna Crawford	ifrs@deloitte.com.au
China	Gordon Lee	ifrs@deloitte.com.cn
Japan	Shinya Iwasaki	ifrs@tohmatsu.co.jp
Singapore	James Xu	ifrs-sg@deloitte.com
Europe-Africa		
Belgium	Thomas Carlier	ifrs-belgium@deloitte.com
Denmark	Jan Peter Larsen	ifrs@deloitte.dk
France	Laurence Rivat	ifrs@deloitte.fr
Germany	Jens Berger	ifrs@deloitte.de
Italy	Massimiliano Semprini	ifrs-it@deloitte.it
Luxembourg	Martin Flaunet	ifrs@deloitte.lu
Netherlands	Ralph Ter Hoeven	ifrs@deloitte.nl
Russia	Maria Proshina	ifrs@deloitte.ru
South Africa	Nita Ranchod	ifrs@deloitte.co.za
Spain	José Luis Daroca	ifrs@deloitte.es
Switzerland	Nadine Kusche	ifrsdesk@deloitte.ch
United Kingdom	Elizabeth Chrispin	deloitteifrs@deloitte.co.uk