

## STAFF PAPER

May 2013

## IFRS Interpretations Committee Meeting

<b>Project</b>	<b>Disclosures—Transfers of Financial Assets Amendments to IFRS 7</b>		
<b>Paper topic</b>	Servicing agreements		
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This paper has been prepared by the staff of the IFRS Foundation for discussion at a public meeting of the IFRS Interpretations Committee. Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRS Interpretations Committee or the IASB can make such a determination. Decisions made by the IFRS Interpretations Committee are reported in IFRIC *Update*. The approval of a final Interpretation by the Board is reported in IASB *Update*.

**Background**

1. The IASB issued *Disclosures-Transfers of Financial Assets* (Amendments to IFRS 7) —herein called ‘the transfer disclosures’—in October 2010. The transfer disclosures included the addition of paragraphs 42A-42H to IFRS 7 *Financial Instruments: Disclosures* and are effective for annual periods beginning on or after 1 July 2011.
2. According to paragraph 42B in IFRS 7, the objective of the transfer disclosures is to enable users of financial statements:
  - (a) to understand the relationship between transferred financial assets that are not derecognised in their entirety and the associated liabilities; and
  - (b) to evaluate the nature of, and risks associated with, the entity’s continued involvement in derecognised financial assets.
3. Paragraph 42C in IFRS 7 sets out a description of the term ‘continuing involvement’ in transferred financial assets for the purposes of applying the transfer disclosures:

For the purposes of applying the disclosure requirements in paragraphs 42E–42H, an entity has continuing involvement in a transferred financial asset if, as part of the transfer, the entity retains any of the contractual rights or

obligations inherent in the transferred financial asset or obtains any new contractual rights or obligations relating to the transferred financial asset. For the purposes of applying the disclosure requirements in paragraphs 42E–42H, the following do not constitute continuing involvement:

- (a) normal representations and warranties relating to fraudulent transfer and concepts of reasonableness, good faith and fair dealings that could invalidate a transfer as a result of legal action;
- (b) forward, option and other contracts to reacquire the transferred financial asset for which the contract price (or exercise price) is the fair value of the transferred financial asset; or
- (c) an arrangement whereby an entity retains the contractual rights to receive the cash flows of a financial asset but assumes a contractual obligation to pay the cash flows to one or more entities and the conditions in paragraph 3.2.5(a)–(c) of IFRS 9 are met.

4. In October 2012 the IFRS Interpretations Committee (the Interpretations Committee) received a submission that requested clarification through an Annual Improvement about whether servicing rights and obligations are continuing involvement for the purposes of the transfer disclosures. That submission contained two views:

- (a) **View 1:** Servicing rights and servicing obligations **do not** constitute continuing involvement for the purposes of the transfer disclosures.
- (b) **View 2:** Servicing rights and servicing obligation **do** constitute continuing involvement for the purposes of the transfer disclosures.

## **Previous discussions on this topic**

5. The Interpretations Committee and the IASB discussed this issue in January 2013 and February 2013, respectively. Summaries of those discussions are set out below. The relevant IFRIC Update and IASB Update are attached as Appendix A and Appendix B to this paper.

### *Interpretations Committee*

6. In January 2013, the Interpretations Committee discussed whether a clarification through an Annual Improvement was needed on whether servicing rights and obligations are continuing involvement for the purpose of the transfer disclosures.
7. In that meeting the Interpretations Committee noted that, based on the wording in paragraph 42C of IFRS 7, it was not clear whether servicing arrangements are continuing involvement for the purposes of applying the transfer disclosure requirements. Consequently, the Interpretations Committee recommended that the IASB should consider clarifying the requirements for continuing involvement in paragraph 42C of IFRS 7.

### *IASB*

8. In February 2013, the staff reported the Interpretations Committee's discussion and recommendation to the IASB. The IASB indicated that their intention was that servicing arrangements would meet the definition of continuing involvement for the purposes of the IFRS 7 disclosures and that paragraph 42C includes servicing arrangements in the transfer disclosure requirements.
9. The IASB asked the staff to report this view to the Interpretations Committee at a future meeting and to ask the Interpretations Committee whether, and if so how, it thinks that clarification should be given to clarify that servicing agreements are in the scope of the transfer disclosures.

## **Additional observations**

10. At its meeting in February 2013, the IASB acknowledged that some interested parties are particularly concerned about the clarity of paragraph 42C(c);

specifically, whether that guidance explicitly scopes out servicing agreements from the transfer disclosures.

11. IASB members noted that paragraph 42C(c) discusses ‘pass-through arrangements’; ie arrangements whereby an entity retains the contractual rights to receive cash flows but assumes a contractual obligation to pay those cash flows to another entity. In other words, that paragraph is confirming that the cash flows collected to be passed through are not themselves continuing involvement for the purposes of these disclosures. In contrast, the Board noted that a servicing agreement itself is not a pass-through arrangement. That is because the servicer does not pass through the actual cash flows that it receives as a fee for servicing the transferred financial asset. Therefore, paragraph 42C(c) is not relevant to servicing agreements and thus it does not scope out such agreements from the transfer disclosures.
  
12. The IASB also acknowledged that there may be rare circumstances in which a servicing agreement may not constitute continuing involvement for the purposes of the transfer disclosures. For example, this may be the case if the servicer receives its full servicing fee irrespective of whether any of the transferred asset’s cash flows are ultimately collected. In this case, the servicer’s return is completely de-linked from the future performance of the transferred asset. However, the IASB expects that such situations would arise very infrequently, and as a result, the Board would expect that almost all servicing agreements will fall within the scope of the transfer disclosures.

### **Next steps**

13. If the Interpretations Committee decides that clarification should be given that servicing agreements are within the scope of the transfer disclosures, we think there are at least two alternatives. The Interpretations Committee could:
  - (a) publish an agenda decision that sets out the IASB’s intention (as discussed at the February 2013 Board meeting) that servicing agreements would constitute continuing involvement and therefore are

within the scope of the transfer disclosures (a draft is attached to this paper as Appendix C); or

- (b) recommend that the Board should amend paragraph 42C(c) of IFRS 7 to clarify that the guidance in that paragraph does not scope out servicing agreements from the transfer disclosures.

**Question for the Interpretations Committee**

Does the Interpretations Committee think that clarification should be given that servicing agreements are in the scope of the transfer disclosures? If so, how does the Interpretations Committee recommend that such clarification is given?

## Appendix A—IFRIC Update from January 2013

### **IFRS 7 *Financial Instruments: Disclosure*—Disclosures—Transfers of Financial Assets (Amendments to IFRS 7)**

The IASB issued *Disclosures—Transfers of Financial Assets* (Amendments to IFRS 7) in October 2010. The transfer disclosures include the addition of paragraphs 42A–42H to IFRS 7 *Financial Instruments: Disclosure* and are effective for annual periods beginning on or after 1 July 2011. IFRS 7 paragraph 42C includes the definition of ‘continuing involvement’ for the purpose of the transfer disclosures.

The Interpretations Committee received a request to seek clarification through an Annual Improvement on whether servicing rights and obligations are continuing involvement for the purpose of the transfer disclosures.

In this meeting the Interpretations Committee noted that, based on the wording in IFRS 7 paragraph 42C, it was not clear to the Interpretations Committee whether servicing arrangements are continuing involvement for the purposes of applying the transfer disclosure requirements. Consequently, the Interpretations Committee recommended that the IASB should consider clarifying the requirements for continuing involvement in paragraph 42C of IFRS 7.

## Appendix B—IASB Update from February 2013

### ***Disclosures—Transfers of Financial Assets (Amendments to IFRS 7)—Scope of disclosures***

The IASB issued *Disclosures—Transfers of Financial Assets (Amendments to IFRS 7)* (the transfer disclosures) in October 2010. The transfer disclosures amend IFRS 7 *Financial Instruments: Disclosures* to require an entity to disclose information related to the transfer of financial assets, including its continuing involvement in the transferred assets. The amendment to IFRS 7 also included a description of the term ‘continuing involvement’ in paragraph 42C for the purpose of the transfer disclosures.

In October 2012 the IFRS Interpretations Committee received a request to seek clarification through an Annual Improvement on whether servicing rights and obligations are continuing involvement for the purpose of the transfer disclosures. The staff discussed this issue at the January 2013 Interpretations Committee meeting, where the Interpretations Committee noted that, based on the wording in IFRS 7 paragraph 42C, it was not clear whether servicing arrangements are continuing involvement for the purposes of applying the transfer disclosure requirements. Consequently, the Interpretations Committee recommended that the IASB should consider clarifying the requirements for continuing involvement in paragraph 42C of IFRS 7.

In this meeting, the IASB indicated that their intention was that servicing arrangements would meet the definition of continuing involvement and that paragraph 42C includes servicing arrangements in the transfer disclosure requirements. The IASB asked the staff to report this view to the Interpretations Committee and to ask the Interpretations Committee whether, and if so how, it thinks that clarification should be given to clarify that servicing agreements are in the scope of the transfer disclosures.

#### ***Next steps***

The staff will report the results of this discussion to the Interpretations Committee at a future meeting.

**Appendix C—Proposed wording for tentative agenda decision**

- C1 If the Interpretations Committee decides to publish a tentative agenda decision, we propose the following wording:

***Disclosures—Transfers of Financial Assets (Amendments to IFRS 7)***

The IASB issued *Disclosures—Transfers of Financial Assets (Amendments to IFRS 7)* (the transfer disclosures) in October 2010. The transfer disclosures amended IFRS 7 *Financial Instruments: Disclosures* to require an entity to disclose information related to the transfer of financial assets, including its continuing involvement in the transferred assets. The amendments to IFRS 7 also included a description of the term ‘continuing involvement’ in paragraph 42C for the purpose of the transfer disclosures.

In October 2012 the IFRS Interpretations Committee received a request for clarification through an Annual Improvement on whether servicing agreements constitute continuing involvement for the purpose of the transfer disclosures.

In January 2013 the Interpretations Committee discussed the issue and recommended that the IASB should consider clarifying the requirements for continuing involvement in paragraph 42C of IFRS 7. In February 2013 the IASB indicated that their intention was that servicing agreements would meet the definition of continuing involvement for the purposes of the IFRS 7 disclosures and that paragraph 42C includes servicing agreements in the transfer disclosure requirements.

In the light of the IASB’s discussion, the Interpretations Committee observed that an amendment to IFRS 7 is not needed and [decided] not to add this issue to its agenda.