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ISCA Financial Reporting Bulletin 9 (Revised)

FRB 9 (Revised January 2023):
Accounting Implications of
the Interest Rate Benchmark Reform in
Singapore

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Note:

- *This FRB has been updated from FRB 9 (issued on 21 February 2022) for the following:*
 - *Additional background information on MAS Recommended Rate (MRR) and supplementary guidance for active transition of SOR contracts; and*
 - *Updates on accounting considerations on the use of MRR and supplementary guidance in financial contracts and hedge accounting*

- *Although this FRB makes references to SFRS(I) 9 Financial Instruments and SFRS(I) 1-39 Financial Instruments: Recognition and Measurement, the guidance in this FRB is also applicable to entities applying FRS 109 Financial Instruments and FRS 39 Financial Instruments: Recognition and Measurement.*

- *References made to publicly available information, including those made to the Association of Banks in Singapore (ABS) and IASB websites, are accurate as at the date of issuance of this FRB. Members are strongly advised to refer to the respective ABS' webpages relating to the transition to SORA for the latest updates on the transition.*

Table of Abbreviations

The following abbreviations are used often in this publication:

Abbreviations	Description
ABS	Association of Banks in Singapore
ASC	Accounting Standards Council Singapore
IASB	International Accounting Standards Board
IFRS	International Financial Reporting Standards
IBOR	Interbank Offered Rate
ISDA	International Swaps and Derivatives Association
LIBOR	London Interbank Offered Rate
MAS	Monetary Authority of Singapore
MRR	MAS Recommended Rate
SC-STC	Steering Committee for SOR and SIBOR transition to SORA
SFEMC	Singapore Foreign Exchange Market Committee
SFRS(I)	Singapore Financial Reporting Standards (International)
SIBOR	Singapore Interbank Offered Rate
SOFR	Secured Overnight Financing Rate
SOR	Swap Offer Rate
SORA	Singapore Overnight Rate Average
SPPI	Solely Payments of Principal and Interest

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1. Background

Globally, there has been a shift away from interbank offered rates and a move towards the adoption of alternative, nearly risk-free benchmark rates. This is commonly known as the interbank offered rate (IBOR) benchmark reform. Due to the upcoming discontinuation of USD London Interbank Offered Rate (LIBOR) by end of June 2023, the Steering Committee for SOR and SIBOR transition to SORA¹ (SC-STs) together with the Association of Banks in Singapore (ABS) and Singapore Foreign Exchange Market Committee (SFEMC), has recommended the discontinuation of Swap Offer Rate (SOR) and Singapore Interbank Offered Rate (SIBOR) and a shift towards the use of Singapore Overnight Rate Average (SORA) as the alternative interest rate benchmark in Singapore. The timeline for SORA to replace SOR and SIBOR is by the end of June 2023 and December 2024 respectively.

In order to address the financial reporting implications of the IBOR reform, the International Accounting Standards Board (IASB) undertook their “Interest Rate Benchmark (IBOR) Reform and its Effects on Financial Reporting” project in two phases.

In September 2019, IASB amended IFRS 9 *Financial Instruments*, IAS 39 *Financial Instruments: Recognition and Measurement* and IFRS 7 *Financial Instruments: Disclosures* under its Phase 1 amendments to provide temporary reliefs from the potential effects of the uncertainty caused by the reform and allow entities to continue their hedge accounting relationships during the period of uncertainty, with an effective date for annual periods beginning on or after 1 January 2020. Shortly after that, the Accounting Standards Council (ASC) issued equivalent Phase 1 amendments to SFRS(I) 9 *Financial Instruments*, SFRS(I) 1-39 *Financial Instruments: Recognition and Measurement* and SFRS(I) 7 *Financial Instruments: Disclosures* with the same effective date.

In August 2020, IASB amended IFRS 9, IAS 39, IFRS 7, IFRS 4 *Insurance Contracts* and IFRS 16 *Leases* under its Phase 2 amendments to assist entities in applying the Standards when changes are made to contractual cash flows or hedging relationships because of the reform, with an effective date for annual periods beginning on or after 1 January 2021. Shortly after, ASC issued equivalent Phase 2 amendments to SFRS(I) 9, SFRS(I) 1-39, SFRS(I) 7, SFRS(I) 4 *Insurance Contracts* and SFRS(I) 16 *Leases* with the same effective date.

The above developments have given rise to questions over how entities in Singapore that hold financial instruments affected by the IBOR reform and/or engage in hedge accounting should account for them during the IBOR reform before and when the benchmark interest rates in the financial contracts are replaced by alternative benchmark rates.

In Singapore, ABS’ SC-STs formed a technical subgroup, Subgroup 7 (SG 7) to consider the accounting implications of the transition of SOR and SIBOR to SORA. SG 7 requested ISCA to publish guidance concerning IBOR reform in relation to accounting matters. In response, the ISCA Financial Reporting Committee (FRC) set up a dedicated working group (IBOR Working Group²) which comprises representatives from SG 7 and ISCA Banking and Finance Committee, together with FRC Core Sub-Committee members.

¹ SC-STs was established by the Monetary Authority of Singapore (MAS) to oversee the industry-wide interest rate benchmark transition from SOR & SIBOR to SORA.

² ISCA gratefully acknowledge and thank the following members of the IBOR Working Group for their contributions towards the development of this publication:

- Mr Chen Voon Hoe (IBOR WG Chairman)
- Ms Chan Yen San
- Mr Chua Kim Chiu
- Mr Andrew Goh (representative from SC-STs SG 7)
- Mr Aylwin How
- Mr Lian Wee Cheow
- Ms Ong Suat Ling
- Mr Jonathan Phua (representative from SC-STs SG 3)
- Ms Wong Tien Chi

ISCA, through its FRC and IBOR Working Group, is issuing this Financial Reporting Bulletin (FRB) to guide entities reporting under International Financial Reporting Standards (IFRSs) issued by the IASB, or Singapore Financial Reporting Standards (International) (SFRS(I)s) and Financial Reporting Standards (FRSs) issued by the ASC, in addressing some of the accounting implications arising from the IBOR reform in Singapore.

2. Scope of this FRB

This FRB addresses accounting implications arising from the IBOR reform.

The accounting matters addressed in this FRB were brought to the attention of the IBOR Working Group by the SG 7. This FRB is intended to assist entities holding financial contracts that reference benchmark interest rates that will be replaced by alternative benchmark rates during the IBOR reform to understand the accounting implications.

This FRB addresses accounting matters that were considered by the IBOR Working Group.

The accounting matters addressed within this FRB are not exhaustive. Preparers are strongly advised to consult their auditors/advisors if necessary.

3. Overview of the Interest Rate Benchmark Reform (or Interbank Offered Rate (“IBOR”) Reform)

3.1 International Developments in IBOR Reform

In 2014, the Financial Stability Board³ recommended the reform of specified major interest rate benchmarks such as interbank offered rates. Since then, public authorities in many jurisdictions have taken steps to implement interest rate benchmark reform and increasingly encouraged market participants to ensure timely progress towards the reform of interest rate benchmarks, including the replacement of interest rate benchmarks with alternative nearly risk-free interest rates that are based, to a greater extent, on transaction data (alternative benchmark rates).

On 5 March 2021, the Financial Conduct Authority⁴ confirmed the dates on which all London Interbank Offered Rate (LIBOR) settings will either cease to be provided, or will no longer be representative, as follows:

- (a) Overnight and 1-month, 3-month, 6-month and 12-month USD LIBOR settings – Immediately after 30 June 2023; and
- (b) All other LIBOR settings – Immediately after 31 December 2021.

³ The Financial Stability Board (FSB) is an international body that monitors and makes recommendations about the global financial system. FSB’s report on reforming major interest rate benchmarks can be found [here](#).

⁴ The [Financial Conduct Authority \(FCA\)](#) is a financial regulatory body for financial firms providing services to consumers and seeks to maintain the integrity of the financial markets in the United Kingdom. FCA made an [announcement](#) on the end of LIBOR on 5 March 2021.

3.2 Regulatory landscape of the Financial Services industry and Interest Rate Benchmarks in Singapore

3.2.1 Regulatory Landscape

The Monetary Authority of Singapore (MAS) is the sole regulator in Singapore having regulatory oversight of the financial services industry across various sectors. The MAS is also the central bank of Singapore.

The following organisation and committees were commissioned by MAS to undertake the groundwork relating to the interest rate benchmark reform in Singapore:

(a) Association of Banks in Singapore (ABS):

ABS is a non-profit organisation that represents the interests of the commercial and investment banking community.

(b) Steering Committee for SOR and SIBOR transition to SORA (SC-STTS):

SC-STTS was set up by ABS and MAS in August 2019 to oversee the industry-wide interest rate benchmark transition from SOR to SORA. In 2020 the scope was extended to include the transition of SIBOR to SORA.

(c) Singapore Foreign Exchange Market Committee (SFEMC)⁵:

The SFEMC, comprising industry representatives and MAS, aims to foster the growth and development of Singapore as a leading global financial centre in Asia, with specific focus on foreign exchange, money markets, fixed income and derivatives markets.

3.2.2 Interest Rate Benchmarks

In Singapore there are currently three published Singapore Dollar (SGD) interest rate benchmarks, namely SOR, SIBOR and SORA. SOR and SIBOR are administered by the ABS Benchmarks Administration Co Pte Ltd and published on ABS' website. SOR and SIBOR are widely used as interest rate benchmarks in financial contracts. SORA is administered and published by MAS.

(a) Singapore Overnight Rate Average (SORA)⁶

SORA is a volume-weighted average rate of borrowing transactions in the unsecured overnight interbank SGD cash market in Singapore between 8am and 6.15pm.

MAS, as the administrator of SORA, reviews SORA's methodology and governance processes periodically to ensure that it continues to capture the underlying interest rates adequately and is aligned with the International Organization of Securities Commissions (IOSCO) Principles.

SORA is computed based on actual transactions and generally viewed as being nearly free of credit risk ("near risk-free" rates). The short tenor (overnight) lending has minimal credit risk and therefore minimal credit spread.

⁵ SFMEC Terms of Reference [<https://www.sfemc.org/sfemc-terms-of-reference.html>]

⁶ MAS website on SORA [<https://www.mas.gov.sg/monetary-policy/sora/>]

On 14 May 2020, DBS Bank issued the first floating-rate notes in Singapore referencing SORA. On 16 June 2020, OCBC Bank made its first SORA-pegged loan to CapitaLand, followed shortly by the launch of home loans referencing SORA in July 2020. Since then, more banks in Singapore have opted for the issuance of SORA-pegged banking products.

(b) Swap Offer Rate (SOR)⁷

SOR is defined by ABS as the synthetic rate for deposits in SGD. SOR represents the effective cost of borrowing SGD synthetically by borrowing USD funds for the same maturity and swapping out the USD funds in return for SGD funds.

SOR is used mainly in bonds and loans by large institutions with hedging requirements⁸ and in certain housing loans. SOR relies on USD LIBOR in its computation methodology. The shift away from SOR is necessary given that SOR will discontinue together with the cessation of USD LIBOR on 30 June 2023.

(c) Singapore Interbank Offered Rate (SIBOR)⁷

SIBOR is computed based on the contributions from a panel of banks of the interest rates at which they could borrow funds from one another. It is commonly used as a reference interest rate for banking products such as housing loans and loans to corporate customers. ABS has confirmed its plan to cease 6-month SIBOR on 31 March 2022, followed by 1-month SIBOR and 3-month SIBOR by end 2024.

3.3 Singapore's Transition from SOR and SIBOR to SORA

As mentioned in Section 3.1, USD LIBOR is expected to cease after 30 June 2023. Hence, SOR is also expected to cease at the same date, given it has USD LIBOR as an input. All financial contracts using SOR as the reference benchmark rate that mature after this date will have to be addressed (e.g. updated or terminated). It was confirmed in March 2021 that SOR and SIBOR will not be available as benchmark rates after 30 June 2023 and 31 December 2024 respectively.

On 30 August 2019, ABS and SFEMC identified SORA as an alternative interest rate benchmark for SOR. On 11 December 2020, SC-STs, together with ABS and SFEMC, also recommended⁹ the discontinuation of SIBOR and adoption of a SORA-centred approach. A SORA-centred approach means that SORA will be the only interest benchmark to be used in Singapore after the cessation of SOR and SIBOR. It was also mentioned in the same paper that this shift is expected to support a deepening of SORA markets, resulting in more transparent loan market pricing for borrowers, and more efficient risk management for lenders.

⁷ ABS website on published SOR & SIBOR rates [<https://abs.org.sg/benchmark-rates/rates-sibor>]

⁸ Extracted from page 5 of ABS publication on [SORA: A Guide for Corporates and SMEs](#)

⁹ ABS-SFMEC & SC-STs' [response paper](#) to feedback received on SIBOR Reform and the Future Landscape for SGD Interest Rate Benchmarks

3.3.1 Fallback Provisions

Benchmark fallbacks or fallback reference rates (fallbacks) are replacement rates that may apply to financial instruments referencing a particular benchmark. Fallbacks take effect if the relevant benchmark (e.g. USD LIBOR, SGD SOR) becomes unavailable while market participants continue to have exposure to that rate.

(a) Fallback Rate (SOR) [*Revised January 2022*]

The Fallback Rate (SOR) in various tenors (i.e., overnight, 1-month, 3-month and 6-month) is administered by the ABS Benchmarks Administration Co Pte Ltd and published on Bloomberg and Refinitiv.

In Singapore, Fallback Rate (SOR) has been identified¹⁰ in the SORA Market Compendium issued by SC-STS as the primary fallback reference rate for SOR derivatives that incorporate the International Swaps and Derivatives Association (ISDA) IBOR Fallback Supplement. In addition, it was mentioned in the SORA Market Compendium that the Fallback Rate (SOR) can be used as a fallback reference rate for securities and loans that reference SOR.

Similar to SOR, Fallback Rate (SOR) is a foreign exchange implied SGD rate, based on swap points from actual transactions in the USD/SGD foreign exchange swap market and the USD LIBOR, and is available in the same tenors as SOR. Fallback Rate (SOR) rates will use the fallback for USD LIBOR (i.e. "Fallback Rate (SOFR)"¹¹) in place of USD LIBOR rates in their computation.¹²

Fallback Rate (SOR) only serves as a temporary fallback reference rate and is not intended for usage in new contracts. For contracts that reference SOR and contain fallback clauses that reference Fallback Rate (SOR), the Fallback Rate (SOR) will apply following the permanent cessation of USD LIBOR after 30 June 2023 or USD LIBOR losing its representativeness. Fallback Rate (SOR) itself will discontinue after 31 December 2024. Therefore, market participants should seek to transition legacy contracts to SORA as soon as possible.

(b) MAS Recommended Rate [*January 2023 Update*]

On 18 July 2022, it was announced¹³ by ABS and SC-STS that the MAS Recommended Rate (MRR) serves as the contractual fallback reference rate in the ISDA Documentation and the SC-STS' recommended fallbacks for bilateral and syndicated business loans, that will apply after Fallback Rate (SOR) is discontinued after 31 December 2024. MRR is recommended by the MAS or by a committee officially endorsed or convened by the MAS.

The MRR for respective tenors is computed as the sum of Compounded SORA in arrears and an MRR Adjustment Spread for the respective tenor. The applicable MRR Adjustment Spread is determined using the historical median of the spread between SOR and Compounded SORA in arrears for the respective tenor, using a 5-year lookback period ended 18 July 2022. Please refer to the guidance¹⁴ issued by SC-STS for more details.

¹⁰ Please refer to Section 2.4 in [SORA Market Compendium on the Transition from SOR to SORA](#).

¹¹ Fallback Rate (SOFR) is calculated by compounding USD Secured Overnight Financing Rate (SOFR) and adding the relevant spread adjustment. Fallback Rate (SOFR) is published by Bloomberg Index Services Limited, and it will be the fallback rate for USD LIBOR derivatives that adhere to the ISDA Fallbacks Protocol.

¹² Please refer to [Fallback Rate \(SOR\) Factsheet](#).

¹³ Please refer to [media release](#) by ABS and SC-STS issued on 18 July 2022.

¹⁴ Please refer to [Implementation of Supplementary Guidance on Adjustment Spreads for the Conversion of Legacy SOR Loans to SORA](#) issued on 14 December 2022.

The differences between SORA, Fallback Rate (SOR) and MAS Recommended Rate are summarised as below:

	SORA	Fallback Rate (SOR)	MAS Recommended Rate
Usage	<ul style="list-style-type: none"> Identified by SC-STS as the risk-free rate to replace SOR Market participants are encouraged to transition to and use SORA as the contractual benchmark rate 	<ul style="list-style-type: none"> Identified by SC-STS as the primary fallback reference rate for SOR contracts Not intended for usage in new contracts Only applicable following the permanent cessation of USD LIBOR after 30 June 2023 or USD LIBOR losing its representativeness Discontinue after 31 December 2024 	<ul style="list-style-type: none"> Identified by SC-STS as the fallback reference rate for SOR contracts Not intended for usage in new contracts Only applicable after the discontinuation of Fallback Rate (SOR) on 31 December 2024
Calculation¹⁵	Volume-weighted average rate of borrowing transactions in the unsecured overnight interbank SGD cash market in Singapore	FX-implied rate of Fallback Rate (SOFR)	Sum of Compounded SORA in arrears and MRR adjustment spread (based on 5 years historical median of the spread between SOR and Compounded SORA in arrears) for respective tenors

3.3.2 Supplementary Guidance for Active Transition for legacy SOR contracts to SORA [January 2023 Update]

On 18 July 2022, SC-STS had published a supplementary guidance¹⁶ for adjustment spreads which is applicable until 31 December 2024. These adjustment spreads would be based on a linear interpolation between a reference spread based on a recent and shorter historical median of the SOR-SORA spread (“Reference Spot Spreads”) and the MRR Adjustment Spreads that would apply after 31 December 2024. It was recommended by SC-STS that these adjustment spreads under this set of supplementary guidance should be applied directly without the need for further negotiation for unhedged loans, and can be a starting point for discussions among counterparties for bilateral derivatives and hedged loans. Please refer to the guidance¹⁴ issued by SC-STS for more details.

¹⁵ Please refer to the [Calculation Methodology for Fallback Rate \(SOR\)](#) for more details.

¹⁶ Please refer to the [Response to Consultation Feedback: Adjustment Spreads for the Conversion of Legacy SOR Contracts to SORA](#) for more details.

4. IBOR Reform and its Effects on Financial Reporting

The International Accounting Standards Board (IASB) undertook a two-phase approach to address accounting issues arising from the IBOR reform. The amendments issued by IASB in both phases were then also issued in Singapore by ASC.

4.1 Interest Rate Benchmark Reform - Phase 1 Amendments

Phase 1 amended SFRS(I) 9 *Financial Instruments*, SFRS(I) 1-39 *Financial Instruments: Recognition and Measurement* and SFRS(I) 7 *Financial Instruments: Disclosures*.

These amendments mainly provide temporary exceptions from the potential effects of the uncertainty caused by the reform and allow entities to continue their hedge accounting relationships during the period of uncertainty. They are effective for annual periods beginning on or after 1 January 2020 and will cease to be applied at the earlier of when the uncertainty from IBOR reform is no longer present and when the hedging relationship is discontinued. In addition, the amendments added specific disclosures about the extent to which hedging relationships are affected by the amendments.

In relation to these temporary exceptions from applying specific hedge accounting requirements, paragraphs 6.8.1 to 6.8.12 were added to SFRS(I) 9 and paragraphs 102A to 102N were added to SFRS(I) 1-39. As for disclosures, paragraph 24H was added to SFRS(I) 7.

4.2 Interest Rate Benchmark Reform - Phase 2 Amendments

Phase 2 amended SFRS(I) 9 *Financial Instruments*, SFRS(I) 1-39 *Financial Instruments: Recognition and Measurement*, SFRS(I) 7 *Financial Instruments: Disclosures*, SFRS(I) 4 *Insurance Contracts* and SFRS(I) 16 *Leases*.

The objective of the Phase 2 amendments¹⁷ was to address issues that might affect financial reporting during the IBOR reform, including the effects of changes to contractual cash flows or hedging relationships arising from the replacement of an interest rate benchmark with an alternative benchmark rate. These amendments are effective for annual periods beginning on or after 1 January 2021 with earlier application permitted.

The following are the key reliefs provided under the Phase 2 amendments to SFRS(I) 9¹⁸ and SFRS(I) 1-39¹⁵ for changes arising from the IBOR reform:

¹⁷ Please refer to [IASB IBOR Reform and its Effects on Financial Reporting—Phase 2](#) for the amendments.

¹⁸ SFRS(I) 9 and SFRS(I) 1-39 are equivalent to FRS 109 and FRS 39 respectively.

4.2.1 Practical Expedient for Changes to Contractual Cash Flows Required by the Reform

Scope and effect of practical expedient

Paragraphs 5.4.5 to 5.4.9 were added to SFRS(I) 9 under the section “Changes in the basis for determining the contractual cash flows as a result of interest rate benchmark reform”. This is applicable to financial assets and financial liabilities accounted for under the amortised cost method.

The practical expedient provided in SFRS(I) 9 paragraph 5.4.7 requires entities to apply B5.4.5 to account for a change in the basis for determining the contractual cash flows of a financial asset or financial liability that is required by interest rate reform.

SFRS(I) 9 paragraph B5.4.5 explains that the periodic re-estimation of the future interest payments for floating-rate financial assets or floating-rate financial liabilities normally has no significant effect on their carrying amounts.

IFRS 9 Basis For Conclusions paragraph BC5.308

“Applying the practical expedient in paragraph 5.4.7 of IFRS 9, an entity would account for a change in the basis for determining the contractual cash flows of a financial asset or a financial liability required by the reform as being akin to a ‘movement in the market rates of interest’ applying paragraph B5.4.5 of IFRS 9. As a result, an entity applying the practical expedient to account for a change in the basis for determining the contractual cash flows of a financial asset or a financial liability that is required by the reform would not apply the derecognition requirements to that financial instrument, and would not apply paragraphs 5.4.3 or B5.4.6 of IFRS 9 to account for the change in contractual cash flows. In other words, changes in the basis for determining the contractual cash flows of a financial asset or a financial liability that are required by the reform would not result in an adjustment to the carrying amount of the financial instrument or immediate recognition of a gain or loss. The IASB concluded that the application of the practical expedient would provide useful information about the effect of the reform on an entity’s financial instruments in the circumstances in which it applies.”

As explained in paragraph BC5.308 above, the entity is not required to apply the derecognition requirements to the financial instrument or apply SFRS(I) 9 paragraphs 5.4.3 or B5.4.6 to account for the change in contractual cashflows.

The practical expedient is applied if the following conditions are met:

- (a) The contractual changes are a direct consequence of interest rate benchmark reform;
and
- (b) The new basis for determining the contractual cash flows as a result of the interest rate benchmark reform is economically equivalent to the previous basis.

Without the practical expedient, SFRS(I) 9 would require an entity to first consider whether changes to contractual cash flows of a financial instrument would result in the derecognition of the financial asset or financial liability. If these changes do not result in derecognition, an entity would have to apply modification accounting in accordance with either SFRS(I) 9 paragraphs 5.4.3 or B5.4.6. This would mean recalculating the gross carrying amount and recognising a gain or loss immediately in profit or loss. The gross carrying amount of the financial asset would be recalculated as the present value of the modified contractual cash flows that are discounted at the financial instrument’s original effective interest rate.

Contractual changes not in scope of practical expedient

SFRS(I) 9 paragraph 5.4.9 states that if there are any changes to the contractual terms of the financial instruments other than those required by IBOR reform, an entity will first apply the practical expedient to the changes required by IBOR reform. The entity will then apply the other applicable requirements in SFRS(I) 9 to the additional changes to which the practical expedient does not apply. If the other changes do not result in the financial instrument being derecognised, the entity accounts for the changes as a modification of the financial instrument using the revised effective interest rate which references the new, alternative benchmark rate.

4.2.2 Reliefs for Hedge Accounting

ASC added paragraphs 6.9.1 to 6.9.13 to SFRS(I) 9 under the section “Additional temporary exceptions arising from interest rate benchmark reform”. ASC added the equivalent paragraphs 102P to 102Z3 to SFRS(I) 1-39.

In addition to the temporary exceptions for specific hedge accounting requirements under the Phase 1 amendments, the Phase 2 amendments provide additional temporary exceptions from certain hedge accounting requirements so that, subject to meeting the applicable criteria, changes to hedge designations and hedge documentation required by the IBOR reform would not result in discontinuation of hedge accounting.

Changes to the hedge documentation to preserve hedge accounting

When an entity ceases to apply the IBOR Phase 1 amendments to a hedging relationship, the entity is required to amend the formal designation of a hedging relationship as previously documented to reflect the changes that are required by the IBOR reform in accordance with SFRS(I) 9 paragraph 6.9.1. Otherwise, this would result in the discontinuation of hedge accounting. If hedge accounting is to be continued this would require designation of a new hedging relationship.

Changes to hedge documentation required by the IBOR reform include:

- (a) Designating an alternative benchmark rate as the hedged risk (e.g. from SOR interest rate risk to SORA interest rate risk).
- (b) Changing the description of the hedged item (e.g. from a SOR based borrowing to a SORA based borrowing), including the designated portion of the hedging instrument.
- (c) For those applying SFRS(I) 1-39, amending the description of how the entity will assess hedge effectiveness (see SFRS(I) 1-39.102P(d)).

To amend the hedge designation, the entity needs to ensure that the following two conditions in SFRS(I) 9 paragraph 5.4.7 are met:

- (a) The change is necessary as a direct consequence of interest rate benchmark reform;
and
- (b) The new basis for determining the contractual cash flows as a result of the interest rate benchmark reform is economically equivalent to the previous basis.

Changes to the hedge documentation are required to be made by the end of the reporting period during which the change required by the interest rate reform is made to the hedged risk, hedged item or hedging instrument.

An entity can also preserve hedge accounting when amending the description of the hedging instrument if the following three conditions under SFRS(I) 9 paragraph 6.9.2 or SFRS(I) 1-39 102Q are met.

- (a) The entity makes a change required by the reform using an approach other than changing the basis for determining the contractual cash flows of the hedging instrument;
- (b) The original hedging instrument is not derecognised; and
- (c) The chosen approach is economically equivalent to changing the basis for determining the contractual cash flows of the original hedging instrument.

Other reliefs for hedge accounting

The following are other reliefs provided for specific hedge accounting requirements under the Phase 2 amendments:

- (a) Amounts accumulated in the cash flow hedge reserve

When a hedged item in a cash flow hedge is amended to reflect the changes that are required by the reform, the amount accumulated in the cash flow hedge reserve will be deemed to be based on the alternative benchmark rate on which the hedged future cash flows are determined. Therefore, the entity reclassifies the cash flow hedge reserve to profit or loss only when the cash flows of the amended hedged item affect profit or loss. The same relief is also provided for a discontinued cash flow hedging relationship.

- (b) Groups of items designated as hedged items

When a group of items is designated as a hedged item and an item in the group is amended to reflect the changes that are required by the reform, an entity will allocate the hedged items to sub-groups based on the benchmark rate being hedged, and designate the benchmark rate for each sub-group as the hedged risk. An entity will assess each sub-group separately to determine whether the sub-group is eligible to be a hedged item.

- (c) Separately identifiable requirement

If an entity reasonably expects that an alternative benchmark rate will be separately identifiable within a period of 24 months from the date that benchmark rate is first designated, it can designate the rate as a non-contractually specified risk component even if it is not separately identifiable at the designation date. This is applied on a rate-by-rate basis and is also applicable to new hedge accounting relationships.

- (d) Retrospective effectiveness assessment (SFRS(I) 1-39 only)

When performing a retrospective hedge effectiveness assessment under SFRS(I) 1-39, an entity may choose to reset the cumulative fair value changes of the hedged item and hedging instrument to zero immediately after ceasing to apply the Phase 1 relief on a hedge-by-hedge basis.

4.2.3 Disclosures

ASC added paragraphs 24I and 24J to SFRS(I) 7 to require additional disclosures relating to the interest rate benchmark reform.

5. Accounting Considerations

Issued October 2021

5.1 What does “necessary as a direct consequence” of interest rate benchmark reform mean?

Interest rate benchmark reform refers to the market-wide reform of interbank offered rates (IBOR) including their replacement with alternative benchmark rates, such as those resulting from the Financial Stability Board’s recommendations set out in its July 2014 report *Reforming Major Interest Rate Benchmarks*.¹⁹

The scope of the Phase 2 reliefs is limited to changes in contractual cash flows that are “necessary as a direct consequence” of the reform. This condition was designed to capture only changes in the basis for determining the contractual cash flows that are required to implement the reform.²⁰

SFRS(I) 9 does not give specific examples of changes that are a direct consequence of interest rate benchmark reform. Therefore, entities may be required to exercise judgement to determine if the changes are direct consequences of the reform. The necessary changes might also vary depending on the type of contract (for example, a loan, or a derivative). However, the following are some examples of changes that would generally be a direct consequence of interest rate benchmark reform:

- (a) Replacement of the existing interest rate benchmark affected by IBOR reform with an alternative benchmark rate;
- (b) Addition of a fixed spread made to reflect the basis difference between the existing interest rate benchmark affected by the IBOR reform as compared to the new alternative benchmark rate;
- (c) Amendments in the computation method used to derive the applicable interest rate (for example, where the new methodology calculates the interest rate as a daily compounded average of an overnight benchmark rate instead of a quoted rate); and
- (d) Addition of a fallback clause to address any of the above changes.

The following changes are some examples which would generally not be a direct consequence of interest rate benchmark reform:

- (a) Amendments to the original contracted amount or due date;
- (b) Amendments to the arrangement (type/nature) or repayment methods (for example, changing a revolving loan facility to a term loan);
- (c) Changes in credit spread to reflect changes in the credit quality of the borrower;
- (d) Changes in terms that are unrelated to the interest rate benchmark such as changing payments to be indexed to the price of a commodity;
- (e) Changes in the contracting parties who are not related to the original contracting parties; and

¹⁹ IFRS 9 Basis For Conclusion paragraph BC6.546

²⁰ IFRS 9 Basis For Conclusion paragraph BC5.310

- (f) Amendments to the type of currency used in the contract.

Where there are changes to contractual terms that are not a direct consequence of the IBOR reform, an entity would have to apply the requirements in SFRS(I) 9 paragraph 5.4.9 to account for these changes.

5.2 What does “economically equivalent” mean?

IASB requires “economic equivalence” as the second condition for applying the Phase 2 reliefs, because the objective of the reform is limited to the transition to alternative benchmark rates – i.e. it does not encompass other changes that would lead to value transfer between the parties to a financial instrument.²¹

Examples of changes that are economically equivalent to the previous basis (that is, the basis immediately preceding the change) are provided in SFRS(I) 9 paragraph 5.4.8 as follows:

- (a) The replacement of an existing interest rate benchmark used to determine the contractual cash flows of a financial asset or financial liability with an alternative benchmark rate – or the implementation of such a reform of an interest rate benchmark by altering the method used to calculate the interest rate benchmark – with the addition of a fixed spread necessary to compensate for the basis difference between the existing interest rate benchmark and the alternative benchmark rate. IFRS 9 Basis For Conclusion paragraph BC5.316 adds that in such circumstances, no additional analysis is required to determine that the economic equivalence condition has been satisfied;
- (b) Changes to the reset period, reset dates or the number of days between coupon payment dates in order to implement the reform of an interest rate benchmark; and
- (c) The addition of a fallback provision to the contractual terms of a financial asset or financial liability to enable any change described in (a) and (b) above to be implemented.

IASB intends “economic equivalence” to be principle-based and has therefore provided no detailed application guidance. Acknowledging that different entities in different jurisdictions would implement the reform differently, the IASB does not require a particular approach for assessing this condition. As IASB has set no “bright line”, an entity is required to apply judgement to assess whether its circumstances meet the economic equivalence condition. For example, assuming that the entity determines that replacing an interest rate benchmark with an alternative benchmark rate is necessary for the affected financial instrument as a direct consequence of the reform, the entity determines²²:

- (a) What alternative benchmark rate will replace the interest rate benchmark and whether a fixed spread adjustment is necessary to compensate for a basis difference between the alternative benchmark rate and the interest rate benchmark preceding replacement. The entity would assess the overall resulting cash flows, including amounts relating to interest (i.e. alternative benchmark rate plus any fixed spread adjustment), to determine whether the economic equivalence condition is met. In other words, in this example, the entity would assess whether the interest rate has remained substantially similar before and after the replacement – specifically, whether the interest rate after replacement (i.e. the alternative benchmark rate plus the fixed

²¹ IFRS 9 Basis For Conclusion paragraph BC5.311

²² IFRS 9 Basis For Conclusion paragraph BC5.315

spread) is substantially similar to the interest rate benchmark immediately preceding the replacement; and

- (b) Whether the alternative benchmark rate (plus the necessary fixed spread described in (a)) is applied to the relevant affected financial instruments.

There is no requirement in SFRS(I) 9 for economic equivalence to be demonstrated or assessed by comparing the fair value or discounted present value of the cash flows of an instrument immediately before and after the change. If the entity can demonstrate that economically, the basis for determining the contractual terms will remain substantially the same immediately before and after the transition, it would not normally be necessary to make a quantitative evaluation for each financial instrument transition. However, a comparison of fair values or discounted present value of the cash flows before and after the transition are examples of quantitative assessments. Conversely, an example of a qualitative assessment is the use of SORA plus an adjustment spread based on either market SOR-SORA basis swap rate or supplementary guidance (see Section 3.3.2) as recommended by the SC-STs under the purview of MAS. This basis is considered as economically equivalent because the SORA rate plus an adjustment spread based on SOR-SORA basis swap rate or supplementary guidance is deemed to be economically equivalent to the SOR rate.

January 2023 Update

With the declining liquidity in SOR-SORA basis swap markets, SC-STs published a supplementary guidance to help market participants price the adjustment spread for active transition of legacy wholesale SOR contracts to SORA until 31 December 2024. The SC-STs' supplementary guidance is endorsed by MAS and received strong support from the consultation with market participants. Please refer to Section 3.3.2 for more information on how adjustment spread is calculated based on the supplementary guidance.

5.3 Does changing the contractual benchmark rate of a SOR/SIBOR-based loan/borrowing to SORA qualify for the Phase 2 relief for amortised cost measurement?

Pursuant to SFRS(I) 9 paragraph 5.4.7, an entity applies the Phase 2 relief for amortised cost measurement if, and only if, both conditions are met:

- (a) The change is “necessary as a direct consequence” of interest rate benchmark reform; and
- (b) The new basis for determining the contractual cash flows is “economically equivalent” to the previous basis (i.e. the basis immediately preceding the change).

The change of the contractual benchmark rate from SOR/SIBOR to SORA is deemed “necessary as a direct consequence” of the IBOR reform in Singapore due to the following:

- (a) Both SOR and SIBOR are subject to the interest rate benchmark reform in Singapore and will discontinue after 30 June 2023 and end of 2024 respectively;
- (b) SORA has been recommended to be the main benchmark for SGD financial markets, replacing both SOR and SIBOR;
- (c) Therefore, for a loan referencing SOR/SIBOR and maturing after the index cessation date, it is necessary to consider making changes to the loan terms prior to the cessation of SOR/SIBOR (if the loan is not repaid prior). A change to the referenced

interest rate to SORA instead of SOR/SIBOR can be considered as a direct consequence of the reform.

For SOR/SIBOR-based loans/borrowings that transition to SORA, entities will also need to make a determination of whether the “economic equivalence” condition is also met (See Section 5.2 on the accounting considerations for this assessment).

When the two conditions in SFRS(I) 9 paragraph 5.4.7 are met, entities apply the practical expedient in SFRS(I) 9 paragraph B5.4.5 to adjust the effective interest rate for the changes required by interest rate benchmark reform. The effect is such that there should be no change to the carrying amount of a financial asset or a financial liability that is measured at amortised cost on the date of contract modification.

Illustrative Example 1

Entity X has an existing S\$100m borrowing at 3-month SOR + 1%^a, maturing on 31 December 2025. Assuming no transaction costs, the original effective interest rate of the borrowing is based on 3-month SOR + 1%^a. Interest is payable in arrears every 3 months.

Due to the interest rate benchmark reform, the borrowing is modified on 31 December 2021 on the following basis:

- The contractual benchmark rate of 3-month SOR is replaced by SORA* plus an adjustment spread.
- Assume that the published SOR-SORA basis swap rate is 0.5%. The new basis (SORA* + 0.5%) for determining the contractual cash flows is substantially similar to the preceding basis (3-month SOR).
- Accordingly, the original contractual interest rate of 3-month SOR + 1%^a is amended to SORA* + 1.5%^b.
- There is no change to the other terms of the borrowing.

Entity X has assessed that:

- (a) The change of benchmark interest rate from 3-month SOR to SORA plus an adjustment spread is necessary as a result of the IBOR reform and hence, is a direct consequence of IBOR reform in Singapore; and
- (b) The new basis of SORA* + 0.5% for determining the contractual cash flows is economically equivalent to the original basis of 3-month SOR.

Therefore, on 31 December 2021, Entity X will apply the Phase 2 practical expedient to adjust the effective interest rate of the borrowing to reflect SORA* + 1.5%^b. As a result, there will be no change to the carrying amount of the borrowing as at the date of contract modification.

^a This refers to Entity X's credit spread of 1%.

^b The revised spread of 1.5% includes Entity X's credit spread of 1%.

* SORA in this example refers to SORA daily compounded in arrears (explained in Section 5.5 and Appendix A) over each 3-month interest period.

5.4 What are the considerations to qualify for Phase 2 reliefs in order to continue cash flow hedge accounting?

For the purpose of applying the Phase 2 reliefs in order to continue their existing hedge accounting assuming risk management objective remains unchanged, entities have to meet the following conditions:

- (a) Changes in the basis for determining the contractual cash flows of the hedged item and hedging derivative are “necessary as a direct consequence” of interest rate benchmark reform²³;
- (b) The new basis for determining the contractual cash flows is “economically equivalent” to the previous basis²⁴;
- (c) The original hedging derivative is not derecognised²⁵; and
- (d) The formal hedge designation and hedge documentation should be amended by the end of the reporting period (including interim reporting period if applicable) during which the change required by interest rate benchmark reform is made to the hedged item or hedging derivative²⁶.

When the above conditions are met, the following Phase 2 reliefs for hedge accounting are applied:

- (a) The amendment of hedge designation and the hedge documentation constitutes neither the discontinuation of the hedging relationship nor the designation of a new hedging relationship²⁷; and
- (b) The amount accumulated in the cash flow hedge reserve is deemed to be based on the alternative benchmark rate on which the hedged future cash flows are determined.²⁸

Notwithstanding the above, if the transition results in mismatch in the critical terms of the hedged item (or hypothetical derivative) and the hedging derivative, any hedge ineffectiveness should be recognised immediately in profit or loss.

Illustrative Example 2

Entity X has an existing S\$100m borrowing that pays 3-month SOR + 1%^a, maturing on 31 December 2025. The borrowing is hedged by an interest rate swap (“IRS”) that receives 3-month SOR and pays 0.8%, maturing on 31 December 2025. All critical terms of the borrowing and the IRS match. Entity X has designated the IRS since inception as a cash flow hedge of the borrowing’s exposure to cash flow variability attributable to SOR.

Due to the interest rate benchmark reform, both the borrowing and the IRS are modified on 31 December 2021 on the same basis:

- The contractual benchmark rate of 3-month SOR is replaced by SORA* plus an adjustment spread.
- The adjustment spread is determined based on the SOR-SORA basis swap rate of 0.5%, as the new basis of SORA* + 0.5% for determining the contractual cash flows is substantially similar to the old basis of 3-month SOR.
- There is no change to the other terms of the borrowing.

²³ SFRS(I) 9 paragraphs 5.4.7(a) and 6.9.1

²⁴ SFRS(I) 9 paragraphs 5.4.7(b) and 6.9.1

²⁵ SFRS(I) 9 paragraph 6.9.2

²⁶ SFRS(I) 9 paragraph 6.9.4

²⁷ SFRS(I) 9 paragraph 6.9.4

²⁸ SFRS(I) 9 paragraph 6.9.7

Illustrative Example 2 (Cont'd)

The table below shows the contractual cash flows before and after the modification of both the hedged borrowing and the IRS.

	Hedged Borrowing	Hedging IRS		Total Interest Rate Payable ^c by Entity X
	Pay Float	Receive Float	Pay Fix	
Before	3-month SOR + 1% ^a	3-month SOR	0.8%	1.8%
After	SORA* + 1.5% ^b	SORA*	0.3%	1.8%

^a This refers to Entity X's credit spread of 1%.

^b The revised spread of 1.5% includes Entity X's credit spread of 1%.

^c While the hedged risk is the 3-month SORA, we have included the Entity X's credit spread of 1% to show the total interest rate payable.

Entity X's year end is on 30 June, but it prepares and announces its half-year interim results for 31 December 2021. On 31 December 2021, Entity X will amend its hedge documentation to reflect the changes in the hedged item and the hedging instrument – specifically, it will designate the SORA-based IRS to hedge the SORA cash flows of the borrowing.

Entity X has assessed that the changes to the hedged borrowing and the hedging IRS qualify for Phase 2 reliefs for hedge accounting, because:

- The change of benchmark interest rate from 3-month SOR to SORA plus fixed adjustment spread is necessary as a direct consequence of IBOR reform in Singapore;
- The replacement of 3-month SOR with SORA* + 0.5% is on an economically equivalent basis;
- The transition approach does not result in the derecognition of the IRS; and
- The hedge designation and hedge documentation have been amended in the same reporting period ending 31 December 2021 when the hedged borrowing and the IRS are modified.

Hence, the hedge accounting relationship would be preserved.

The amount accumulated in the cash flow hedge reserve as at 31 December 2021 is deemed to relate to the hedged cash flows based on SORA*, and there is no reclassification to profit or loss arising from the SOR-SORA transition. Notwithstanding so, the test for hedge effectiveness is required to be applied prospectively using the revised hedge designation from the date of change. Any hedge ineffectiveness is to be recognised immediately in profit or loss.

Additional considerations:

- In this example, we have assumed a simple scenario whereby both the hedged item and hedging instrument transit to the alternative benchmark rate on the same day using the same adjustment spread. Differences including transition timing or mismatch in critical terms may give rise to hedge ineffectiveness.
- If the hedged item and/or the hedging derivative are/is amended in a reporting period that begins before 1 January 2021, the reporting entity has to early adopt Phase 2 amendments to SFRS(I) 9 in order to apply the Phase 2 reliefs.

* SORA in this example refers to SORA daily compounded in arrears (explained in Section 5.5 and Appendix A) over each 3-month interest period.

For discontinued hedging relationships, the following Phase 2 relief can be applied:

SFRS(I) 9 paragraph 6.9.8 provides relief for cash flow hedges in a discontinued hedging relationship. An entity is required to apply SFRS(I) 9 paragraph 6.5.12 in order to determine whether the hedged future cash flows are expected to occur and the amount accumulated in the cash flow hedge reserve for that hedging relationship shall be deemed to be based on the alternative benchmark.

For example, an entity discontinues hedge accounting for a cash flow hedge but re-enters into another interest rate swap to hedge its SORA-based cashflows. If the new hedged item (borrowing) is measured at amortised cost, the accumulated cash flow hedge reserve would be amortised to profit or loss over the remaining term of the borrowing if the hedged future cash flows (SORA-based cash flows) are still expected to occur.

5.5 From a borrower's perspective, does a SORA compounded in advance interest rate give rise to an embedded derivative that is not closely related to the host debt?

Singapore Overnight Rate is the interest rate for unsecured SGD borrowings between banks for a period of one day. SORA is a volume-weighted average of the overnight rates on actual transactions for a given business day and is published by 9.00am on the next business day.

A debt instrument referencing SORA is effectively a floating-rate note (FRN) with daily interest rate reset to SORA. However, instead of paying interest on a daily basis, the borrower will pay interest at the end of the interest period of either 1 month, 3 months or 6 months. Also, instead of calculating the interest daily, the interest amount for the entire period (1 month, 3 months or 6 months) is calculated at a compounded SORA of 1-month, 3-month or 6-month tenor.

If the compounded SORA is calculated based on the actual daily SORA readings (published the next business day) over the same period, the resulting interest rate is called "SORA compounded in arrears". An FRN referencing SORA compounded in arrears is consistent with a basic debt instrument, without an embedded interest rate derivative.

If the compounded SORA is calculated based on the actual daily SORA readings over an agreed preceding observation period, the resulting interest rate is called "SORA compounded in advance". For example, if the contractual basis is to reset interest rate for the month of February 2021 to the historical SORA for the month of January 2021, the resulting interest rate is called "SORA compounded in advance". Under SFRS(I) 9, this would result in a host debt instrument which contains an embedded interest rate derivative.

When considering whether such an embedded derivative should be separately accounted for at Fair Value through Profit or Loss (FVTPL), the borrower should assess whether that embedded derivative is closely related to the host contract.

SFRS(I) 9 paragraph B4.3.8(a) states that an embedded interest rate derivative is closely related to the host debt, unless (i) the hybrid contract can be settled in such a way that the holder would not recover substantially all of its recognised investment or (ii) the embedded derivative could at least double the holder's initial rate of return on the host contract and could result in a rate of return that is at least twice what the market return would be for a contract with the same terms as the host debt.

An example would be a term borrowing at a variable interest rate referencing SORA compounded in advance, reset every 3 months, with the interest amount being settled at the end of 3 months. The interest rate in this example is said to be SORA compounded in advance as it is based on actual daily SORA reading over a preceding observation period of 3 months. Hence, there is an embedded derivative in this borrowing. The embedded derivative is "closely related" to the host contract (i.e. borrowing) if the following conditions are met:

- (a) The hybrid contract (compound instrument, i.e. borrowing plus embedded derivative) can be settled in such a way that the holder (lender) would recover substantially all of its recognised investment; or

- (b) The embedded derivative could not have doubled the holder's initial rate of return on the host contract and could not result in a rate of return that is at least twice what the market rate would be for a contract with the same terms as the host contract.

In this example, the conditions are likely to be met because the SORA compounded in advance is expected to be not materially different from SORA compounded in arrears. If the embedded derivative is closely related to the host contract, it is not required to be separated and the borrower can continue to account for this borrowing using amortised cost.

In addition, due consideration should be given to the materiality concept in assessing whether the derivative is closely related to the host contract.

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5.6 From a lender's perspective, do benchmark interest rates based on SORA compounded in advance meet the solely payments of principal and interest (SPPI) criterion?

As described in Section 5.5, the compounded SORA in advance is calculated based on the actual daily SORA readings over an agreed preceding observation period. This would result in an imperfect time value of money element in the context of lagging interest rates and / or tenor mismatches (see Appendix A *Embedded Derivatives and SORA-based Interest Rate* for illustrations). If the modified time value of money element could result in contractual cash flows that are significantly different from the benchmark cash flows, the financial asset does not meet the SPPI criterion.

The assessment of whether SORA compounded in advance meets the SPPI criterion should focus on:

- (a) What the lender is being compensated for (i.e. whether the lender is receiving consideration for only time value of money, credit risk, other basic lending risks and profit margin) and whether there is cash-flow variability due to risks in the contractual terms of the financial asset, which are inconsistent with a basic lending arrangement;
- (b) How different the contractual (undiscounted) cash flows could be compared to the (undiscounted) cash flows that would arise if the time value of money element was not modified (the benchmark cash flows). The "benchmark" test should be qualitatively or quantitatively performed at the initial recognition of a financial asset, considering effect of the modified time value of money for:
 - i. Each reporting period; and
 - ii. Cumulatively over the life of the instrument - For the same time lag or mismatch in tenors, the overall effect of modification to the time value of money element will be lower for a loan with longer maturity relative to one with shorter maturity.

For example, consider a 5-year loan with quarterly interest based on 3-month SORA compounded in advance. The lender has assessed that:

- (a) The SORA compounded in advance compensates the lender for only time value of money and does not introduce variability that is inconsistent with a basic lending arrangement.
- (b) The daily SORA rates effective for 19 (out of 20) quarters would be used, other than the interest in the first quarter which is based on the daily SORA rates 3 months before the start of the loan. It has assessed that the time lag is not too long and the rate is not expected to be highly volatile, so it is clear that the contractual (undiscounted) cash flows based on 3-month SORA compounded in advance could not be significantly different from the (undiscounted) benchmark cash flows in each annual reporting period and

cumulatively over the life of the loan. Therefore, the lender has qualitatively concluded that the SPPI criterion is met.

In some circumstances, the entity may be able to make that determination by performing a qualitative assessment of the time value of money element whereas, in other circumstances, it may be necessary to perform a quantitative assessment. If it is clear, with little or no analysis, whether the contractual (undiscounted) cash flows on the financial asset under the assessment could (or could not) be significantly different from the (undiscounted) benchmark cash flows, an entity need not perform a detailed assessment.

SFRS(I) 9 does not define “significant” in the context of the “benchmark” test. Entities will therefore need to exercise judgement in determining this.

5.7 If an entity relies on the fallback clauses in its SOR-based contracts and uses Fallback Rate (SOR) after 30 June 2023, is the change considered as “required by interest rate benchmark reform”?

Yes. Changing the basis for determining contractual cash flows from SOR to Fallback Rate (SOR) is deemed as “required by interest rate benchmark reform” as per SFRS(I) 9 paragraph 5.4.7. This is because:

1) The contractual changes are necessary as a direct consequence of the interest rate benchmark reform

When SOR becomes unavailable and the contract includes a fallback provision referencing Fallback Rate (SOR), or when a fallback provision referencing Fallback Rate (SOR) is added to the contractual terms, the replacement of SOR with Fallback Rate (SOR) is considered as a direct consequence of IBOR Reform in Singapore because the use of Fallback Rate (SOR) as a fallback reference rate for SOR derivatives is supported by SC-STs²⁹. Fallback Rate (SOR) will be the fallback rate for SOR derivatives that adhere to the ISDA Fallbacks Protocol. Fallback Rate (SOR) can also be used in fallback clauses of SOR-based loans and securities that reference SOR³⁰.

2) The new basis for determining the contractual cash flows as a result of the interest rate benchmark reform is economically equivalent to the previous basis

SOR is an SGD interest rate benchmark that uses USD LIBOR as an input. Fallback Rate (SOR) follows the same calculation formula as SOR, except that the USD LIBOR in the calculation is replaced by Fallback Rate (SOFR). Fallback Rate (SOFR) includes a spread adjustment that accounts for the basis difference between USD LIBOR and SOFR. This spread adjustment is calculated using a historical median approach which is determined by ISDA after its consultation process. Given that Fallback Rate (SOFR) is economically equivalent to USD LIBOR, Fallback Rate (SOR) would in turn be economically equivalent to SOR.

Where financial assets (such as loans and bonds held) and financial liabilities (such as borrowings and bonds issued) measured at amortised cost are transitioned from SOR to Fallback Rate (SOR), entities are able to apply the practical expedient as described in Section 4.2.1 because the change from SOR to Fallback Rate (SOR) is triggered as a result of IBOR reform.

²⁹ SC-STs noted that compared to a fallback rate based on SORA, Fallback Rate (SOR) is more similar to and correlated with SOR, and the use of Fallback Rate (SOR) as the fallback reference rate would reduce the risk of value transfer. Please refer to [Fallback Rate \(SOR\) factsheet](#).

³⁰ Please refer to respective sections on capital market products and corporate loans in [SORA Market Compendium on the Transition from SOR to SORA](#).

January 2023 Update

With reference to Section 3.3.1(b), the MAS Recommended Rate (MRR) will serve as the contractual fallback rate in the ISDA documentation for derivatives and the SC-STIS' recommended fallbacks for bilateral and syndicated business loans, that will apply after. Fallback Rate (SOR) is discontinued after 31 December 2024. This means that a legacy SOR contract that matures after 31 December 2024 will first fallback to Fallback Rate (SOR) on 1 July 2023 upon the cessation of SOR, and the contractual benchmark will subsequently fallback to MRR on 1 January 2025 upon the cessation of Fallback Rate (SOR).

Changing the contractual benchmark rate from SOR to Fallback Rate (SOR) and subsequently to MRR would be deemed as "required by interest rate benchmark reform" because:

- The MRR is the rate endorsed by MAS as the replacement for Fallback Rate (SOR), and the changes in contractual benchmark rates in accordance with ISDA documentation or similar fallback provisions is a direct consequence of the interest rate benchmark reform; and
- MRR, which is computed as the sum of Compounded SORA in arrears and an MRR adjustment spread for the applicable tenor, would be deemed as economically equivalent to SOR. The MRR adjustment spread accounts for the structural differences between SOR and SORA, and it is determined using the 5-year historical median of the spread between SOR and the Compounded SORA in arrears for the respective tenor. There is a clearly defined market mechanisms for transition which is widely accepted by the market.

Illustrative Example 3

Entity X has an existing S\$100m borrowing at 3-month SOR + 1%^a, maturing on 31 December 2024. Assuming no transaction costs, the original effective interest rate of the borrowing is based on 3-month SOR + 1%^a. Interest is payable in arrears every 3 months.

Due to the interest rate benchmark reform, Entity X has modified the interest rate of the borrowing to the following basis:

- The fallback clause is added^b to use 3-month Fallback Rate (SOR) as the fallback reference rate where 3-month SOR is unavailable.
- Accordingly, the original contractual interest rate of 3-month SOR + 1%^a is amended to 3-month Fallback Rate (SOR) + 1%^a, in the event that 3-month SOR is unavailable.
- There is no change to the other terms of the borrowing.

Entity X has assessed that:

- (a) When 3-month SOR is unavailable or cease to be published after 30 June 2023, the change of benchmark interest rate from 3-month SOR to 3-month Fallback Rate (SOR) is necessary as a result of the IBOR reform and hence, is a direct consequence of IBOR reform in Singapore; and
- (b) The new basis of 3-month Fallback Rate (SOR) for determining the contractual cash flows is substantially similar to the original basis and hence economically equivalent to the original basis of 3-month SOR.

Illustrative Example 3 (Cont'd)

Upon the activation of the fallback clause on 1 July 2023, Entity X will apply the practical expedient to prospectively adjust the effective interest rate of the borrowing to reflect 3-month Fallback Rate (SOR) + 1%^a. As a result, there will be no change to the carrying amount of the borrowing (and no modification gain or loss) as at the date of contract modification.

January 2023 Update

The MRR is the applicable fallback rate for loans maturing after 31 December 2024 when Fallback Rate (SOR) is discontinued. Assuming that the loan matures on 31 December 2026, the applicable contractual fallback rate is as follows:

- 1 July 2023 to 31 December 2024: 3-month Fallback Rate (SOR) + 1%^a; and
- 1 January 2025 to 31 December 2026: MRR + 1%^a,

As the fallback to Fallback Rate (SOR) and MRR is “required by interest rate benchmark reform”, Entity X will apply the practical expedient to prospectively adjust the effective interest rate of the borrowing to reflect Fallback Rate (SOR) + 1%^a or MRR + 1%^a in the applicable interest period. As a result, there will be no change to the carrying amount of the borrowing (and no modification gain or loss) as at the date of contract modification.

^a This refers to Entity X's credit spread of 1%.

^b This assessment can be applied to contracts with a fallback provision, or when a fallback provision referencing to Fallback Rate (SOR) is added to the contractual terms.

5.8 If an entity relies on the Fallback Rate (SOR) to transition its hedged item and/or hedging instrument that reference SOR, can hedge accounting still be applied?

Fallback Rate (SOR) only serves as a temporary fallback reference rate as it will discontinue after 31 December 2024.

For hedging relationships that mature on or before 31 December 2024, an entity may decide to rely on fallback clauses to transition both its hedged item and hedging instrument to Fallback Rate (SOR). In such a case, hedge accounting can still be applied on either of the following depending on the entity's facts and circumstances:

1) Applying Phase 1 amendments to SFRS(I) 9

The entity may assess that there is still uncertainty arising from the IBOR reform as Fallback Rate (SOR) only serves as a temporary fallback and it does not represent the alternative benchmark rate (or any related spread adjustment agreed between parties to the contracts). In addition, the use of Fallback Rate (SOR) will be triggered at the earlier of a permanent cessation of USD LIBOR (i.e. after 30 June 2023) or when USD LIBOR is no longer representative. Consequently, the uncertainty in respect of timing of when SOR will be replaced by Fallback Rate (SOR) or whether and when the entity may progress to transition to the alternative benchmark rate remains.

Phase 1 amendments include reliefs that allow entities to continue their hedge accounting relationships during the period when IBOR reform gives rise to uncertainties (“IBOR uncertainty”) about:

- a) The interest rate benchmark designated as a hedged risk; and/or
- b) The timing or the amount of interest rate benchmark-based cash flows of the hedged item or of the hedging instrument.

Determining whether or not IBOR uncertainty has ceased requires judgement. If the entity concludes that IBOR uncertainty is still present, it may apply the Phase 1 reliefs to preserve the existing hedging relationship. Notwithstanding, any actual hedge ineffectiveness (due to difference in the critical terms of the hedged item and those of the hedging instrument or any other reasons), should be immediately recognised in profit or loss.

January 2023 Update

With reference to Section 3.3.1(b), it has been announced by ABS and SC-STS that the MRR will apply as a contractual fallback reference rate in wholesale SOR contracts after 31 December 2024. MRR will replace Fallback Rate (SOR) when Fallback Rate (SOR) is discontinued on 31 December 2024.

Entities should consult with their auditors if they believe there is still uncertainty with respect to the timing and the amount of the interest rate benchmark-based future cash flows of the hedged item or the hedging instrument. Phase 1 reliefs may no longer be applicable, depending on entities' facts and circumstances.

2) Applying Phase 2 amendments to SFRS(I) 9

As set out in Section 5.7, replacement of SOR with Fallback Rate (SOR) upon the cessation of SOR is a change that is required by interest rate benchmark reform. If the entity concludes that IBOR uncertainty is no longer present, it should apply the reliefs in Phase 2 amendments to preserve the existing hedging relationship, provided that the following are met:

- a) The original hedging instrument has not been derecognised; and
- b) The hedge documentation has been updated to reflect this change in the hedged risk, hedging instrument and hedged item.

In other cases, such as where the hedging relationships end after 31 December 2024 or where there is mismatch in the critical terms between the hedged item and the hedging instrument, entities should consult with their auditors if they intend to rely on Fallback Rate (SOR) and the MRR to transition its SOR-based hedging relationships.

Any hedge ineffectiveness is required to be recognised immediately in profit or loss, regardless of the application of Phase 1 or Phase 2 amendments.

Illustrative Example 4

Entity X has an existing S\$100m borrowing that pays 3-month SOR + 1%^a, maturing on 31 December 2024. The borrowing is hedged by an interest rate swap ("IRS") that receives 3-month SOR and pays 0.8%, maturing on 31 December 2024. All critical terms of the borrowing and the IRS match. Entity X has designated the IRS since inception as a cash flow hedge of the borrowing's exposure to cash flow variability attributable to SOR.

Due to the interest rate benchmark reform, the entity intends to rely on fallback clauses to transition both the borrowing and the IRS to Fallback Rate (SOR). Specifically:

- Entity X has amended the fallback clause on the IRS in accordance with the ISDA Fallback Protocol.
- Entity X has also amended the fallback clause of the borrowing such that it has the same effect as the ISDA fallback clause.
- There is no change to the other terms of the borrowing and the IRS.

Illustrative Example 4 (Cont'd)

When 3-month SOR is no longer available after 30 June 2023, the fallback clauses for both the borrowing and the IRS will be triggered and the contractual benchmark rate 3-month SOR will be replaced with 3-month Fallback Rate (SOR) for the relevant tenor.

The table below shows the contractual cash flows before and after trigger of the fallback clauses.

	Hedged Borrowing	Hedging IRS		Total Interest Rate Payable by Entity X
	Pay Float	Receive Float	Pay Fix	
Prior to cessation of SOR	3-month SOR + 1% ^a	3-month SOR	0.8%	1.8%
Upon trigger of fallback clause upon cessation of SOR	3-month Fallback Rate (SOR) + 1% ^a	3-month Fallback Rate (SOR)	0.8%	1.8%

^a This refers to Entity X's credit spread of 1%.

Entity X has amended the hedge documentation for changes made to the fallback provisions of the borrowing and the IRS and to designate 3-month Fallback Rate (SOR) as the hedged risk.

Entity X has assessed that uncertainty due to IBOR reform is no longer present ^b. The existing cash flow hedging relationship between the borrowing and the IRS is preserved under the Phase 2 amendments for SFRS(I) 9 because:

- a) The replacement of 3-month SOR with 3-month Fallback Rate (SOR) upon the trigger of fallback clauses in the IRS and the borrowing is necessary as a direct consequence of IBOR reform in Singapore;
- b) The replacement of 3-month SOR with 3-month Fallback Rate (SOR) is on an economically equivalent basis;
- c) The transition approach does not result in derecognition of the IRS; and
- d) The hedge designation and the hedge documentation has been amended to reflect the change in the hedged risk, hedging instrument and hedged item.

Accordingly, the amount accumulated in the cash flow hedge reserve is deemed to relate to the hedged cash flows based on 3-month Fallback Rate (SOR), and there is no immediate reclassification to profit or loss arising from the cessation of SOR.

^b If Entity X has assessed that IBOR uncertainty is still present, it may apply the Phase 1 reliefs under SFRS(I) 9 and assume that the existing hedging relationship has not been altered as a result of the IBOR reform.

Appendix A: Embedded Derivatives and SORA-based Interest Rate

Embedded Derivatives

SFRS (I) 9 Appendix A Defined Terms defines a derivative as a financial instrument or other contract with all the following characteristics:

- Its value changes in response to the change in a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract (sometimes called the 'underlying');
- It requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors; and
- It is settled at a future date.

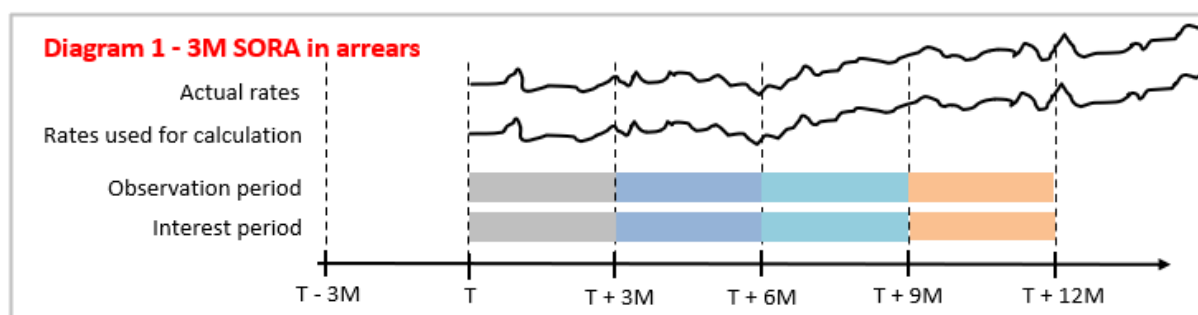
Examples of derivatives include interest rate swaps and foreign exchange forwards.

SFRS(I) 9 paragraph 4.3.1 states that “An embedded derivative is a component of a hybrid contract that also includes a non-derivative host—with the effect that some of the cash flows of the combined instrument vary in a way similar to a stand-alone derivative. An embedded derivative causes some or all of the cash flows that otherwise would be required by the contract to be modified according to a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract.”

Debt instruments may contain embedded interest rate terms that can change the amount of interest that would otherwise be paid or received. For example, if the interest rate on the loan would increase exponentially as SOR decreases (i.e. a leveraged inverse floater), the embedded derivative would not be closely related to the host contract and thus would be accounted for on a FVPL basis.

Comparison of SORA compounded in arrears and SORA compounded in advance

SORA compounded in arrears



Singapore Overnight Rate is the interest rate for unsecured SGD borrowings between banks for a period of one day. SORA is a volume-weighted **average** of the overnight rates on actual transactions for a given business day and is published by 9.00am on the next business day.

A debt instrument referencing SORA is effectively a floating-rate note (FRN) with daily interest rate reset to SORA. However, instead of paying interest on a daily basis, the borrower will pay interest at the end of an interest period of either 1 month, 3 months or 6 months. The interest amount for the entire period (1 month, 3 months or 6 months) is calculated at a compounded SORA of 1-month, 3-month or 6-month tenor.

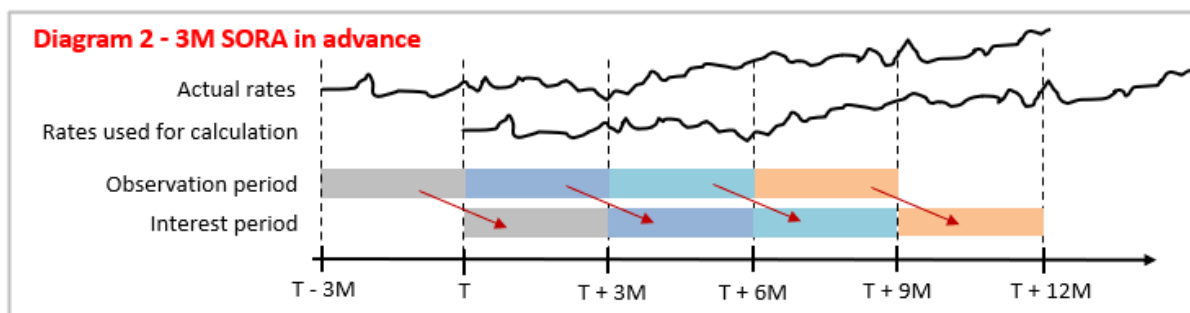
If the compounded SORA is calculated based on the actual daily SORA readings (published the next business day) over the relevant period, the resulting interest rate is called “SORA compounded in arrears”.

As illustrated in Diagram 1 above, the compounded SORA for T + 3 months is calculated based on the actual daily SORA readings over the same period and the resulting interest rate is called “SORA compounded in arrears”.

An FRN referencing SORA compounded in arrears is consistent with a basic debt instrument, without an embedded interest rate derivative.

SORA compounded in advance

While SORA compounded in advance products offer the advantage of increased payment certainty, the time lag in the interest rate as explained below might result in some of the cash flows of the combined instrument varying in a way similar to the effect of a stand-alone derivative.



As illustrated in Diagram 2 above, the compounded SORA for T + 3 months is calculated based on the actual daily SORA readings over an agreed **preceding** observation period and the resulting interest rate is called “SORA compounded in advance”.

SFRS(I) 9 would regard the host debt instrument to contain an embedded interest rate derivative causing the cash flows of the hybrid instrument (host plus embedded derivative) to vary from those determined based on SORA compounded in arrears.

For reference: ISCA Financial Reporting Codification Framework

In November 2019, ISCA issued the ISCA Financial Reporting Codification Framework (Framework). The Framework establishes a formalised categorisation, degrees of authority and a due process for future issuance of ISCA's technical documents. It provides credence to ISCA's technical content, promulgates ISCA's views on the application of accounting standards as well as promotes quality, consistency and best practices in financial reporting.

The Framework is summarised in the table below.

Category	Nature	Degree of authority	Due Process	Highest level of approval
1. Financial Reporting Practice (FRP)	Recommended best practices for financial reporting for specific industries, sectors or transactions	Expected to apply	Public consultation required	ISCA Council
2. Financial Reporting Guidance (FRG)	Technical guidance, views and insights on specific financial reporting issues for specific industries, sectors or transactions	Expected to follow or explain departures	Public consultation required	ISCA Financial Reporting Committee (FRC), with authority delegated by the ISCA Council
3. Financial Reporting Bulletin (FRB)	Technical bulletin containing discussions and highlight of emerging topical financial reporting issues	For information and educational purposes	Public consultation not required	ISCA FRC

For more details on the Framework and the guidance issued under the Framework, please refer to the following:

- Framework <https://isca.org.sg/standards-guidance/financial-reporting/due-process/codification-framework>
- FRG <https://isca.org.sg/standards-guidance/financial-reporting/technical-guidance-issued-by-isca-professional-standards-division/technical-guidance-issued-under-codification-framework/financial-reporting-guidances>
- FRB <https://isca.org.sg/standards-guidance/financial-reporting/technical-guidance-issued-by-isca-professional-standards-division/technical-guidance-issued-under-codification-framework/financial-reporting-bulletins>

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