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25 May 2020

Hans Hoogervorst
Chair
International Accounting Standards Board
Columbus Building
7 Westferry Circus
Canary Wharf
London
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Dear Mr Hoogervorst

Exposure Draft 2020/1 – Interest Rate Benchmark Reform – Phase 2

Deloitte Touche Tohmatsu Limited is pleased to respond to the International Accounting Standards Board's ('the IASB's') exposure draft *Interest Rate Benchmark Reform – Phase 2, Proposed amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16* ('the ED').

We welcome the ED given the urgency of the issue and significant impact of the benchmark interest rate reforms on IFRS reporters. We appreciate the responsiveness of the IASB in accelerating the due process with the aim to finalise these important amendments as soon as practicably possible.

We are largely supportive of the amendments. In particular, we support the key changes that ensure that entities that apply hedge accounting will continue to do so as they transition to new benchmark interest rates and that the accounting for the modification of hedged items, when those modifications arise directly from the reforms, are reflected on a prospective basis via the application of IFRS 9:B5.4.5. We consider these as being the two most important elements of the proposals.

We have included detailed observations on how these two important elements apply in various hedge accounting strategies in the Appendix to this letter. In summary:

- We believe it could be clearer that an entity can de-designate a portion of fixed rate debt to reflect the interest rate differential between the old and new benchmark interest rate and in so doing minimise the change in fair value hedge accounting adjustments when transitioning from one benchmark interest rate to the other.
- We question whether all changes in cash flows arising from the reforms, whether it is a change in contract or the exercise of an existing contractual provision, should be referred to as a 'modification', particularly given the use of the term elsewhere in IFRS 9 and other standards. We also note that the description is used merely to describe those arrangements that fall into the scope of IFRS 9:B5.4.5.
- We believe it could be clearer whether the 24 months assessment of 'separately identifiable' applies to new hedge accounting relationships that did not arise following a modification.
- We propose that approaches other than 'repapering' derivatives, such as entering into offsetting contracts and new derivatives that are economically similar to repapering, should be afforded the same relief.
- The amendments should also apply to redefining the benchmark interest rate on debt host contracts and associated embedded derivatives.

- We support the reinstatement of hedge accounting for those relationships that ceased because of benchmark interest rate reform; however, we suggest that reinstatement should be an accounting policy choice applied to all the entity's hedge accounting relationships, or none at all, given the practical problems that may arise in reinstating relationships in some cases.

If you have any questions concerning our comments, please contact Andrew Spooner in London at +44 (0) 20 7007 0204.

Yours sincerely

Veronica Poole
Global IFRS Leader

Appendix 1

Question 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 (i.e. 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. 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.

We largely support the proposals. Specifically, we support the application of IFRS 9:B5.4.5 when the cash flows of the hedging instrument and/or hedged item change because of the interest rate benchmark reform.

We note that the ED articulates the application of IFRS 9:B5.4.5 as a practical expedient and that the proposed paragraph BC25 implies that if it was not for the practical expedient the accounting would follow IFRS 9:5.4.3 or B5.4.6. We question whether this would always be the case given that IFRS 9:B5.4.5 applies to floating-rate financial instruments when the cash flows are re-estimated to reflect changes in market rates of interest. In some cases, particularly where fallback provisions set out how the cash flows are determined when the benchmark interest rate changes, we consider that the application of the existing requirements in B5.4.5 would naturally apply. Our observation, therefore, is that the requirement to apply B5.4.5 may not need to be described as a practical expedient. Instead, the Standard could simply require the application of B5.4.5 for changes in cash flows arising from interest rate benchmark reform.

We support the statement in proposed paragraph BC15 that determining what is a modification may not be straightforward and so we support the Board in limiting their view on modifications to those modifications arising from interest rate benchmark reform. We note that the proposed paragraph BC20 states the IASB will consider more broadly the modification requirements in IFRS 9 after these amendments are finalised. We agree that now is not the time to look at the subject more broadly. We note, however, that modification and derecognition requirements are intertwined and this work would affect balances outside of IFRS 9 that are subject to the derecognition requirements, such as leases.

IFRS 9:B5.4.5 applies only to amortised cost measurement (including debt financial assets measured at FVTOCI, and debt instruments at FVTPL when the entity elects to present the effective interest rate separately from other gains or losses as permitted by IFRS 7:B5(e). Yet, the interest rate benchmark reform also applies to derivatives that will be modified, which are measured as at FVTPL and so amortised cost measurement does not apply. The proposed paragraph 6.9.3 does not draw this distinction and therefore we believe the amendment could be clearer that paragraph 6.9.3 does not apply to those derivatives. Any difference in the fair value on modification should be recognised immediately as part of the fair value movement.

We support the examples of modifications included in proposed paragraph 6.9.4 and support the statement in proposed paragraph BC31 that the list is not exhaustive. We note that the examples of modifications include cases where the contractual term is unchanged, rather than an existing term exercised, such as a fallback provision that is designed to apply when a benchmark interest rate is replaced. We support that the accounting for pre-existing provisions should be consistent with the treatment that applies when an equivalent term is introduced via a change to the contractual terms, i.e. B5.4.5 applies. However, given these fallback provisions are not modifications, as noted by the Board in proposed paragraph BC32, we question whether the term 'modification' is the right term to use to describe the arrangements that fall into the scope of the amendment, particularly given the use of this term elsewhere in IFRS 9. Similar to our comment on the term 'practical expedient' above, it may be simpler not to use the term 'modification' given in some cases contracts are not actually modified. Instead, proposed paragraph 6.9.4 could say "Examples of changes arising from interest rate benchmark reform are limited to".

We consider there is an inconsistency between proposed paragraphs BC35 and 6.9.6. Paragraph BC35 indicates that an entity first assesses derecognition for the whole contract and then, if the contract is not derecognised, the amendments apply to those modifications that are in scope of the amendments, with other modifications being accounted for applying the existing requirements of IFRS 9. However, paragraph 6.9.6 states that an entity first applies IFRS 9:6.9.3 to the modifications that are in scope of the amendments, and the residual modifications that are not in scope are assessed separately for derecognition. We presume paragraph 6.9.6 presents the correct order in which the requirements should be applied, and so we suggest that paragraph BC35 should be amended to reflect this.

Benchmark interest rates are often used when determining the floating interest rate on debt host contracts with the same benchmark interest rate used for the floating leg of the separated embedded derivative. For example, an entity may have bifurcated a GBP issued equity-linked note into say a 3m-GBP LIBOR floating rate debt host contract with a receive 3m-GBP LIBOR pay GBP equity index. Practically, as these benchmarks cease to exist, entities will need to transition away from these rates and use a new rate. We would welcome an acknowledgement of this problem and that entities should be able to move to a new benchmark interest rate applying paragraph B5.4.5 (and not B5.4.6). Like other examples cited above, this is not strictly a modification as the contract has not contractually changed given the benchmark interest rate is not contractual, rather it was imputed at initial recognition for the purpose of separation. Permitting entities to move the debt host contract and derivative at the same time to a new benchmark interest rate would ensure that entities can continue measuring these arrangements after previous benchmark interest rates have ceased in a way that is consistent with similar arrangements that are contractually modified.

We support the amendment to IFRS 4 *Insurance Contracts* so that insurance entities that apply IAS 39 instead of IFRS 9 can apply the same approach to modifications subject to benchmark interest rate reform as those applying IFRS 9. We also support the amendment to IFRS 16 *Leases* so that benchmark interest rate-linked leases can be accounted for applying the same modification approach as those benchmark interest rate-linked financial instruments in IFRS 9.

Question 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.

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.

We are supportive of the proposals to permit hedge accounting relationships and associated documentation to be amended without cessation of hedge accounting. However, we think the drafting could be clearer as to the changes that are permitted to the documentation of fair value hedges when an entity redesignates the portion of cash flows reflecting the new designated risk.

For fair value hedges of interest rate risk, the quantum of the hedged cash flows will often be re-designated, reflecting the fact that the portion of the cash flows designated under the old benchmark rate will differ from the portion under the new benchmark interest rate (given new benchmark interest rates are generally lower than old benchmark interest rates). Proposed paragraph 6.9.7 could be clearer that such a designation is acceptable as paragraph 6.9.7(b) refers to "amending the description of the hedged item". This could be read as simply amending for the change in the benchmark rate, as opposed to the *amount* that the benchmark interest rate represents. Fair value hedging of interest rate risk for a designated portion equal to the benchmark interest rate is a common hedge accounting strategy and therefore we would favour an explicit reference to amending the amount of the hedged item to reflect the differential between the old and the new rate.

To illustrate, if the original interest rate swap was receive 5% pay LIBOR and was designated as a fair value hedge of the portion of interest equivalent to 5% plus principal on the fixed rate debt, when the entity transitions to say SONIA, and SONIA is say 10 basis points less than LIBOR at the date of re-designation, the entity should be permitted to designate the portion of interest equivalent to 4.9% plus the principal on the fixed rate debt. This will ensure that entities that hedge the portion of fixed rate debt equivalent to the benchmark interest rate can continue to do so without creating new hedge ineffectiveness because new benchmark interest rates are designed to be risk free whereas the old benchmark interest rates were not. A detailed illustration is included in Appendix 2 to this letter.

Question 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-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.

We are broadly supportive of the proposed accounting for the hedged item and hedging instrument but have some observations on its application for both fair value and cash flow hedges.

We note that proposed paragraph 6.9.11(b) refers to the hedged item being remeasured "based on the alternative benchmark rate". We have understood that as being consistent with our response to Question 2 that an entity can redesignate the portion of cash flows in a fair value hedge to reflect the new benchmark interest rate. We have included an example of redesignating the portion of cash flows in Appendix 2 to this letter to show that without the ability to do this entities would recognise a greater accounting mismatch, which we do not believe would faithfully reflect the risk that is economically hedged.

We note the application of proposed paragraph 6.9.11 will lead to a net gain/loss in profit or loss even when the hedging instrument has been amended to be economically equivalent as the previous hedging instrument. This gain/loss arises because of the remeasurement of the hedged item under 6.9.11(b). We acknowledge that proposed paragraph BC61 indicates that the IASB has considered alternative approaches, such as amortisation, instead of recognition immediately in profit or loss. Given it could be seen as counter-intuitive to recognise a gain or loss for a relationship that has been replaced on an economically equivalent basis, we also considered whether an alternative amortisation approach would be preferable, noting that under normal hedge accounting rules, when a fair value hedge ceases, the fair value hedge adjustment is amortised. However, as demonstrated in Appendix 2 to this letter, given that alternative benchmark rates are designed to have less risk than the rates they replace, this will generally result in an *increase* in the fair value hedge adjustment. We consider recognition of this difference in profit or loss at the date of redesignation is simpler than amortisation, and we believe will result in a more faithful representation of performance in future periods as the fair value changes in the new benchmark interest rate derivative and the fair value hedge adjustment will offset, assuming there are no other sources of hedge ineffectiveness. Additionally, we can see practical problems with amortising the difference in fair value hedge adjustments as this will result in a balance that increases each period (ignoring other amortisation the entity is required to do under existing hedge accounting requirements), potentially accruing over many years given the debt may have many years before it matures.

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We have a similar observation for cash flow hedging. We support the indication in the proposed paragraph BC63(b) that the amount deferred in the cash flow hedge reserve reflects the cumulative change in fair value of the hedged cash flows as if the hedged cash flows had been based on the alternative benchmark interest rate. We have read this as requiring that the hypothetical derivative, used for determining how much of the gain/loss on the hedging instrument is recognised in OCI, should be adjusted to reflect that the hedged cash flows have been modified to be based on the new benchmark interest rate. Yet, proposed paragraph 6.9.12(b) refers to the "cumulative change in fair value of the hedged item calculated based on the alternative benchmark rate". This could be read as requiring that the old hedged cash flows (based on the old benchmark interest rate) be discounted by the new benchmark interest rate. Similar to the fair value hedge accounting example we described above, we believe the reference to "hedged item" should include the amount and/or basis of the redesignated hedged item, in this case reflecting that the hedged item post-modification is the new benchmark interest rate cash flows, and not the old benchmark interest rate cash flows.

We are aware that financial institutions and clearing houses may not contractually modify derivatives to change the benchmark interest rate (often referred to as 'repapering'), but may instead enter into a new derivative equal and opposite to the original one (so both are based on old benchmark interest rates), along with a new benchmark interest rate derivative that is designed to have a fair value equivalent to the original one. The economic outcome is that the two old benchmark interest rates offset and will subsequently either be retained until maturity or cancelled, leaving the new benchmark interest rate outstanding. Economically this combination of derivatives is equivalent to repapering of the original contract and therefore we believe this technique, if the two derivatives are entered into at the same time and in contemplation of each other, should be deemed as a continuation of the hedge relationship to which the amendments would apply (even though on a gross basis the entity is still exposed to the old benchmark interest rate and so still retains old benchmark uncertainty). We consider this approach is reasonable because this technique can be easier to execute than modifying contracts and leads to an economically similar outcome.

Question 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 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.

We support the proposal to provide relief from the separately identifiable test for 24 months from the date the alternative benchmark rate is designated as a risk component as this will allow time for new benchmark interest rates to become established. This relief also ensures entities that seek to move to these new rates early are not unduly disadvantaged relative to those that wait until the new rates are more established.

We believe the proposed paragraph 6.9.17 could be clearer that the entity's subsequent assessment of whether it expects the alternative benchmark rate will not be separately identifiable within 24 months is made at the entity's reporting date, as opposed to made on a continuous basis. As the assessment is a forward-looking assessment, we believe it would be less onerous for that exercise to be performed at each reporting date, as opposed to within a reporting period. If it were the latter, an entity would be required to know when in the period it would have reached a different conclusion on its assessment, which we do not believe is practical.

We note that proposed paragraph 6.9.17 requires discontinuation of the hedge relationship prospectively from the date it is assessed that the separately identifiable condition is not expected to be met for the 24-months period. It would be helpful if the amendment was clear that in such circumstances the entity applies the normal requirements for cessation of hedge accounting, being IFRS 9:6.5.10 for fair value hedges and IFRS 9:6.5.12 for cash flow hedges.

We suggest that proposed paragraph 6.9.16 could be clarified to indicate whether the 24-months assessment applies to designated hedge relationships that do not arise as a result of a redesignation. In other words, can the 24-months assessment apply to a new benchmark interest rate derivative when that derivative was entered into as a new instrument for the first time rather than as a result of a modification? We presume the 24-months assessment would apply because an alternative interpretation would result in modified hedge relationships being treated favourably to those designations that did not arise following a modification.

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Question 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.

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.

We appreciate the IASB's effort to try to accommodate an exception from the general rule of only applying hedge accounting prospectively by requiring that those hedge relationships that ceased due to benchmark interest rate reform shall be reinstated. However, we note there could be practical difficulties in reinstating in some cases. An entity may have modified its hedging instrument from an old benchmark interest rate to a new alternative benchmark rate and not applied hedge accounting for the newly modified instrument. Given the entity has not applied hedge accounting, it may not be practical to know in retrospect whether they would have applied hedge accounting had the amendment been available. In other cases, the modified derivative may have been designated in a different hedge relationship, but reinstatement would require the entity to de-designate that relationship and reinstate the one that ceased. In this case, the entity has applied hedge accounting to the new instrument, albeit in a different relationship, so to reverse the accounting may not be reasonable given the new hedge relationship would have needed to be consistent with the entity's risk management policies in order for it to be designated. Further, for fair value hedges, if the entity was unable to pass the separately identifiable test when it attempted to designate its new alternative benchmark interest rate hedging instrument, if reinstatement is required, it is not clear whether the 24-month period described in proposed paragraph 6.9.16 starts from the date the hedge relationship is reinstated.

Noting these complications, our preference is to permit reinstatement of hedge accounting relationships at the entity's election as an accounting policy choice to be applied consistently to all of its hedge relationships that ceased because of benchmark interest rate reform (as opposed to a hedge by hedge election). This strikes the right balance of addressing practical concerns that exist and the avoidance of 'cherry-picking' reinstatement of only certain hedge accounting relationships. If an entity reinstates its hedge relationships it should be required to state that fact.

Question 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 are supportive of the objectives for disclosure expressed in proposed paragraph IFRS 7:24I.

We are supportive of the specific disclosure requirements in proposed paragraph 24J except the requirement in (c). Paragraph 24J(c) requires an entity to disclose "a description of how the entity determined the base rate and relevant adjustments to that rate, including any significant judgements the entity made to assess whether the conditions in paragraphs 6.9.3 and 6.9.5(b)-(c) […] were met". These disclosures require entities to explain why they consider their modifications to be subject to the amendment (e.g. why a modification is economically equivalent). We do not consider that such an explanation would provide meaningful information given the bilateral nature of modifications of derivative and debt contracts where both parties agree on a modification of cash flows that is fair to both parties. We are concerned that entities would be unable to express how they reached such a conclusion without reverting to boilerplate disclosures. Whether a modification is economically equivalent is relevant in determining whether the modification is in the scope of the amendment and, if the outcome is that it is in scope, we do not believe this should warrant specific explanation, except if it was deemed that a significant judgement made in the process of applying the entity's accounting policies which would be required by IAS 1:122.

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Appendix 2

Fair value hedge

- Entity A issues 6% fixed rate debt with a nominal and fair value of CU100.
- At the date of issue, the fixed rate reflecting LIBOR for the term of the debt instrument is 5% (i.e. 1% difference between this and the coupon on the debt of 6% represents the non-benchmark interest rate risk, including the non-performance risk of the entity).
- Entity A enters into an on-market receive 5% pay LIBOR interest rate swap that matures when the debt matures and designates it as a fair value hedge of the interest rate risk of LIBOR for the portion of debt reflecting LIBOR.
- Entity A modifies its interest rate swap to an alternative benchmark interest rate, SONIA. At the date of modification, LIBOR is 4% and SONIA is 3.9%, i.e. SONIA is 10 basis points less than LIBOR. In order to be "economically equivalent" the new interest rate swap is receive 4.9% pay SONIA, i.e. the fixed rate is 10 basis points lower than the LIBOR swap reflecting SONIA is 10 basis points less than LIBOR.

	Year	**1**	**2**	**3**	**4**	**5**		
Old hedged item	CU	5	5	5	5	105		
LIBOR at date of redesignation	4.00%							
PV of cash flows	CU	4.808	4.623	4.445	4.274	86.302	104.452	Sum
Therefore FV adjustment under LIBOR							4.452	A

	Year	**1**	**2**	**3**	**4**	**5**		
SONIA at date of redesignation	3.90%							
PV of cash flows designating old portion		4.812	4.632	4.458	4.290	86.718	104.911	Sum
Therefore FV adjustment under SONIA							4.911	B
Difference recognised in P&L							0.459	(B-A)

	Year	**1**	**2**	**3**	**4**	**5**		
However, if redesignate new portion to reflect that SONIA is lower than LIBOR	CU	4.9	4.9	4.9	4.9	104.9		
PV of cash flows	CU	4.716	4.539	4.369	4.205	86.636	104.464	Sum
Therefore FV adjustment under SONIA							4.464	C
Difference recognised in P&L							0.013	(C-A)

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- The ability to redesignate the quantum of cash flows to reflect the differential between the old benchmark rate and the alternative benchmark rate greatly reduces the difference in fair value hedge adjustments applying IFRS 9:6.9.11(b) – CU 0.013 recognised in profit or loss versus CU 0.459. Given the alternative benchmark rate is 10 basis points lower than the previous designated benchmark, we support the ability to redesignate the amount of cash flows designated by 10 basis points in this case to reflect the new designated risk on the lower portion of cash flows to which the entity is exposed.

Cash flow hedge

- Entity A issues floating rate debt paying LIBOR plus 100 bps with a nominal and fair value of CU100.
- Entity A enters into an on-market receive LIBOR pay 5% interest rate swap that matures when the debt matures and designates it as a cash flow hedge of the interest rate cash flow variability of LIBOR for the portion of debt reflecting LIBOR.
- At the point of original designation the hypothetical derivative used to measure ineffectiveness under the cash flow hedge is exactly equal to the actual derivative taken out by Entity A (this assumes payment dates, reset dates, maturity dates and notionals of the derivative match exactly the relevant terms of the debt).
- Entity A modifies both the floating rate debt and the interest rate swap to an alternative benchmark interest rate, SONIA. At the date of modification, LIBOR is 4% and SONIA is 3.9%, i.e. SONIA is 10 basis points less than LIBOR. In order to be "economically equivalent" the new interest rate swap is receive SONIA pay 4.9%, i.e. the fixed rate on the swap is 10 basis points lower than the LIBOR swap reflecting that SONIA is 10 basis points less than LIBOR. Similarly, the floating rate debt is modified such that Entity A will now pay SONIA plus 110bps (i.e. 10 basis points more than before reflecting the fact that SONIA is 10 basis points lower than LIBOR).
- We consider that it should be possible within the amendment for Entity A to reset the hypothetical derivative to receive SONIA pay 4.9% to reflect that the new cash flow risk of the modified cash flows on the debt is SONIA, not LIBOR. Without a reset of the hypothetical derivative, this will lead to hedge ineffectiveness in profit or loss that does not reflect the fact that post-modification Entity A does not have LIBOR risk, and the new SONIA cash flow variability risk has been eliminated by its new derivative.