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STAFF PAPER

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IASB Meeting

Project	**Financial Instruments: Classification and Measurement**		
Paper topic	Comment letter and outreach summary—Limited Amendments to IFRS 9		

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Introduction

1. On 28 November 2012 the IASB published the exposure draft ED/2012/4 *Classification and Measurement: Limited Amendments to IFRS 9* (Proposed amendments to IFRS 9 (2010))—herein called the 'Limited Amendments ED'. The comment period ended on 28 March 2013, and the IASB has received 163 comment letters.
2. The IASB members and staff have also conducted meetings with interested parties. To date, there have been more than 40 formal outreach meetings, including meetings with financial and non-financial preparers, auditors, regulators and users of financial statements. These outreach efforts have included global, regional and national entities. Some meetings have been conducted jointly with the FASB.
3. The outreach efforts are ongoing and include:
   (a) An online survey for users of financial statements. The survey was launched on 7 May 2013 and shared with various relevant parties, including the FASB. The survey closes on 31 May 2013.
   (b) Outreach with users of financial statements, including joint outreach with the FASB.
   (c) Joint outreach with the FASB on their proposed Accounting Standards Update *Financial Instruments—Overall (Subtopic 825-*

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10): Recognition and Measurement of Financial Assets and Financial Liabilities ('proposed ASU'). The FASB published its proposed ASU on 14 February 2013, and the comment period ends on 15 May 2013.

4. The staff will bring an update on the outreach activities with users of financial statements to a future joint meeting. In addition, the FASB staff will present an analysis of the feedback received by the FASB on their proposed ASU at a future joint meeting.

Purpose of this paper

5. This paper summarises the **main points** received in the comment letters and the outreach activities on the Limited Amendments ED.
   (a) The first section of the paper (paragraphs 8-14) provides a high level overview of the feedback received on the proposals.
   (b) The following sections (paragraphs 15-64) discuss feedback on the proposals in greater detail.
   (c) Paragraph 65 summarises frequently raised comments on matters that are outside the scope of the Limited Amendments ED.
6. An analysis of the comment letters by respondent type and region is included as Appendix A.
7. The staff will provide a more detailed analysis of specific issues during redeliberations.

An overview of the feedback

8. **Objectives of the Limited Amendments ED** – Many respondents commented on the objectives of the Limited Amendments ED and expressed a view as to whether the IASB has achieved those objectives. Specifically:
   (a) **Addressing application questions** – Many respondents supported the IASB's objective to clarify the application issues. Nearly all welcomed the IASB's intentions in clarifying the contractual cash flow characteristics assessment, although many had remaining

application questions or concerns. Fewer, but still many, welcomed the IASB's intentions in clarifying the 'hold to collect' business model, although some were concerned that the proposed clarifications placed too much emphasis on the level of sales instead of focussing on the reasons for the sales, and resulted in the 'hold to collect' business model being unduly restrictive and rules-based.

(b) **Considering the interaction with the insurance contracts proposals** – Many respondents, especially insurers, supported the IASB's objective to consider the interaction between the accounting for financial assets and insurance contracts liabilities. (On the other hand, some thought it would be premature to modify the accounting for financial assets given the stage of the Insurance Contracts project.) Nearly all of the respondents who supported the objective welcomed the proposed introduction of the mandatory FVOCI *category* for debt instruments to address accounting mismatches between financial assets and insurance contracts liabilities. However, they noted that the proposals do not fully eliminate those mismatches and requested the IASB to consider ways to further reduce those mismatches. Many insurers stated that the business model assessment in IFRS 9 does not reflect the linkage between financial assets and insurance contracts liabilities, which is the core of how insurers manage their business.

(c) **Reducing key differences with the FASB's model** – Some respondents specifically commented on convergence with the FASB's model for the classification and measurement of financial instruments. All of those respondents welcomed the boards' efforts to align their models; however, they were split relatively evenly between three views on how important this objective was:

  (i) Some welcomed the greater alignment of the two models, even if that is only achieved at the principle level. Some encouraged the boards to continue to work together to achieve further convergence in the application guidance in order to facilitate financial reporting by multinational entities;

(ii) Others acknowledged the benefits of convergence in general but emphasised that the IASB should only amend IFRS 9 if the amendments would improve the existing Standard;

(iii) Finally, some thought that alignment of the models at just the principle level without convergence at a detailed level is unhelpful because detailed differences are harder to appreciate than the glaring ones.

Regardless of their views on convergence in general, many asked the boards to use the same words in the application guidance if they meant the same thing. They noted that in the absence of such clarity, the more detailed or stricter requirements could end up being applied in practice even though this might not have been intended by the boards. They were particularly concerned with differences in the application guidance on the business model assessment.

9. **Contractual cash flow characteristics of financial assets** (paragraphs 15-32) – Nearly all respondents agreed that a financial asset can have cash flows that, for the purposes of IFRS 9, represent solely payments of principal and interest ('solely P&I'), even if the economic relationship between the principal and the consideration for the time value of money and credit risk is modified. They supported the IASB's efforts to clarify this point and noted that the proposals would result in more appropriate classification outcomes. However many respondents stated that the proposed clarifications do not go far enough in addressing common application questions and raised a number of detailed questions and concerns.

10. **Business model for managing financial assets** (paragraphs 33-55 of the ED) – A majority of respondents agreed with measuring some debt instruments at fair value through other comprehensive income (FVOCI); responses were split relatively evenly between three broad views:
    (a) support for the introduction of the mandatory FVOCI measurement category *as proposed* by the Limited Amendments ED;
    (b) agreement in principle with measuring some debt instruments at FVOCI, but subject to conditions or *different* classification requirements compared to those in the ED; and

(c) disagreement with the proposed introduction of the third measurement category into IFRS 9.

In addition, some respondents were concerned with what they considered inappropriate limitations on the 'hold to collect' business model—either due to the proposed clarifications to the 'hold to collect' business model, or due to the introduction of the FVOCI category. Finally, some questioned whether the outcomes of the business model assessment would be sufficiently different from the outcomes under IAS 39 *Financial Instruments: Recognition and Measurement*, and therefore questioned whether there would be sufficient benefit to justify the costs of transitioning to a new Standard.

11. **Fair value option** (paragraphs 56-58) – Nearly all respondents who commented on the fair value option agreed that the existing fair value option for accounting mismatches in IFRS 9 should be extended to financial assets that would otherwise be mandatorily measured at FVOCI. However, some respondents favoured an unrestricted fair value option for those assets, as has been proposed by the FASB's proposed ASU, and others advocated an unrestricted fair value option for *all* financial assets.
12. **Transition and effective date** (paragraphs 59-61) – Nearly all respondents who commented on the transition proposals agreed that after the completed version of IFRS 9 is issued, only that version of IFRS 9 should be available for early application. In addition, many respondents urged the IASB to confirm as soon as possible that the mandatory effective date of IFRS 9 would be deferred.
13. **Early application of the 'own credit' requirements** (paragraph 62) – Nearly all respondents who commented on the 'own credit' requirements for financial liabilities welcomed the proposal that entities should be permitted to early apply just those requirements without also applying the rest of IFRS 9. However, nearly all respondents also recommended that the IASB should make just the 'own credit' requirements available for early application before the completed version of IFRS 9 is issued by amending IAS 39 and/or IFRS 9 (2010).

14. **Complexity** – Many respondents commented on complexity and noted that reducing complexity in the accounting for financial instruments was one of the IASB's original objectives in replacing IAS 39.
    (a) **Introduction of the FVOCI measurement category** – Nearly all respondents who commented on complexity believed that the introduction of the mandatory FVOCI measurement category would increase the complexity of the accounting model relative to IFRS 9 without this category. In addition, many respondents also believed that introducing a third measurement category would mean that the difference between the measurement categories would be a finer distinction, and therefore that performing the business model assessment would in itself be more complex. Generally those respondents who believed that the FVOCI measurement category represented an improvement to IFRS 9 believed that this added complexity was justified, whereas those who disagreed with the proposals thought the complexity was unnecessary.
    (b) **Proposed clarifications to the contractual cash flow characteristics assessment** – Some respondents also noted their view that the proposed clarifications to the contractual cash flow characteristics assessment would add complexity to IFRS 9. Provided that their detailed comments or questions were addressed, it seemed that they would support the proposed clarifications to the contractual cash flow characteristics assessment despite the added complexity (ie the benefits of the clarifications should then outweigh the costs and complexity of the change).

Feedback on the proposed clarifications to the contractual cash flow characteristics assessment

What did the ED propose?

15. After IFRS 9 was issued, the IASB received questions about the application of the contractual cash flow characteristics assessment, most notably in relation to financial assets that contain interest rate mismatch features[1]. Consequently, in the Limited Amendments ED the IASB proposed to clarify that if the economic relationship between the principal and the consideration for the time value of money and credit risk is modified by leverage or an interest rate mismatch feature (a 'modified economic relationship'), a financial asset could have cash flows that represent solely P&I if the difference between the asset's contractual cash flows and the 'benchmark' cash flows[2] could not be more than insignificant. The Limited Amendments ED also proposed application guidance on how this assessment should be made.

***Can* cash flows be solely P&I if there is a modified economic relationship?**

16. Nearly all respondents *agreed* that a financial asset with a modified economic relationship can have cash flows that represent solely P&I and noted that the proposed clarification would result in more appropriate classification outcomes. However, many respondents believed that the clarification does not go far enough in addressing common application questions and expressed concern that some financial assets they view as 'plain vanilla' or 'normal lending' would still not meet the solely P&I condition in IFRS 9.

[1] When an interest rate is reset but the frequency of the reset does not match the tenor of the interest rate

[2] Cash flows on a comparable financial asset that does not contain the modification. The appropriate comparable financial asset is a contract of the same credit quality and with the same contractual terms (including, when relevant, the same reset periods), except for the contractual term under evaluation. [paragraph 4.1.9B of the Limited Amendments ED]

17. A few respondents *disagreed* with clarifying the application of the notion of solely P&I to particular instruments. They believed that the notion of solely P&I:
    (a) should be clarified more broadly instead of addressing particular instruments (see also paragraph 32), or
    (b) should not be used to classify financial assets (see also paragraph 39(a)).

***When* is a modified economic relationship consistent with solely P&I?**

18. Nearly all respondents agreed that a financial asset with a modified economic relationship has cash flows that are solely P&I if the difference between the asset's cash flows and the benchmark cash flows could not be more than insignificant. However, many commented on:
    (a) **The scope of the assessment** – Respondents had comments and questions about a variety of features other than interest rate mismatches and leverage, and asked whether such features would (or should) automatically result in a financial asset being measured at FVPL, or whether the guidance on assessing a modified economic relationship could (or should) also be applied to such financial assets.
    (b) **The threshold for the difference in cash flows** – Respondents had comments and questions about whether the 'not more than insignificant' threshold for the difference between the actual and the benchmark cash flows is appropriate, often in conjunction with comments on the scope of the assessment.

Scope of the assessment

19. Many respondents questioned why the modified economic relationship guidance should apply only to interest rate mismatch features and leverage, and whether the guidance should also apply to other features (and if not, why), notably:
    (a) other features that modify the economic relationship between the principal and the consideration for the time value of money and

the credit risk, eg averaged and lagging interest rates (ie when an interest rate is reset to an average rate calculated from past data),

(b) particular features that are specifically addressed by the existing application guidance in IFRS 9, eg prepayment and extension options, and

(c) features that are unrelated to the principal and the consideration for the time value of money and credit risk (eg interest payments linked to an equity index).

20. Those respondents believed that in some cases such financial assets could have cash flows that *economically* represent principal and interest and asked the IASB to consider whether the modified economic relationship guidance could (or should) be applied to some or all of these features, and if so, which ones. In many cases, these comments were raised in conjunction with comments on the appropriate threshold for the assessment (see also paragraph 22(c)). Some respondents also questioned why there should be different guidance for different features, eg why the guidance for assessing prepayment and extension options for consistency with the notion of solely P&I should be different from the guidance for assessing interest rate mismatch features and leverage.

The threshold for the difference in cash flows

21. Nearly all respondents believed that financial assets with a modified economic relationship should be eligible for the amortised cost or mandatory FVOCI categories if the contractual cash flows could not be *more than insignificantly* different from the benchmark cash flows.

22. However, many respondents felt that more financial assets should be accommodated. Many felt that the 'not more than insignificant' threshold is too strict and made alternative suggestions, often in conjunction with the comments on the scope with the assessment, including:

(a) Some suggested that a '*significant*' threshold should be used instead—that is, a financial asset within the scope of the modified economic relationship assessment (see also paragraphs 19-20) should be considered to have cash flows that are solely P&I if the

contractual cash flows could not be *significantly* different from the benchmark cash flows.

(b) Others suggested that the threshold from the '*double-double*' test in IAS 39 should be used for this assessment.

(c) A few respondents expressed the view that requiring cash flows to represent '*solely*' P&I was too strict to begin with, and suggested that financial assets should *not* be measured at fair value through profit or loss (FVPL) if their cash flows '*substantially*', '*primarily*', or '*materially*' represent P&I (eg a financial asset with an insignificant embedded derivative should be eligible for amortised cost).

23. Some respondents agreed in principle with the 'more than insignificant' threshold, but only if that would actually have a practical effect on classifications, ie if it would allow more financial assets to be measured at amortised cost.

Application guidance – Assessing a modified economic relationship

24. Respondents' overall comments on the clarity and appropriateness of the application guidance for assessing a modified economic relationship often depended on their interpretation of that guidance. In particular:

(a) Some respondents were comfortable with the proposed guidance and the need to apply judgment and they were confident that they would be able to apply it in practice and/or draw appropriate classification conclusions. These respondents encouraged the IASB not to provide any additional more prescriptive guidance on how to perform the assessment.

(b) Others, in contrast, thought that the proposed guidance was not sufficiently clear or robust and could lead to diversity in practice. They urged the IASB to provide further application guidance to ensure consistency in application and to enable entities to draw appropriate classification conclusions.

(c) Other respondents thought that the application guidance was clear but required an unduly burdensome (eg quantitative assessment)

that would be difficult to apply. They emphasised that this assessment would be required for all financial assets within its scope (depending on the business model), so they urged the IASB to carefully weigh the complexity of the required assessment and the benefits for the financial reporting. Some of these respondents suggested that the assessment should be optional (see also paragraph 28).

(d) Finally, a few respondents stated that the proposed guidance was not sufficient and/or clear, especially for non-sophisticated entities, and asked the IASB to provide additional guidance and/or illustrative examples.

25. Many respondents raised questions and concerns about specific aspects of the application guidance for assessing a modified economic relationship. For example, respondents asked:
    (a) what is the principle underlying the modified economic relationship assessment and its scope (see also paragraphs 19-20);
    (b) whether the quantitative assessment of a modified economic relationship was required and if so, whether it should be based on the present values of cash flows, gross cash flows, fair values and/or effective returns;
    (c) what is 'not more than insignificant', and how that relates to the general materiality provisions in IFRSs;
    (d) whether qualitative factors should be considered in assessing a modified economic relationship;
    (e) whether an entity is required to base the assessment on actual, (rather than hypothetical) benchmark cash flows, if an actual benchmark instrument exists (see also paragraph 26); and
    (f) if hypothetical benchmark cash flows were required to be constructed (see also paragraph 26), how to construct them.

26. Some respondents specifically stated that if the actual benchmark instrument exists, an entity should be required to use that actual benchmark instrument for the assessment and should not be permitted to construct a hypothetical benchmark.

27. Many respondents believed that the modified economic relationship guidance should **only** apply *if* an actual benchmark instrument exists. These comments were often raised in conjunction with the comments on classification of financial assets with regulated interest rates (see also paragraph 30). These respondents believed that performing the assessment on the basis of hypothetical benchmark cash flows would be complex (if not impossible) and the results would not be relevant because those cash flows do not actually exist.
28. Finally, some respondents specifically stated that the assessment of a modified economic relationship should be optional, and entities should be permitted to instead measure the relevant financial assets at FVPL rather than apply the assessment.

Do the clarifications result in more useful information?

29. Many respondents thought that the proposals in the Limited Amendments ED would improve the usefulness of financial information by resulting in more appropriate classification outcomes. Still, many expressed the view that some common products that they consider 'basic lending' should qualify for measurement at amortised cost (or FVOCI).
30. Many respondents pointed out that the proposed amendment does not seem to address the issue of regulated interest rates. Many argued that FVPL would not provide useful information for some or all such financial assets. However, the views on *which* financial assets with regulated interest rates should be measured at amortised cost differed, as well as *why* and *how* this should be addressed. Specifically:
    (a) ***Which* assets with regulated interest rates should be measured at amortised cost** – Some respondents made a distinction between financial assets issued in environments in which all interest rates are regulated and financial assets issued in free markets where only some interest rates are regulated and thought that only the financial assets in regulated environments should be measured at amortised cost. Others did not make such a distinction and

thought that a broader group of financial assets with regulated interest rates should be measured at amortised cost.

(b) ***Why* such financial assets should be measured at amortised cost, and *how* this should be achieved** – Some respondents believed that conceptually financial assets with regulated interest rates are not necessarily inconsistent with the underlying rationale of the notion of solely P&I in IFRS 9, and therefore they should be captured by that principle and application guidance (eg by clarifying that principle and/or application guidance). Other respondents did not comment on whether they believed that financial assets with regulated interest rates were consistent with the notion of solely P&I in IFRS 9 but stated that such financial assets should be eligible for measurement at amortised cost. In most cases, they did not express a view on how this should be achieved.

31. Many respondents raised other examples of features and instruments for which changes were not proposed in the Limited Amendments ED that they believed could or should qualify for amortised cost (or mandatory FVOCI), including:

    (a) **Purchased 'plain vanilla' financial assets prepayable at par** – many respondents raised application questions and concerns about the relevant application guidance in IFRS 9.

    (b) **Contingently prepayable financial assets** – these constituents

        (i) raised questions about which contingencies would be consistent with the guidance in IFRS 9 (eg which contingencies can be considered related to 'credit deterioration of the issuer') and/or

        (ii) challenged the relevant application guidance in IFRS 9[3] (ie why only *these* contingencies are considered consistent with the notion of solely P&I in IFRS 9).

    (c) **Financial assets with contingent features** – a few constituents raised questions and concerns about classification of financial

[3] IFRS 9 B4.1.10(a)

assets with contingent features that (a) are improbable (including those that would have a significant effect if the contingency arose); or/and (b) would not have a significant impact of the asset's cash flows (including when the contingency is likely to arise).

(d) **Financial assets with bail-in features** – A few respondents raised concerns about the treatment of so-called 'bail-in instruments'—such as debt instruments issued by a regulated financial institution that would convert into equity instruments if more capital is required for regulatory purposes in a stress event. In particular, they questioned whether it was appropriate to require fair value measurement if the bail-in is unlikely to occur.

(e) **Financial assets with interest deferral features** – a few respondents raised concerns about FVPL classification of financial assets that contain an interest deferral feature and interest is not accrued on the deferred interest. In particular, they questioned whether it was appropriate to require fair value measurement if the interest deferral is unlikely to occur.

(f) **Non-recourse financial assets** – a few respondents raised questions about classification of non-recourse financial assets and requested clarifications.

(g) **Contractually linked financial assets** – a few respondents raised questions about specific aspects of the contractually linked guidance in IFRS 9[4] and requested clarifications.

(h) **Off-market financial assets** – a few respondents raised questions about classification of financial assets originated or acquired at below-market interest rates or returns.

General comments on solely P&I

32. In addition to commenting on the proposals, many respondents raised broader questions or comments on the notion of 'solely P&I' in IFRS 9 and how to apply it. Many respondents requested clarifications of the

[4] IFRS 9 B4.1.20-B4.1.26

solely P&I principle, often in conjunction with requesting specific clarifications for particular instruments. A few respondents believed that clarifying the solely P&I principle would eliminate such application questions on particular instruments. General comments on the principle of solely P&I included:

(a) Many asked whether interest for purposes of IFRS 9 could contain elements other than consideration for the time value of money and credit risk, such as consideration for liquidity risk or profit margin or/and whether and how it captures a bank's specific considerations in pricing its financial assets (eg cost of funding).

(b) Some raised questions about what is time value of money and whether this concept is universal or jurisdiction-specific.

(c) Some requested that 'principal' should be defined in IFRS 9 and/or challenged the relevant language in the Basis for Conclusions in IFRS 9.[5]

(d) Some thought the application of the solely P&I principle would be clarified if it were linked more closely with the objective of amortised cost measurement.

(e) Some respondents from particular jurisdictions continued to support the bifurcation of financial assets. On the other hand, most respondents did not suggest that bifurcation should be re-introduced for financial assets and some specifically stated they would disagree with re-introducing it.

[5] BC4.23 states that 'cash flows that are interest always have a close relation to the amount advanced to the debtor (the 'funded' amount).

Business model for managing financial assets

What was proposed?

33. The Limited Amendments ED proposed to introduce a mandatory FVOCI measurement category for debt instruments. Financial assets would be required to be measured at FVOCI if they:
    (a) are held within a business model in which financial assets are managed both in order to collect contractual cash flows and for sale (a 'hold to collect and for sale' business model), and
    (b) have contractual cash flows that are solely P&I.
34. In addition, the IASB proposed additional application guidance on both the types of business activities and the frequency and nature of sales that would (and would not) be consistent with the 'hold to collect' business model.

The proposed introduction of the mandatory FVOCI measurement category

35. As noted earlier in this paper, a majority of respondents agreed with measuring some debt instruments at fair value through other comprehensive income (FVOCI); responses were split relatively evenly among three broad views:
    (a) *support for* the introduction of the mandatory FVOCI measurement category *as proposed* by the Limited Amendments ED;
    (b) *agreement in principle* with measuring some debt instruments at FVOCI, but subject to conditions or to *different* classification requirements compared to those in the Limited Amendments ED, and
    (c) *disagreement with* the proposed introduction of the third measurement category into IFRS 9.
36. Many respondents *agreed* with the FVOCI measurement category as proposed in the Limited Amendments ED. That is, they agreed that:

(a) Financial assets should be **mandatorily** measured at FVOCI if they are managed in a 'hold to collect or for sale' business model **and** have cash flows that are solely P&I.

(b) Both collecting contractual cash flows and realising fair values are relevant to the performance of such financial assets. Consequently, these respondents also agreed that the FVOCI measurement category should result in **amortised cost information being provided in profit or loss, and fair value information being presented in the statement of financial position.**

(c) The increased **complexity** of the business model assessment **would be justified** by the usefulness and relevance of the information provided.

37. Some respondents who supported FVOCI pointed out that this would reduce a key difference between IFRS 9 and the classification and measurement model in the FASB's proposed ASU.

38. Other respondents *agreed in principle* with FVOCI as proposed, but only on the condition that it would not result in a reduced number of financial assets that would qualify for amortised cost measurement.

39. Another group of respondents *agreed in principle* with measuring some debt instruments at FVOCI, but they suggested something different from the proposals. Such suggested alternative approaches included:

(a) **Financial assets should be mandatorily measured at FVOCI irrespective of whether they have cash flows that are solely P&I,** as long as the assets are managed in a 'hold to collect or for sale' business model. For example, some respondents, notably in the insurance industry, stated that their business model is driven by the linkage between financial assets and insurance contracts liabilities and that the business model concept in IFRS 9 fails to reflect this linkage. These respondents argued that derivatives and equity instruments can be held as part of the same asset-liability management strategy as debt instruments and should therefore be

eligible for measurement at FVOCI.[6] Some of these respondents also pointed out that if the asset-liability linkage is reflected in the business model test, the fair value option for accounting mismatches would not be needed because both the asset and liability sides of a matched position would already be accounted for consistently.

(b) **The FVOCI measurement category should be the residual category.** Some respondents felt that a 'hold to collect or for sale' business model is more difficult to define than the other business models. Accordingly, they believed that the FVOCI category should be the residual measurement category and that the business models for the amortised cost and FVPL categories should be defined. Respondents suggested the FVPL measurement category could be defined on the basis of the notions of 'held for trading' or 'managed on a fair value basis'.[7]

(c) **The FVOCI category should be an option—either in addition to, or instead of—a mandatory measurement category.** These suggestions were often made in the context of further reducing accounting mismatches for the insurance industry and included several variations:

(i) Some suggested a FVOCI option for all financial assets to address **accounting mismatches** regardless of the cash flow characteristics of the financial assets. Some suggested that this option could be available *in addition to* a mandatory FVOCI measurement category, whereas others suggested it could be available *instead of* a mandatory measurement category.

(ii) Others suggested a defined FVPL measurement category[8] coupled with an **unrestricted option** to classify financial assets that do not fall into that defined category at

[6] Some respondents noted that non-financial assets (eg investment properties) could also be held as part of that asset-liability management strategy and therefore should also be eligible for measurement at FVOCI.
[7] Including financial assets that are held for trading.
[8] These constituents believed that the FVPL category should be limited to (a) financial assets that do not meet the solely P&I condition; and (b) financial assets held-for-trading.

amortised cost or FVOCI. These constituents believed that such an approach provides appropriate flexibility in classification and is particularly helpful for the insurance industry.

40. Lastly, a minority of respondents *disagreed* with the proposed introduction of a FVOCI measurement category. They cited one or more of the following arguments:
    (a) 'Hold to collect and for sale' is **not a distinct business model** for the management of financial assets but rather is an accounting construct to achieve a particular accounting outcome.
    (b) Introducing an additional measurement category into IFRS 9 would add **complexity**, which in their view **would not be justified** by the usefulness of the information provided. In addition, some noted that addressing the interaction between the accounting for financial assets and insurance contracts liabilities should not add complexity to IFRS 9 for all entities. Some also thought it would be premature to modify the accounting for financial assets given the stage of the Insurance Contracts project.
    (c) The outcomes of the business model assessment **might not be very different to** the outcomes from applying **IAS 39**; therefore, there might not be sufficient benefit to justify the costs of transitioning to a new Standard.

41. In commenting on the proposed introduction of the FVOCI measurement category, some respondents also made observations on the effect on the volatility in profit or loss and/or other comprehensive income. In particular:
    (a) **Volatility in profit or loss** – All respondents who commented on volatility in profit or loss favoured less volatility. Some asserted that the proposed introduction of the FVOCI measurement category would result in reduced volatility in profit or loss and therefore welcomed it.
    (b) **Volatility in other comprehensive income** – Some respondents noted that even though volatility in profit or loss will be reduced, the proposed FVOCI measurement category will lead to volatility

in other comprehensive income. A few respondents also noted concern about the interaction between the proposed FVOCI measurement category and the fact that the Basel III Framework removes of the ‘regulatory filter’ for fair value gains or losses recognised in other comprehensive income, and the resulting volatility in regulatory capital. Some of these respondents stated that they would still support the introduction of the FVOCI measurement category even without the regulatory filter.

Application guidance: Distinguishing business models

Overall comments

42. Many respondents raised concerns and questions on the application guidance for distinguishing between business models and requested clarifications. Other respondents expressed the view that the application guidance was clear and appropriate and in many cases did not raise any specific issues.
43. Respondents’ comments on the application guidance often depended on their interpretation of that guidance (and/or their interpretation of existing IFRS 9). For example, some non-financial entities noted that the guidance seemed to require sophisticated policies and documentation to set out how they manage their financial assets and expressed concern that such requirements would impose a significant operational burden that is not justified. They pointed out that their business models for managing financial assets are generally not as strictly defined as the business models of banks or insurers, and expressed a concern that it would be unduly difficult for them to evidence a ‘hold to collect’ business model in order to measure financial assets at amortised cost.
44. Some respondents stated that the application guidance on the ‘hold to collect’ business model was clear, although they did not agree with the resulting classification outcomes. They raised questions about the distinction between the ‘both hold to collect and for sale’ business model and the residual FVPL category.

'Hold to collect' vs. 'hold to collect and for sale' business models

45. Subject to the general questions on the business model assessment (see paragraphs 51-55), many respondents noted that the distinction between (a) the 'hold to collect' and 'hold to collect and for sale' business models was clearer than (b) the distinction between 'hold to collect and for sale' business model and the residual FVPL measurement category.

46. However, although many thought the guidance on the 'hold to collect' business model was relatively clear, they challenged particular aspects of it. For example, many expressed the view that particular sales in addition to those envisaged by the proposals can be integral to the objective of the 'hold to collect' business model, and that such sales do not always indicate a 'hold to collect and for sale' business model. Specifically, these respondents thought that sales should be considered consistent with the 'hold to collect' business model if they are:
    (a) required by a regulator (eg sales to prove liquidity of the financial assets), or
    (b) made to manage credit concentration risk.

    Consequently, these respondents stated that even if these sales are more than infrequent and/or more than insignificant they should not disqualify the financial assets from being measured at amortised cost.

47. In addition, some respondents were concerned that selling financial assets due to anticipated deterioration in their credit quality might in some cases be viewed as contradicting a 'hold to collect' business model. Even though IFRS 9 already states that sales for credit deterioration do not contradict a 'hold to collect' business model[9], they were concerned that sales that would satisfy this provision would be too 'late' in the pattern of credit deterioration. That is, they worried that sales would only qualify under this provision if they occurred once the entity *actually realises* a loss due to the deterioration in credit quality (ie when credit deterioration has *occurred*), rather than if they were made to *prevent* realising such a loss (ie when credit deterioration is *expected*).

[9] Specifically, paragraph B4.1.3 of IFRS 9 (as it would be amended by the Limited Amendments ED) states that an entity may sell financial assets from a 'hold to collect' business model if the credit quality of the financial asset has deteriorated such that they no longer meet the entity's documented investment policy.

48. Some respondents also raised questions about how the infrequency and insignificance of sales should be assessed (eg by reference to profit or loss, the carrying value of the portfolio, or some other measure).

'Hold to collect and for sale' business models vs. FVPL

49. Many respondents stated that it would be challenging to distinguish financial assets that should be measured at FVPL from some 'hold to collect and for sale' business models. For example, they raised questions about the meaning of 'managed on a fair value basis' (an example of FVPL[10]) and how to distinguish such financial assets from financial assets that are 'managed to maximise return' (an example of FVOCI[11]). Some respondents also questioned whether there is a particular level/amount of sales that would disqualify financial assets from being measured at FVOCI (and if so what that level/amount was).
50. Others were concerned that financial assets would be required to be measured at FVOCI if some financial assets are held and others are sold, even if the financial assets are managed and performance is reported on a fair value basis, or if fair value information is required to be provided as a result of regulation or investor demand. These respondents noted that measuring these financial assets at FVPL would provide more useful information.

Other comments on business model assessment

51. A variety of respondents, including preparers, auditors, and regulators, expressed a concern that the application guidance on the business model assessment seems to place an undue emphasis on the *level* of sales of financial assets measured at amortised cost, as opposed to the *reasons* for those sales and other factors (such as the reporting to senior management and the compensation policy).
52. Many respondents stated that a business model assessment that is based primarily on the level of sales would be complex to apply because financial assets are classified at initial recognition and are not

[10] Paragraph B4.1.6 of the Limited Amendments ED
[11] Example 1 in paragraph B4.1.4B of the Limited Amendments ED

subsequently reclassified except in the rare circumstances when the business model changes. One example cited the treatment of financial assets that were classified based on the level of past and expected sales as at initial recognition but where the actual level of sales turned out to be different over a given period of time. They questioned whether this would be considered a change in the business model, or even an accounting error, and asked how financial assets in that business model should be classified going forward.

53. Respondents also expressed a concern that the tensions around such questions could encourage 'bright-line' interpretations being developed in order to enhance comparability and enforceability, with the added risk that these interpretations could result in accounting treatment similar to the 'held to maturity' category in IAS 39.

54. Moreover, many respondents thought that a business model assessment determined by the level of sales could result in artificial classifications when an entity does not know exactly how much selling activity will take place. For example:
    (a) Some thought that the 'hold to collect and for sale' business model could effectively become a default category because both holding and selling are consistent with the objective of such business models.
    (b) Others thought that entities might default to measuring more financial assets at FVPL, because it is the residual category.

55. In addition, if an entity knows which financial assets within a group of financial assets are more likely to be held versus sold, some respondents commented about whether some financial assets could be classified in one category, and others in another category. Some were concerned that entities would have different approaches to 'splitting' groups of assets. They thought these differences would reduce comparability, and they requested more guidance on the level at which the business model assessment should be performed. In contrast, others thought there should be room for judgment in splitting groups of financial assets, and believed that in many cases being able to split a group of financial assets actually indicates multiple business models within that group of financial assets.

Fair value option

56. Nearly all respondents agreed with the proposal to extend the existing fair value option for accounting mismatches in IFRS 9 to financial assets that would otherwise be mandatorily measured at FVOCI. Some noted that this would be consistent with the underlying logic for the existing fair value option in IFRS 9 for financial assets measured at amortised cost and would preserve an entity's ability to mitigate accounting mismatches.
57. Some respondents advocated an **unrestricted** fair value option for financial assets that would otherwise be measured at **amortised cost or FVOCI**. Some of these respondents were of the view that FVPL may sometimes provide more useful information to users of financial statements, particularly for entities in the financial services sector. However, they did not think this would always be the case. Consequently, they thought entities should have flexibility to measure financial assets at FVPL. They acknowledged the concerns raised by regulators in the past, but thought these concerns could be mitigated by adequate disclosures.
58. Others thought that the fair value option should be unrestricted, but **only** for financial assets that would otherwise be measured at **FVOCI**. In making this latter suggestion, some specifically noted that it:
    (a) would be consistent with the FASB's proposals that included an unrestricted fair value option for financial assets that would otherwise be measured at FVOCI.
    (b) would enable entities who opposed the introduction of the FVOCI measurement category to avoid using that category altogether by electing the fair value option.

Transition and effective date

59. Of those who commented on the transition to IFRS 9, nearly all agreed with the proposal that after IFRS 9 is completed and issued, only that completed version of IFRS 9 (ie including classification and measurement, impairment and hedge accounting) should be available for

early application. Many noted that this would increase comparability compared to the phased early application currently permitted under IFRS 9.

60. Some respondents disagreed with the early application of IFRS 9 altogether. They emphasised the need for comparability and therefore opposed any early application of IFRS 9. A few other respondents requested the ability to early apply only the forthcoming hedge accounting chapter of IFRS 9.[12]

61. Although a question was not included in the Limited Amendments ED, many respondents asked the IASB to confirm as soon as possible that the mandatory effective date of IFRS 9 would be deferred, in particular given the lead time needed to implement the proposals on expected credit losses.[13] Many, notably respondents from the insurance industry and standard setters, also requested that the mandatory effective date of IFRS 9 should be aligned with the mandatory effective date of Phase II of the project on IFRS 4 *Insurance Contracts*.

Early application of the 'own credit' requirements

62. Nearly all respondents supported the proposal that entities should be permitted to choose to early apply just the 'own credit' requirements for financial liabilities. However, most of these respondents also asked the IASB to make these provisions available for early application before IFRS 9 is completed and issued. Most respondents suggested that these requirements be incorporated into IAS 39. They believed that would be the quickest way to make these requirements available for jurisdictions that follow an endorsement process. Other respondents thought that

[12] According to the tentative decisions in the General Hedge Accounting project, entities would be able to early apply the forthcoming hedge accounting chapter of IFRS 9, if they also apply the existing classification and measurement requirements in IFRS 9. While these tentative decisions combine hedge accounting with classification and measurement for purposes of early application, the practical effect for entities with few financial assets (such as corporates) would be similar to the right to early apply just the hedge accounting requirements.

[13] The Exposure Draft ED 2013/3 *Financial Instruments: Expected Credit Losses* includes a question on the lead time needed to implement the proposals on expected credit losses and the appropriate resulting mandatory effective date for IFRS 9. Once this feedback is received, the appropriate date can be considered by the IASB.

incorporating these requirements into IFRS 9 (2010) is also a viable alternative.

First-time adopters of IFRS

63. A few respondents discussed considerations unique to first-time adopters of IFRS. On the one hand, they wanted to avoid two rounds of change in a short period of time and therefore saw benefits in applying IFRS 9 in their first IFRS financial statements. On the other hand, they would prefer not to be reporting under IFRS 9 when all of their competitors were still applying IAS 39.
64. In addition, they requested relief from restating comparatives, noting in particular that the lead time required to implement the final requirements on expected credit losses could, in effect, force them to adopt IAS 39 in their first IFRS financial statements and then shortly thereafter apply IFRS 9.

Other comments

65. Some respondents made comments on various matters outside of the scope of the Limited Amendments ED. The matters that constituents raised most frequently included:
    (a) **Recycling** – Many respondents commented on recycling. Specifically:
        (i) Some reiterated their disagreement with the prohibition of recycling of fair value gains and losses on equity instruments *designated* at FVOCI, and noted that this was inconsistent with the proposals for the *mandatory* FVOCI measurement category.
        (ii) Some respondents re-iterated their disagreement with the prohibition of recycling the ‘own credit’ gains and losses on financial liabilities designated under the fair value

option[14]. These respondents noted that the non-recycling of 'own credit' gains and losses is inconsistent with the treatment of financial liabilities measured at amortised cost. This is because when a financial liability measured at amortised cost is derecognised, the 'own credit' gain or loss forms part of the gain or loss recognised in profit or loss at derecognition. However, if the same financial liability was designated under the fair value option, the 'own credit' gain or loss would not form part of the gain or loss recognised in profit or loss on derecognition. In addition, some noted that that prohibiting recycling of the 'own credit' gains and losses for these financial liabilities is inconsistent with the FASB's proposed ASU, which proposes recycling of these gains and losses.

(iii) Some respondents asked the IASB to develop a clear, consistent principle for recycling (or non-recycling).

(b) **Interaction between phases of the project to replace IAS 39** – Some respondents encouraged the IASB to further consider the interaction between the phases of the project to replace IAS 39 in order to ensure there weren't any unintended consequences.

(c) **Cost exemption for unquoted equities –** Some respondents reiterated their request that the IASB should reintroduce the cost exemption that existed in IAS 39 for unquoted equity instruments, and for physically-settled derivative instruments linked to such equity instruments.

[14] The issue of recycling would only arise if those financial liabilities are derecognised prior to maturity (ie before 'own credit' changes have unwound to zero).

Appendix A: Comment letters by respondent type and region